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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

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| IN RE; SUBPOENA DIRECTED TO SAFECO |) | |
| INSURANCE COMPANY OF AMERICA, |) | NO. CV-05-396-CI |
| |) | |
| |) | ORDER GRANTING SAFECO'S |
| [NOTWEN CORPORATION, WCH/GAN |) | MOTION TO QUASH AND |
| PARTNERS, LTD., and WILLIAM C. |) | DENYING MOTION FOR |
| NEWTON, Plaintiffs, v. AMERICAN |) | PROