

c. *Puget's Production of the Chambers*

i. *Establishing Microtherm's Specifications*

On January 27, 2000, before Puget began molding the chambers, Microtherm and Puget engaged in detailed discussions concerning Microtherm's requirements for the parts to be molded for the Seisco water heater and the mold tools that would be involved. (Seitz, 20 T.T. 41). Puget learned the chamber was going to be used in a water heater designed for residential use. (Fletcher, 29 T.T. 152)<sup>46</sup>; (Savelieff Dep. at 40); (Seitz, 3 C.T. 534-35); (PX 84). During these discussions, Seitz emphasized that Microtherm could not afford to have inferior parts given the intended use of the parts and the water heater. (Seitz, 3 C.T. 536). Seitz, however, never showed any Puget employee a complete Seisco water heater and Puget never knew the heater used a circuit board. (Seitz, 2 C.T. 376). Puget assured Microtherm that its employees were experts in meeting Microtherm's molding requirements. (Seitz, 20 T.T. 41).

ii. *Setting Up the Chamber Mold*

Puget and Microtherm agreed that the chamber tool would be run on a 500-ton injection molding machine. (Seitz, 3 C.T. 529). Fletcher later determined the chamber tool did not fit on Puget's 500-ton machine. (Fletcher, 29 T.T. 88); (Seitz, 16 T.T. 26; 26 T.T. 9-10, 52). Without informing Microtherm, Fletcher moved the chamber mold to Puget's 600-ton injection molding machine. (Fletcher, 29 T.T. 88); (Seitz, 16 T.T. 26; 26 T.T. 9-10, 52). Molding on the larger machine required reducing the shot size (amount of nylon pellets put into the machine) and ultimately reducing processing temperatures because using a larger machine increased the residency

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<sup>46</sup> Despite knowing the shape of the chamber and that it would be used in a water heater, Fletcher did not know the water pressures to which the part would be subject. (Fletcher Dep. at 173-74).

time (the time the pellets spend in the barrel before injection), creating a risk of thermally degrading the nylon if high temperatures were used. (*See* Fletcher, 29 T.T. 88); (PX 108); (Seitz, 3 C.T. 529, 531); (Seitz, 20 T.T. 53).

On January 31, 2000, Fletcher manufactured an initial test chamber using heater band temperatures around 560°F, which he believed to be within DuPont's recommended range for processing Zytel.<sup>47</sup> (Fletcher, 29 T.T. 89-91, 136-37); (Seitz, 15 T.T. 42). Fletcher never knew the actual melt temperature at which he processed the chambers, because he lacked the standard equipment, i.e., a pyrometer, necessary to test the melt temperature. (Fletcher, 29 T.T. 95, 131). He started the mold temperature at 325°F. (Fletcher, 29 T.T. 89-90). Fletcher did not document this test run or keep the part produced, but testified that the run did not produce an acceptable part. (Fletcher Dep. at 132-33).

After this first run, Fletcher intentionally lowered the heater band temperatures by over 100°F to 430°F, 440°F, 440°F, 440°F, and 460°F.<sup>48</sup> (Fletcher, V29, pp. 89-92); (PX 109).<sup>49</sup> At the time he

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<sup>47</sup> DuPont did not recommend that all heater bands be set as high as 560°F in order to reach the optimal melt temperature or recommended range. Instead, DuPont recommended increasing heater band temperatures from 510°F to 560°F to reach the melt temperature range of 539°F to 581°F.

<sup>48</sup> While Fletcher never determined the melt temperature associated with these heater band settings, Dr. Bradley testified that Puget's melt temperature under these conditions may have been close to the 468°F melt temperature determined by UPG for similar process conditions. (Bradley, 11 T.T. 48-49).

<sup>49</sup> In the Underlying Case, with regard to what was probably the pivotal episode of the Microtherm-Puget dispute, Fletcher testified that Seitz attended the initial molding trial for the chambers and that Seitz, after viewing the first part, told Fletcher to lower the melt temperature because the color of the chamber was not right. (Fletcher, 29 T.T. 89-90). Seitz testified that he never gave any such order, he was never at Puget for any molding of the chambers, and that he was not even in Mexico on January 31, 2000. (Seitz, 15 T.T. 76-78; 19 T.T. 39). He produced credit card bills to show he was in the United States at that time. Seitz testified that he did not know Puget was molding at temperatures below DuPont's recommended range until September or October of 2000. (Seitz, 20 T.T. 53-56). The jury verdict indicates that it believed Seitz's rendition of the events. The evidence regarding Fletcher's unilateral decision to lower the temperature on the baseplates and the consequences of Fletcher's unilateral decision to move the chamber mold to the 600-ton machine also support finding that Fletcher himself made the decision to lower the temperatures when molding the chambers.

lowered the temperatures, Fletcher knew: (a) the lowered temperatures were not within DuPont's recommended range for molding Zytel; (b) a molder should not process Zytel at those temperatures; (c) using the lower temperatures was unusual; (d) molding resin at low temperatures would cause the part to be weak and affect the integrity of the part; (e) at those low temperatures, he would not be able to fill the mold correctly; and (f) he was molding using substandard conditions. (Fletcher, 29 T.T. 90, 112-13, 129-30, 160); (Fletcher Dep. at 121, 187-88); (Mendoza Dep. at 45); (Seitz, 3 C.T. 532). Fletcher molded a chamber at these new temperatures and gave the part to Puget's quality control operators. (Fletcher, 29 T.T. 93, 150). Fletcher claims Seitz (who denies being at Puget that day) then approved the part, and that Seitz and the quality control operators used this part as an exemplar to determine what to look for in the molded part. (Fletcher, 29 T.T. 93, 150). Fletcher then wrote out a process plan using the lower heater band temperatures. (Fletcher, 29 T.T. 92-93, 150); (PX 108).

Puget's operators began production of chambers in February 2000 and used the lower heater band temperatures each time it produced chambers. (Fletcher, 29 T.T. 117); (Seitz, 15 T.T. 42).<sup>50</sup> At some point, Fletcher also lowered the packing pressure used to produce the chambers, which decreased flash, but also lowered the part weight. (Fletcher, 29 T.T. 149).

Later during production, Fletcher told Savalief that he was producing parts using conditions 100°F lower than recommended. (Fletcher, 29 T.T. 114, 153). Savalief expressed his concern that molding at such low temperatures could break the injection machine, so Fletcher took precautions

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<sup>50</sup> In February of 2000, a DuPont representative called Puget to ask about the process parameters for the production of the chambers. (Fletcher Dep. at 147). Puget told the representative that it was using a melt temperature of 520°F. (Fletcher Dep. at 147). Puget never molded chambers using heater bands capable of reaching that melt temperature. Fletcher was, in fact, incapable of measuring a melt temperature given his lack of a pyrometer.

to make sure the machine did not seize up during molding.<sup>51</sup> (Fletcher, 29 T.T. 114). While Puget never broke the molding machine, Puget did break the chamber mold tool approximately six times while trying producing chamber parts, resulting in many delays in production. (Seitz, 19 T.T. 35-36, 89; 26 T.T. 9; 29 T.T. 67); (Seitz, 3 C.T. 528); (Fletcher, 29 T.T. 94); (Saveleiff Dep. at 41). As noted above, Puget's operators had trouble following the complex sequence necessary for putting the mold in place and then getting parts out of the mold. (Mendoza, 37 T.T. 244-45); (Seitz, 26 T.T. 9).

After Puget's troubles molding the chambers began to mount, Puget attempted to modify the chamber tool so it could be put onto the smaller 500-ton machine as originally planned. (Seitz, 16 T.T. 26; 25 T.T. 143; 26 T.T. 9-10, 52); (Mendoza Dep. at 37); (Fletcher, 29 T.T. 88). These modifications involved removing the hydraulic system used to clamp the mold tool into proper position and replacing that system with a bulky manual process. (Seitz, 16 T.T. 27-28). These modifications, however, required blocking off coolant lines on the chamber tool that were necessary to maintain a proper mold temperature, and put tremendous stress on the chambers during the cooling process. (Seitz, 16 T.T. 25, 28-29).

In October 2000, after Microtherm's own quality control manager finally learned that Puget was using low heater band temperatures for the chambers, Puget stopped its production of the chambers stating that Microtherm was "going to sue us anyway, so we figure we'll just cut our losses now, right now." (Seitz, 15 T.T. 102). When Puget finally returned the chamber tool, it was

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<sup>51</sup> Savelieff testified that he was never aware of any issues with the chambers and that his job responsibilities did not include knowing the processing conditions Puget were using. (Deposition of Andre Savelieff (hereinafter Savelieff Dep.) at 47, 67).

damaged and required repairs before it could be used to produce chambers again. (Seitz, 16 T.T. 25; 21 T.T. 12-13); (Seitz, 3 C.T. 531).

Despite all of Puget's troubles in molding the chambers, Fletcher testified that he did not believe it affected the quality of the chambers produced. (Fletcher Dep. at 270). Fletcher and Luethe told Seitz that any concerns regarding quality from molding at low temperatures were unwarranted. (Seitz, 24 T.T. 113). They told Seitz that a molder could deviate substantially from DuPont's recommended range of temperatures without any concern. (Seitz, 25 T.T. 80). Fletcher explained that he had compensated for the lower heater band temperatures with a higher mold temperature. (Seitz, 3 C.T. 512-13). The jury in the Underlying Case, in all likelihood, did not believe many aspects of Fletcher's testimony and this Court certainly shares in that disbelief.

d. *Puget and Microtherm's Post-Production Quality Control*

During their initial meetings, Puget and Microtherm established a quality control plan for the inspection of chambers produced by Puget. (Seitz, 21 T.T. 33); (Fletcher, 29 T.T. 132).<sup>52</sup> Puget's quality control operators visually inspected one chamber every six hours<sup>53</sup> for burrs, bursts, bubbles, blisters, flash, gloss, cold slugs, contamination, color changes, short shots, fissures, and voids. (Seitz, 19 T.T. 18-20); (Fletcher, 29 T.T. 151-52); (Fletcher Dep. at 153); (Albert Dep. at 30-32); (PX 131). During this visual inspection, the operators looked at the surface and insides of the chamber. (Seitz, 20 T.T. 6-7); (Albert Dep. at 32). The operators also conducted a dimensional

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<sup>52</sup> Puget's internal quality control procedures required reviewing customer-supplied specifications and supplementing those specifications these with additional control procedures or tests necessary based on an ongoing evaluation of production. (PX 95). Puget never made any changes to the quality control plan agreed to with Microtherm even in spite of all the processing adjustments Puget made with respect to molding the chambers.

<sup>53</sup> The quality control plan stated that the visual inspection should be conducted once per hour, but Fletcher testified that Puget's quality control operators only performed the inspection once every six hours. (*Compare* PX 131, *with* Fletcher Dep. at 153).

inspection of a chamber to ensure it matched the specified length and thickness for the chambers. (PX 131). Puget never checked the part weight of the chambers<sup>54</sup> nor conducted any tests using microstructural analysis<sup>55</sup>. (Fletcher Dep. at 151); (Seitz, 2 C.T. 369); (Albert Dep. at 50).

After his initial meeting with Puget, Microtherm was concerned that Puget's quality control operators were not well trained, so it sent Microtherm employee James Albert<sup>56</sup> to the Puget facility to conduct the same inspections Puget's operators were supposed to perform.<sup>57</sup> (Seitz, 7 C.T. 1379); (Albert, 40 T.T. 18). When Albert was able to attend the molding of the chambers, he inspected each chamber as it came off the machine. (Albert, 40 T.T. 18); (Fletcher, 29 T.T. 151); (Seitz, 7 C.T. 1374). Overall, Microtherm accepted several thousands chambers produced by Puget during 2000. (Seitz, 20 T.T. 29-30). Puget and Microtherm's quality control rejected some chambers due to voids and bubbles, but during the inspections, none of these individuals were able to see the hairline cracks that existed in the weld line of the neck of the chambers that would grow over time and lead to leaks. (Albert Dep. at 32-33, 175-77); (Seitz, 3 C.T. 539-40; 7 C.T. 1377)

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<sup>54</sup> Chambers molded at the lower temperatures had a much lower part weight than chambers molded at the recommended temperatures (Osswald Dep. (2004) at 105). This means the chambers molded at the lower temperatures did not completely pack or fill during molding. (Osswald Dep. (2004) at 105). This failure to properly pack the part would have been revealed by measuring part weight, but would not have been visible solely through a visual inspection. (Osswald Dep. (2004) at 105).

<sup>55</sup> Microtherm and Puget did not include microscopic structural analysis ("MSA") testing, because they did not think it was necessary. (Seitz, 7 C.T. 1409). MSA tests later performed on the chambers by DuPont showed the glass fibers did not align properly which could cause premature failure. (Malone Dep. at 143-44); (Seitz, 7 C.T. 1409).

<sup>56</sup> Prior to working in quality control for Microtherm, Albert had no experience in the molding of plastics. (Albert, 40 T.T. 15); (Seitz, 21 T.T. 33). Albert testified that nothing in his prior experience qualified him to inspect plastic parts. (Albert, 40 T.T. 15). Albert only performed the visual inspection Seitz instructed him to perform. (Seitz, 25 T.T. 139).

<sup>57</sup> Seitz also participated in quality control when he visited Mavid's factory in Guadalajara. (Seitz, 7 C.T. 1375).

e. Fissures

Dr. Reitman, National Union's expert on plastic injection molding at the coverage trial, examined nearly 200 chambers provided by Microtherm in January of 2009 that had been used in Seisco water heaters. (Reitman, 5 C.T. 897). She observed that many of these chambers had dramatic fissures along the neck of the chambers that were the product of nylon flows that did not properly fuse during the molding process.<sup>58</sup> (Reitman, 5 C.T. 909-15, 1022); (Osswald Dep. (2000) at 153).<sup>59</sup> The frequency of these fissures led Dr. Reitman to conclude that the fissures were a consistent problem during molding. (Reitman, 5 C.T. 918-19). The fissures were so obvious that they should have been seen during a visual inspection of the chambers and, had they been seen, would have been a warning to Puget that its processing parameters needed serious adjustment. (Reitman, 5 C.T. 918-19). Puget's and Microtherm's expert, Dr. Timothy Osswald, testified that during his inspection of the chambers he never saw anything resembling the fissures observed by Reitman.<sup>60</sup> (Osswald Dep. (2009) at 153). He testified, however, that the fissures were most likely the result of flow fronts,<sup>61</sup> but they could be a hairline crack that had "washed out." (Osswald Dep.

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<sup>58</sup> These fissures were separate from the hairline cracks in the weld line. (Reitman, 5 C.T. pp. 915, 925-27). The hairline cracks, though they also existed at the time of molding, could not be seen in a visual inspection. (*Id.*)

<sup>59</sup> The fissures, which looked like small plastic canyons in the side of the chamber, could only have been formed when the plastic was hot or molten enough to flow. (Reitman, 5 C.T. 926). As Dr. Reitman found no other sign of melting or thermal damage anywhere else on these chambers, she had to conclude the fissures were formed during the initial molding process. (*Id.* at 926, 1019).

<sup>60</sup> During the coverage trial, Seitz appeared to testify that he both had seen and had never seen the fissures before. (*Compare* Seitz, 3 C.T. 520, *with* Seitz, 3 C.T. 621). When he testified he had seen the fissures before, he testified they were a product of a surface crack that had been in the field for a long time. (Seitz, 3 C.T. 520).

<sup>61</sup> Dr. Osswald theorized the fissures could be the result of a hairline crack that had "washed out." (Osswald Dep. (2009) at 40-44). Dr. Reitman testified that the surfaces and structures of the fissures did not support a finding that extraordinary in-use conditions (e.g., chlorine or very hot water) could have caused the fissures. (Reitman, 5 C.T. 1019).

(2009) at 40-44). Given the testimony identifying the initial molding of the chambers as the only possible time in which the fissures could have formed, the Court finds that there were at least several of these dramatic fissures in chambers existing at the time the chambers were molded that somehow escaped the attention of Puget and Microtherm's quality control personnel.

J. Whether Puget Intended or Expected Injury to Microtherm

Chuck Fletcher was incredibly confident, some might even say arrogant, regarding his abilities as plastic injection molder. He and Luethe, the general manager of the Puget facility, were adamant in their belief that Puget was properly molding products out of Zytel even though they used far lower temperatures than DuPont recommended for processing Zytel. Even though Fletcher knew using low temperatures was wrong, he may have believed he made an adequate compensation for the low heater band temperatures by using a higher mold temperature.<sup>62</sup> Fletcher and Luethe's beliefs about the quality of Puget's molding process, however wrong and misguided, are sufficient to carry Puget's burden of demonstrating that, subjectively, Puget did not intend or expect any injury to Microtherm.

K. Whether the Injury to Microtherm was Highly Probable

Since there was no intentional tort involved, this leaves the separate question of whether, given all of the circumstances surrounding Puget's molding of the chambers, a reasonable molder would know that it was highly probable that Puget's molding conditions would result in injury to

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<sup>62</sup> Even after admitting he knew what he was doing was wrong, Fletcher never admitted he knew the consequences of his improper molding processes. When asked whether the molecules bonded together when Zytel was molded at low temperatures, Fletcher exercised the civil equivalent of his right to remain silent by simply responding, "I'm not going to answer that question." (Fletcher, 28 T.T. 136).



Microtherm (i.e., whether Puget should have known that it was highly probable its improper molding would lead to injury to Microtherm).

Puget knew that it was manufacturing a chamber for a water heater for residential use, and that the chambers would therefore be exposed to hot water inside people's homes. Puget knew that the chamber mold tool was complex, old, and worn, conditions which a reasonable molder would know required a labor-intensive process to mold quality parts. The complex, thick-walled chamber part would require a greater fill time and additional care when molding beyond what was necessary for the simple baseplate, even though the two parts would be exposed to similar conditions. A reasonable molder would know that the acceptable conditions for molding the baseplate were less than what would be necessary to mold the chambers. Puget also knew that processing Zytel at low heater band temperatures would lead to a melt temperature approximately 100°F below the ideal melt temperature recommended for the use of Zytel. A reasonable molder would know that molding Zytel at such a low temperature would result in: (a) an incomplete melt of the Zytel pellets before injection into the mold; (b) the injection of unmelt into the mold, creating significant molded-in stresses in the chamber parts; (c) poor flow and packing of the part, resulting in a weaker part with a lower part weight; (d) poor fusion of the plastic resin at the weld line, weakening an already weak region in the part; (e) misalignment of the reinforcing glass fibers near the weld line, further stressing this critical area; and (f) a failure of the glass to cross the weld line, creating an empty seam. A reasonable molder would know that lowering the injection pressure on top of lowering the melt temperature would multiply the problems related to the poor packing of the part. Puget also knew or should have known that raising the mold temperature would neither raise the melt temperature nor make adequate compensation for molding at such low processing temperatures.

Further, Puget knew that its operators were inexperienced, but refused to provide them training on how to properly mold using Zytel, even when DuPont offered technical support. Even after Puget knew that its processing conditions were inappropriate and improper for molding the simpler baseplates, Puget did not adjust the similar substandard conditions being used for the more complex chamber part.

A reasonable molder would know that moving the chamber mold tool to the larger 600-ton machine was not suitable for the production of the chamber parts, due to the increase in residency time and decrease in shot size, as these necessitated the use of a low, improper melt temperature. Puget also should have known that when it made modifications to the mold to move the chamber tool back to the 500-ton smaller machine, the modifications resulted in creating additional stresses during the cooling process.

Puget therefore knew it was molding a complex part on a difficult mold tool at outrageously low temperatures, while also using low injection/packing pressure and mold tool modifications that impaired cooling. Puget also knew it was using inexperienced and untrained molders to mold at substandard processing conditions, when even at standard process parameters, the chamber tool required an experienced molder who would implement the labor-intensive process necessary to produce quality parts. A reasonable molder would know given the extraordinarily low temperatures, it was producing parts with improper fusion, packing, and reinforcement at the weld line.<sup>63</sup>

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<sup>63</sup> Knowing it was using such substandard conditions, a reasonable molder would have put into place proper quality control procedures to confirm it was failing to make quality parts. A reasonable molder using these poor processing conditions would have checked the part weight, which would have verified it was not properly packing the chamber mold. A reasonable molder would also have used microstructural analysis to confirm it had created weak, empty weld lines containing cracks. A reasonable molder also would have seen the dramatic fissures that existed from the time of molding in several chamber parts, confirming that there were serious problems in the processing conditions.

Overall, a reasonable molder would know that it was highly probable that it was creating chambers with high built-in stresses throughout the part and, in particular, along the weld line. The reasonable molder would know these stresses made the chambers weak, particularly at the weld line along the neck, and that it was highly probable the chambers would prematurely crack. A reasonable molder would also know that a crack in a part containing hot water would result in hot water leaking onto the remainder of the heater unit and onto the homeowner's personal property. It was therefore highly probable that, given Puget's deliberate use of substandard processing parameters and molding conditions, Puget's molding of the chambers would lead to hot water leaking onto the remainder of the Seisco water heater as well as onto surrounding personal property. That being the case, using an objective highly probable standard, this Court finds that the leaks in question were not an "occurrence" under the Policy and consequently that Puget did not carry its burden of proof with respect to proving the existence of an "occurrence" for the purpose of establishing that National Union owed it a duty to indemnify.

#### IV. PROOF OF COVERED PROPERTY DAMAGE

National Union lastly contends that Puget cannot fulfill its burden to demonstrate that the judgment in the Underlying Case was "because of" property damage covered by Policy or, even if judgment may have been, in part, due to covered property damage, Puget cannot satisfy its burden to allocate the judgment between covered and uncovered property damage. In Texas, the insured carries the burden to establish the insurer's duty to indemnify by presenting facts sufficient to demonstrate coverage. *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Puget Plastics Corp.*, 532 F.3d 398, 401 (5th Cir. 2008) (citing *W. Alliance Ins. Co. v. N. Ins. Co. of N.Y.*, 176 F.3d 825, 831 (5th Cir. 1999)); *Fiess v. State Farm Lloyds*, 392 F.3d 802, 807 (5th Cir. 2004) (citing *Guar. Nat.*

*Ins. Co. v. Vic Mfg. Co.*, 143 F.3d 192, 193 (5th Cir. 1998)); *Wallis v. United Servs. Auto. Ass'n*, 2 S.W.3d 300, 303 (Tex. App.—San Antonio 1999, pet. denied). “No duty to indemnify arises unless the underlying litigation establishes liability for damages covered by the insuring agreement of the policy.” *Puget Plastics*, 539 F.3d at 404 n.10 (citing *Hartrick v. Great Am. Lloyds Ins. Co.*, 62 S.W.3d 270, 275 (Tex. App.—Houston [1st Dist.] 2001, no pet.). In this case, to recover under the Policy, Puget must prove the damages for which it is liable “resulted from ‘property damage.’” *Id.* at 403.

National Union asserts that the judgment from the Underlying Case consists of economic losses that are not the result of covered property damage, or in the alternative, are the result of a mix of covered and uncovered property damage.<sup>64</sup> Under the Policy, National Union is liable for consequential economic losses that arise “because of” covered property damage. *See Puget Plastics*, 532 F.3d 398, 403 (5th Cir. 2008); *Todd Shipyards Corp. v. Turbine Serv., Inc.*, 674 F.2d 401, 418, 423 (5th Cir. 1982). Therefore, to be covered by the Policy, the consequential economic damages must be attributable to covered property damage. *See Puget Plastics*, 532 F.3d at 403 (citing *Am. Home. Assur. Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22, 26 (1st Cir. 1986)); *Arthur Anderson & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816 (Tex. 1997) (consequential damages must be foreseeable and directly traceable to the wrongful act and result from it). During the Underlying Case, Microtherm presented at least two bases for the consequential damages awarded by the jury:

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<sup>64</sup> The United States Court of Appeals for the Seventh Circuit recognized National Union’s argument during its review of the judgment against UPG from the Underlying Case based on UPG’s improper molding of the chambers. *See Wausau Underwriters Ins. Co. v. United Plastics Grp.*, 512 F.3d 953, 958 (7th Cir. 2008). “The deeper problem is that the business losses for which Microtherm sued might well have occurred even if no circuit board had ruptured.” *Id.* If the chambers leaking just caused the Seisco water heater to stop working and could be replaced, “that we know is not property loss.” *Id.*

(1) Puget's poor workmanship led to leaks, which led to complaints, which led to the loss of customers, profits, and company value; and (2) delays in the shipment of plastic water chambers led to the jury's award of economic loss attributable to Puget.

A. Leaks Leading to Economic Damages

In April of 2001, the chambers manufactured by Puget began cracking and leaking. (Seitz, 16 T.T. 36; 21 T.T. 26). The number of cracked chambers per month was low until early 2002, when 50 to 70 Puget chambers failed each month. (Seitz, 16 T.T. 36). As of the trial of the Underlying Case, 800 chambers molded by Puget failed. (Seitz, 17 T.T. 14). Microtherm focused on presenting testimony that these leaks, as well as flaws in UPG chambers, and Dana thermistors, caused the Seisco water heaters to "fail," without providing a significant amount of testimony on what those "failures" actually entailed beyond the possible loss of use of the water heater. Microtherm did present a small amount of testimony indicating that the leaking chambers could simply be replaced, restoring the water heater to full capacity, but also that some chambers could crack and leak in such a way that the leaks damaged the Seisco water heater's circuit board or caused damage to a homeowner's property. (Seitz, 14 T.T. 58; 17 T.T. 40-41).<sup>65</sup>

Microtherm's primary focus during the Underlying Case was that the Seisco water heater "failures" resulting from Puget and UPG's chamber leaks and Dana's faulty thermistors between 1999 and 2002 led to Microtherm suffering: (a) a loss of profits, (Seitz, 23 T.T. 31; 36 T.T. 83); (b) a loss of investors willing to invest capital to keep Microtherm's sales efforts going, (Seitz, 25 T.T.

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<sup>65</sup> This testimony from this case and the Underlying Case regarding the ability to simply replace the chambers and the occasional damage to circuit boards or homeowner's property exists independent of the admission of the warranty records.

120; 26 T.T. 25-26); (c) significant losses in sales, major customers, and opportunities. (Seitz, 17 T.T. 31, 38; 25 T.T. 113, 120, 125; 26 T.T. 48; 37 T.T. 36-37); (d) lost opportunities to pursue new sales efforts. (Seitz, 25 T.T. 104-05; 34 T.T. 133-34); and (e) DuPont's decision not to purchase any part of Microtherm. (Hines, 36 T.T. 77, 81, 121-22). Microtherm's economic loss expert, Dennis Arnie ("Arnie"), testified that he could not allocate or assign any specific amount of economic loss to Puget, or any of the three component manufacturers. (Arnie, 34 T.T. 9, 26, 35). He further testified he could not allocate damages on the basis of the different failures. (*Id.* at 30, 59-60). He concluded there was no adequate, objective, relevant, or reliable basis for either such allocation. (*Id.*)

B. Chamber Leaks as Covered or Uncovered Property Damage

The Policy defines "Property Damage" as:

1. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it;
2. Loss of use of tangible property that is not physically injured. All such loss shall be deemed to occur at the time of the Occurrence that caused it.

(PX 1 at Definition L). The Policy, however, excludes coverage for:

Property Damage to Impaired Property or property that has not been physically injured, arising out of:

1. A defect, deficiency, inadequacy or dangerous condition in Your Product<sup>66</sup> or Your Work<sup>67</sup>; or

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<sup>66</sup> The Policy defines "Your Product" as:

1. Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by:

2. A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to Your Product or Your Work after it has been put to its intended use.

(*Id.* at Exclusion E). “Impaired Property” means:

tangible property, other than Your Product or Your Work, that cannot be used or is less useful because:

1. It incorporates Your Product or Your Work that is known or thought to be defective, deficient, inadequate or dangerous; or
2. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by:

1. The repair, replacement, adjustment or removal of Your Product or Your Work; or
2. Your fulfilling the terms of the contract or agreement.

(*Id.* at Definition D).

With respect to chamber failures, taking all of the above provisions together, the Policy does not cover physical injury to, or loss of use of, the Seisco water heaters incorporating Puget’s

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- a. you;
  - b. others trading under your name; or
  - c. a person or organization whose business or assets you have acquired; and . .
2. Containers (other than vehicles) materials, parts or equipment furnished in connection with such goods or products.

(PX 1 at Definition O).

<sup>67</sup> The Policy defines “Your Work” as “1. Work or operations performed by you or on your behalf; and 2. Material, parts or equipment furnished in connection with such work or operations.” (PX 1 at Definition N).

chambers arising out of a defect, deficiency, or inadequacy in Puget chambers, if the Seisco water heaters can be restored to use by the repair, replacement, or adjustment of the chambers, unless the loss of use is due to “sudden and accidental physical injury” to the chambers after they have been put to their intended use. During the Underlying Case, Microtherm’s evidence showed that the failures of the Seisco water heaters were both the result of chambers that could simply be replaced and chambers that could crack and leak causing damage to the circuit boards and other homeowner property. The former is not covered property damage under the Policy.<sup>68</sup> The latter damage is covered by the Policy. During the Underlying Case, Microtherm did not segregate between these two types of leaking chambers when asserting that the chamber leaks caused loss of use of the heaters and customers complaints, which led to substantial economic damage to Microtherm. The judgment in the Underlying Case therefore includes economic damages that flow from both uncovered and covered property damage.<sup>69</sup>

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<sup>68</sup> National Union has satisfied its burden of showing the impaired property exclusion applies. The record supports finding that these cracks existed at the time of production and grew over time. (*See* Dr. Maureen Reitman (“Reitman”), 5 C.T. 1002). There was no evidence that the cracks were the product of sudden overload fractures. The color of the plastic around the cracks indicated the cracks were time-growth features. (*Reitman*, 5 C.T. 930-31). The “sudden and accidental” exception to the impaired property exclusion is inapplicable to the facts regarding the creation and propagation of the chamber leaks.

<sup>69</sup> During the Underlying Case, Microtherm also presented evidence that Puget was always behind in supplying Microtherm with chambers. (*Seitz*, 15 T.T. 48-49; 19 T.T. 107). From February 2000 onward, Puget failed to meet its production requirements for the chambers, finally completely defaulting on production in October of 2000. (*Seitz*, 19 T.T. 74-75; 19 T.T. 106-07; 20 T.T. 40, 47-48; 21 T.T. 34; 22 T.T. 6). The jury heard that these delays were causing significant, intolerable, and irreparable financial damage to Microtherm’s sales and relationships with manufactured housing customers. (*Seitz*, 19 T.T. 74-75; 20 T.T. 38-40; 22 T.T. 49). *Seitz* informed the jury that the lost sales due to the delay and default totaled at least \$150,000. (*Seitz*, 21 T.T. 34-35; 26 T.T. 49-50). *Seitz* told the jury the delay and default adversely affected Microtherm’s sales to the manufactured housing market, as Microtherm took orders but could not deliver heaters because it lacked the chambers. (*Seitz*, 19 T.T. 74-75, 106); (*Seitz*, 22 T.T. 28). Microtherm even informed DuPont about the impact the delays and default had on its ability to deliver heaters to the manufactured housing industry. (*Seitz*, 19 T.T. 106-07). Indeed, Microtherm transferred the molding business from Puget to UPG before it even knew about the cracks. Microtherm never provided the jury with a value of the loss of customers or loss of value to Microtherm due to the delays and default. Microtherm also never provided the jury with a value of the lost profits or loss in value due to the failures of the component parts. Both of these lines of evidence could have formed the basis of the jury’s award against Puget for causing \$22 million in economic damages to Microtherm, or at least a portion thereof.



C. Allocation of Judgment Between Covered and Uncovered Damages

Texas law recognizes the doctrine of concurrent causes, which provides that where covered and non-covered perils combine to create a loss, the insured is entitled to recover only that portion of the damage caused solely by the covered peril. *Wallis v. United Servs. Auto. Ass'n*, 2 S.W.3d 300, 302-03 (Tex. App.—San Antonio 1999, pet. denied) (citing *Travelers Indem. Co. v. McKillip*, 469 S.W.2d 160, 163 (Tex. 1971)); see *Fiess v. State Farm Lloyds*, 392 F.3d 802, 807 (5th Cir. 2004); *All Saints Catholic Church v. United Nat. Ins. Co.*, 257 S.W.3d 800, 802 (Tex. App.—Dallas 2008, no pet.). The damages recited in a judgment must be apportioned between claims covered by the policy and those that are not.<sup>70</sup> *Willcox v. Am. Home Assur. Co.*, 900 F. Supp. 850, 856 (S.D. Tex. 1995) (citing *Enserch Corp. v. Shand Morahan & Co.*, 952 F.2d 1485, 1493 (5th Cir. 1992)). Since the insured bears the burden on coverage, when there are covered and non-covered perils, the insured must present evidence upon which the fact-finder on coverage can allocate and segregate covered losses from non-covered losses. *Fiess*, 392 F.3d at 807; *Willcox*, 900 F. Supp. at 856;

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<sup>70</sup> This Court previously held on summary judgment, and the Fifth Circuit affirmed, that the \$175,000.00 awarded for the reasonable and necessary cost to repair and/or replace parts provided of work performed by Puget was not covered by the Policy:

damage to the chambers . . . are specifically excluded by the policy's "business risk" exclusion [Exclusion F]. . . . The purpose of a "business risk" exclusion is to protect insurers from damages to an insured's product by his own hand, as this is typically considered a cost of doing business. *Comsys Info. Tech. Services, Inc. v. Twin City Fire Ins. Co.*, 130 S.W.3d 181, 196 (Tex. App.—Houston [14th Dist.] 2003); *T.C. Bateson Const. Co. v. Lumbermans Mut. Cas. Co.*, 784 S.W.2d 692, 695 (Tex. App.—Houston [14th Dist.] 1989). The "business risk" exclusion in National Union's policy specifically excludes "Property Damage to Your Product arising out of it or any part of it." . . . damages to the chambers themselves, including damages arising from a breach of warranty, are clearly excluded by the "business risk" exclusion.

(Docket No. 131). The Fifth Circuit affirmed this holding—Puget cannot recover the damages awarded to Microtherm for the costs of repairing and replacing the plastic water chambers. *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Puget Plastics Corp.*, 532 F.3d 398, 403 (5th Cir. 2008).

*Wallis*, 2 S.W.3d at 303 (*Lyons v. Millers Cas. Ins. Co. of Tex.*, 866 S.W.2d 597, 601 (Tex. 1993)).

Because allocation is central to the claim for coverage, an insured's failure to carry its burden of proof on allocation is fatal to the claim. *Id.*; see *Wilcox*, 900 F. Supp. at 856; *Kelly v. Travelers Lloyds of Tex. Ins. Co.*, No. 14-05-00825, 2007 WL 527911, at \*3 (Tex. App.—Houston [14th Dist.] Feb. 2, 2007, no pet.); *Poteet v. Kaiser*, No. 2-06-397-CV, 2007 WL 4371359, at \*6 (Tex. App.—Fort Worth Dec. 13, 2007, pet. denied). The insured is not required to establish the amount of its damages with mathematical precision, but there must be some reasonable basis upon which the jury's finding rests. *Id.* As this Court has found that economic damages were awarded in the Underlying Case, at least in part,<sup>71</sup> due to covered and uncovered property damage related to the leaking chambers, Puget bears the burden of presenting evidence by which this Court can reasonably apportion the economic damages awarded due to the leaking chambers between covered and uncovered property damage.<sup>72</sup>

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<sup>71</sup> The delays, and the consequential damages stemming therefrom, noted earlier are also not covered property damage. (See PX 1 at Exclusion E, Definitions D & L). These delay damages were no doubt part of the jury award, and thus Puget had the burden to provide this Court with some reasonable basis to segregate out these uncovered losses from the judgment in the Underlying Case. See *Fiess v. State Farm Lloyds*, 392 F.3d 802, 807 (5th Cir. 2004). During the coverage trial, Microtherm, as assignee of Puget, presented Seitz's testimony that these same delays led to the loss of hundreds of sales, but only resulted in a loss of \$10,000.00 to \$15,000.00, contrary to what Seitz presented to the jury in the Underlying Case. (Seitz, 3 C.T. 558-59). Further, Puget also presented Seitz's testimony that the impact on Microtherm's customers was minimal and affected only individual consumers, contrary to Seitz's testimony regarding the irreparable damage to Microtherm's relationship with its manufactured housing customers due to the delays that was presented during the Underlying Case. (Seitz, 3 C.T. 560, 562, 566, 593, 598). Even if this Court considered Microtherm's contradictory testimony in the most favorable light, this does not provide this Court with any basis for explaining how the jury factored the delays into the ultimate economic damages award, and it certainly does not satisfy the burden to prove apportionment by a preponderance of the evidence. The presence of unallocated delay damages in the jury award thus created an additional apportionment problem that Puget has been unable to resolve.

<sup>72</sup> The Court also notes that numerous components of the Seisco water heaters containing Puget chambers also leaked, potentially contributing to the complaints that led to Microtherm's financial damages. These includes leaks at the outlet tube, the mechanical joint, the heater elements, the level detect screw, the O-ring, the nipple region at the connections for the supply, the thermistor, the inlet joint, and the outlet joint. (See, e.g., Seitz, COV6, p. 1231-33). There is little to no evidence that these leaks caused any third-party covered property damage or that the leaks could not be cured by the simple replacement of a part. The presence of these other leaks creates yet another burden

D. Consideration of New Evidence During Coverage Trial

In this case, the Fifth Circuit expressly held that a district court may make new factual findings in coverage actions. *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Puget Plastics Corp.*, 532 F.3d 398, 404 (5th Cir. 2008). Puget “may present evidence at trial regarding facts necessary to determine coverage that were not adjudicated in the underlying case.” *Id.* The jury in the Underlying Case had no reason to allocate the economic damages it awarded between covered property damage, e.g., leaking chambers shorting circuit boards or damaging customers’ homes, and uncovered property damage, e.g., replaceable leaking chambers and delays/default in production and delivery of chambers. The parties were therefore permitted to introduce new evidence on both of these issues during this coverage trial.

E. Allocation of Economic Damages Between Covered and Uncovered Property Damage

The Seisco water heater was designed so that leaking components could be replaced modularly. (Seitz, 14 T.T. 58, 81). In many circumstances, leaking chambers were simply replaced and the heater was restored to full capacity. (Seitz, 14 T.T. 58; 17 T.T. 41; 23 T.T. 39, 55); (Seitz, 2 C.T. 448; 3 C.T. 546; 7 C.T. 1218); (Deposition of William Uecker, Feb. 12, 2009 (hereinafter Uecker Dep. (2009) at 46); (Deposition of Michael Carr (hereinafter Carr Dep.) at 137-38, 206-07). Other times, the chambers cracked in such a way that they leaked onto the circuit board, shorting out the circuits. (Seitz, 14 T.T. 58); (Seitz, 2 C.T. 372); (Carr Dep. at 154); (Deposition of Michael Drabczyk (hereinafter Drabczyk Dep.) at 12); (Uecker Dep. (2009) at 12, 14, 20, 27). A few times, the chamber leaked in such a way that it damaged the homeowner’s property. (Seitz, 17 T.T. 41);

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on Puget to provide a basis for segregating out from the judgment an amount based solely on covered property damage.

(Seitz, 2 C.T. 377); (Uecker Dep. (2009) at 39). There was inconsistent and widely varying testimony concerning the ratio of those chamber leaks that only required replacement of the chambers to chamber leaks that shorted circuits boards or caused damage to the homeowner's property. (*See, e.g.*, Carr Dep. at 136-138 (75% or more chamber leaks did not damage the circuit boards or cause any other damage and creating a situation where the chambers were simply replaceable)); (Deposition of David Seitz, March 12, 2009 (hereinafter Seitz Dep. (2009) at 45) (95% of chamber leaks damaged the circuit boards)).<sup>73</sup> A review of the warranty records, however unreliable they may be, suggests that the percentage may be somewhere in between.

Percentages aside, Puget has not presented this Court with sufficient evidence supporting a reasonable basis on which to allocate the economic damages awarded between those damages from the leaking water chambers that are covered and those that are not. During the Underlying Case, Microtherm's own damage expert testified that he could not allocate the economic damages on a macro-level (i.e., among the various component failures). (*See Arnie*, 34 T.T. 9, 26, 30, 35, 59-60). Though never presented with such a figure, the jury somehow made a determination that Puget caused \$22 million in economic loss to Microtherm. During the coverage trial, Puget/Microtherm did not present its former economic expert (Arnie) or any other expert to address the allocation of the various damages. National Union's expert on economic damages, Jonathan Walker ("Walker"), agreed with the Arnie's conclusion from the Underlying Case—"it's going to be speculative to allocate any particular amount to covered property damage." (Walker, 6 C.T. 1058). The Court has

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<sup>73</sup> During the trial of the Underlying Case, Microtherm asserted that it had to replace 800 Puget chambers. (Seitz, 16 T.T. 20). During the coverage trial, Seitz testified that he could identify specific warranty records of leaking Puget chambers that led to circuit board failures. (Seitz, 7 C.T. 1218, 1352-53). While the number of records Seitz identified ranged during the Court of his testimony from 260 to 295 records, these records, if reliable, would support a different failure rate than the 95% he testified to during trial. (*See id.*)

reviewed the entire trial record, the testimony from the coverage trial and the Underlying Case, the exhibits, and even the warranty records. There is simply no reasonable, reliable, non-arbitrary basis supported by a preponderance of the evidence in the record upon which to allocate economic damages between covered and uncovered risks. Puget's failure or inability to fulfill its obligation of proof is fatal to its claim for coverage.<sup>74</sup>

## V. RESOLUTION OF EVIDENTIARY ISSUES

While the Court has now issued its findings of fact and conclusions of law on the substantive issues involved in this coverage trial, it finds it necessary to discuss two evidentiary issues raised during trial. These rulings have been incorporated into the findings above. The first is its tentative admission of the Microtherm "warranty records" (DX 2) and the associated summary of those records (DX 2.16). The second is the testimony of National Union's economics expert Dr. Jonathan Walker. Neither the records and the related summary<sup>75</sup> nor Dr. Walker's testimony<sup>76</sup> were admitted into evidence in the Underlying Case.

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<sup>74</sup> The Court recognizes that the Seventh Circuit identified another possible layer of trouble for the insured in allocating the damages from the judgment in the Underlying Case. *Wausau Underwriters Ins. v. United Plastics Grp.*, 512 F.3d 953, 959 (7th Cir. 2008). Analogizing to the effects of a bedbug infestation at a hotel, the Seventh Circuit noted that the insured (in its case, UPG) had to address how the timing of covered and uncovered failures affected the overall accrual of economic damages suffered by Microtherm and awarded in the Underlying Case. *Id.* ("Remember . . . the earliest failures may have been the ones that did the most damage to Microtherm's business.") *Id.* While this Court did not feel the necessity to reach an ultimate conclusion on the Seventh Circuit's suggestion, should this be an additional burden of allocation, Puget/Microtherm made no attempt to allocate the damages from the Underlying Case based how they accrued in relation to uncovered versus covered chamber leaks over time.

<sup>75</sup> The records (but not the summary) were offered, but rejected by the state trial court in the Underlying Case.

<sup>76</sup> The testimony of Dr. Walker was elicited for the first time in this coverage action.

A. The “Warranty Records”

The most troublesome issue for this Court as well as for the state court was the question of how to handle the so-called “warranty records” of Microtherm. This Court initially emphasizes that its opinion and judgment in this case is the same regardless of whether the records were admitted or not. The state court wrestled with the admissibility of these records on numerous occasions throughout the trial and ultimately refused their admission. This Court similarly entertained a running battle over these records for the duration of the coverage trial and even in the post-trial submissions. Since it was a trial to the bench, the Court tentatively admitted the records and testimony concerning same, with the understanding that the Court would ultimately rule on their admissibility as part of this final judgment.

The “warranty records” consist of individual customer records divided into two parts—the “user-defined” and “notes” fields. (*See* DX 2). Defendants’ Exhibit 2.16 is a summary of those records that was prepared for this trial. The primary objection by National Union to the admission of these records is that they are riddled with errors and inaccuracies. Its primary legal objection is that the records are hearsay, sometimes “double hearsay”, and are also inadmissible expert testimony.

The “user defined” field for each record was created by a part-time worker/student hired by Microtherm after the filing of the Underlying Case to summarize the “notes” field and enable Microtherm to search and sort the customer records more easily. They were not created in the normal course of business. Even Seitz, the sponsoring witness for the warranty records, testified that the “user-defined” fields were inaccurate and unreliable. In fact, he testified that he did not rely on those fields himself. Further, the Court notes the “user-defined” fields contain hearsay that does not fall under any known exception to the hearsay rule. These fields certainly do not meet the

requirements of Federal Rule of Evidence 803(6). The Court, therefore, has no trouble holding them to be inadmissible. Even if the “user-defined” fields were admissible, the Court agrees with Mr. Seitz that they are unreliable and so the Court would not rely on them.

The “notes” fields present a more difficult issue. Seitz testified to the basic tenants that qualify these records as business records under Rule 803(6). National Union, while not conceding the accuracy of this testimony, strongly points out that these records contain hearsay statements from the owners of the water heaters.<sup>77</sup> National Union also spent a large amount of time during the coverage trial proving to the Court that the “notes” fields contained multiple errors and mistakes.<sup>78</sup> In multiple instances, Seitz agreed with National Union that these errors did indeed exist.

Despite these errors, the Court finds that the “notes” fields were made at or near the time of the events documented from information transmitted by a person with knowledge, that these records were kept in the regular course of business, and that it was the regular practice of the business to keep such records. These records were made by Microtherm’s service technicians at or near the time they received the complaints from the homeowner who was relaying observations as he or she perceived them. The fact that the records contain errors—even multiple errors—does not change the nature of the admissibility of the records. Examples of this abound. Medical records may contain mistakes and misdiagnoses, but that does not necessarily mean that they are not business records. If these records otherwise comply with Rule 803(6), the errors contained within the records

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<sup>77</sup> The Defendants counter that the owners were merely expressing their present sense impression. The owners would call Microtherm with their complaints, Microtherm’s technicians would document these complaints, and on occasion the technician would have the owner describe certain aspects of the problem. Consequently, the Defendants assert the records themselves are admissible under Rule 803(6) and the owner’s hearsay contained therein is admissible under Rule 803(1).

<sup>78</sup> The Court notes that this time was split between showing inaccuracies in the “notes” fields and the previously deemed inadmissible “user-defined” fields.

go to the weight given by the finder of fact, not admissibility. Exhibit 2.16 is also admissible for the same reasons—it is admissible for what it is—a summary of warranty records made for the purposes of this trial to aid the Court in understanding the testimony. While Seitz also noted errors in this summary as well, this again goes to the weight given to the summary. This Court has factored these errors into the weight it has given the warranty records, though it reiterates that the admission of the warranty records does not change the finding that Puget/Microtherm proved that there was covered property loss, but failed to carry its burden of proof with respect to the apportionment of the underlying judgment. Therefore, should the records and/or the summary later be held to be inadmissible, this would not alter the Court’s findings set out above.

B. Dr. Jonathan Walker

Dr. Walker was called to testify as an economics expert by National Union. He has a B.A. from the University of California-Berkeley and a Ph.D. in economics from the Massachusetts Institute of Technology (“MIT”), having studied at MIT on a National Science Fellowship. He is a member of many associations and societies to which economists belong. He has taught economics at the college level. He was employed by the Federal Reserve following graduation and has been with various consulting firms over the last 20 years. He is qualified by training and experience as an expert economist and was offered as such.

The gist of the Defendants’ objection to Dr. Walker is rooted in Federal Rule of Evidence 702 and 703, and *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993). While being somewhat non-specific in their objections, it was clear to the Court that the Defendants claim that Dr. Walker’s testimony amounts only to a rehash and reinterpretation of the evidence (from both the Underlying Case and this one). Instead of assisting this Court as the finder of fact, Defendants assert



that Dr. Walker's testimony actually invaded this Court's province as fact-finder. Defendants also insist Dr. Walker's theory was not the product of reliable principles and methods.<sup>79</sup> Dr. Walker's testimony related to whether the consequential damage award from the Underlying Case was covered property damage under the Policy. While this Court does not agree *in toto* with the Defendants' objections, it does find they have a large amount of merit. While many of the Defendants' criticisms actually go to the weight to be given to Dr. Walker's testimony, some went to relevance and consequently admissibility.

Nevertheless, the Court does not find that *all* of Dr. Walker's testimony is excludable and therefore denies Defendant's request to completely exclude his testimony. This ruling, however, should not be read as the Court accepting and/or relying upon all of his testimony. There were many instances in which his testimony consisted of merely recapping or interpreting the testimony of others, either in this or the Underlying Case. In these instances, the Court, as the finder of fact, saw no need for an expert to interpret what the Court can hear or read for itself. In fact, there actually was precious little of Walker's testimony that the Court found was admissible and helpful.<sup>80</sup>

## VI. CONCLUSION

The above opinion encapsulates in narrative form this Court's findings of fact and conclusions of law. The Court's most pertinent findings can be summarized as follows::

- (1) National Union denied coverage prior to the April 6-7, 2005 mediation;
- (2) by denying coverage prior to the mediation, National Union freed Puget and

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<sup>79</sup> Given the fact that the trial in this matter was to the bench, the Court felt no need to hold a separate *Daubert* hearing to hear the testimony and then listen to the testimony a second time at the trial. Thus, the Court informed the parties that it would incorporate a *Daubert* ruling into this opinion.

<sup>80</sup> Perhaps Dr. Walker's most prescient moment came when he described the reasoning of the jury in the Underlying Case as: "It is what it is." (Walker, 5 C.T. 1051).

Arctic Slope from their contractual restraints that would otherwise have prevented them from taking certain compromising actions during their settlement with Microtherm;

- (3) there was no collusion between Microtherm and its counsel and Puget/Arctic Slope and their counsel;
- (4) there was only one possible “occurrence” in this matter, meaning the underlying limits and/or self-insured retentions were satisfied by the payment at mediation and/or the post-settlement tendering of the limits of the Wausau Policy;
- (5) the judgment in the Underlying Case did not include damages that resulted from the commission of an intentional tort;
- (6) Puget deliberately used substandard processing and work conditions in molding of the chambers;
- (7) Puget did not intend or expect to cause injury to Microtherm and its customers;
- (8) it was highly probable, and a reasonable molder would have known it was highly probable, that Puget’s substandard processing and work conditions in molding the chambers made the chambers weak and likely to fail; therefore, Puget’s actions were not an “occurrence” under the Policy;
- (9) there were many causes (both covered and uncovered by the Policy) for the damages awarded by the jury in the Underlying Case against Puget;
- (10) Microtherm/Puget failed to apportion either in the Underlying Case or in this Court between losses that were covered and losses that were not covered;
- (11) based upon the above findings and those detailed in the text as a whole Microtherm/Puget cannot recover from National Union.

This case is a part of a protracted piece of litigation which has had multiple twists and turns, each of which seems to have led to more problems, and more twists and turns. The parties were forced by circumstance to take positions that were contrary to what most might consider their own best interests under normal circumstances. Microtherm and its counsel spent years pursuing Puget

and others, and weeks during the Underlying Case demonizing Puget and proving it to be incompetent, incapable, and guilty of intentional misdeeds. Microtherm proved that part of its damages were due to delays in product shipments, thermistor problems, cracks caused by UPG and Puget, and leaks caused by other problems (such as leaks at the mechanical joint). In this regard, Microtherm was quite successful. In the instant case, it then became necessary for Microtherm to argue that Puget's conduct was somewhat less nefarious. While Microtherm adduced evidence during Underlying Case that Puget intentionally and knowingly molded in a manner that caused the leaks in order to decrease cycle time and maximize profits, Microtherm was basically forced here to suggest that no such intent existed. Microtherm was not alone in being forced to adopt some unusual positions. National Union in this case adopted what in essence was the same position Microtherm took in the Underlying Case. Its interest in this case was best served by proving that its own insured, Puget, was guilty of trying to intentionally harm Microtherm.

This somewhat ironic situation was made more complicated by the presence of two other defendant-component makers in the state court case, and by the fact that the jury ultimately returned a verdict against the three entities far in excess of any sums contemplated by the evidence and what was perhaps far in excess of that expected by any of the parties. In this Court's estimation, Microtherm's overwhelming success in the Underlying Case added to the difficulty that Puget already faced in being able to apportion the damages which were covered by the National Union insurance policy. Now as Puget's assignee, Microtherm may be, in effect, a victim, at least partially, of its own success. Nevertheless, while unusual, this situation is not unique. The apportionment law in the State of Texas, by which this Court is bound, has led to cases where insureds, in many situations as sympathetic as Microtherm's, have failed to recover insurance proceeds, even in the

face of the existence of admitted covered damage. This rule has been applied to businesses, large and small, homeowners, and even in one reported case, to a church.

Therefore, this Court holds that National Union hereby prevails on its claims that it did not owe either a duty to defend or to indemnify Puget or Arctic Slope and shall enter a declaratory judgment to that effect, consistent with its findings set out above. Microtherm's, Puget's, and Arctic Slope's counterclaims for a declaratory judgment and other relief are denied.<sup>81</sup> National Union is hereby **ORDERED** to submit an agreed (at least to form) final judgment consistent with this opinion within 15 days of the date of this order.

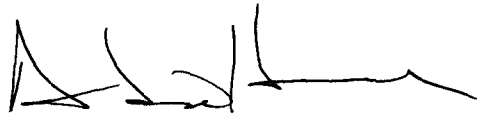
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<sup>81</sup> This Court has presided over this case for over four years. This case has produced one lengthy opinion which was affirmed on an interim appeal. Additionally, as is clear from the testimony in this case, the parties have been involved in seven years of litigation and multiple trials. The parties have spent countless dollars in attorneys' fees and expenses in the presentation of the Underlying Case, this case, and at least one related appeal. Consequently, the Court finds a need to take the further step of making a contingent finding in case the Court of Appeals finds such the following contingent finding useful to prevent further litigation. The two most important rulings in this case are based upon somewhat unsettled points of law with no established pathway for resolving the gaps in precedent. Therefore, this Court shall take the somewhat unusual step of making a contingent finding to prevent the ultimate need of a new trial in the case of an error.

In summary, this Court found that while Puget did not intend or expect the injuries Microtherm suffered, the resulting damage was a highly probable result of the Puget's deliberate actions. In so doing, this Court rejected Microtherm's suggestion that the two prongs delineating whether a deliberate act is an "occurrence" set out in the Fifth Circuit's opinion (apart from the third test—the intentional tort prong) were to both be judged by the subjective intent of the insured. Further, this Court has found that the judgment in the Underlying Case was, in part, based on covered and uncovered property damage, but that Microtherm/Puget did not satisfy their burden of proof to allocate, or provide the Court with a reasonable basis by which it could allocate, between covered and uncovered losses. The Court found that Puget failed to satisfy its burden of proof in this regard. This Court rejected Puget's argument—that Puget did not need to allocate because once it proved the existence of any covered property damage, it was entitled to a judgment for all of the damages found by the jury in the Underlying Case.

Nevertheless, should the Court be wrong in the foregoing analysis (i.e., holding that Puget must allocate and that the "highly probable" prong of the occurrence test is objective), then it would find that Microtherm prevails. It has proved by a preponderance of evidence that covered property damage occurred and was part of the judgment in the Underlying Case and that Puget did not intend or expect to damage Microtherm. The Court notes, as it has before, that it finds by a preponderance of the evidence that covered property damage could be part of the judgment in Underlying Case even without any reliance upon the warranty records. If Puget need not allocate and the "highly probable" prong involves a subjective standard, then National Union's denial of coverage was erroneous, precluding National Union from enforcing the procedural provisions of the Policy. Further, there was no collusion in the settlement agreement. Finally, the Court notes that it finds no merit to the other defenses raised by National Union, but not discussed in this opinion. Thus, should the Fifth Circuit disagree with this Court's two substantive holdings in National Union's favor, this court suggests that it could reverse this case and remand it solely for a determination of damages.

Signed, this the 12th day of August, 2009.

A handwritten signature in black ink, appearing to read 'A. S. Hanen', written over a horizontal line.

Andrew S. Hanen  
United States District Judge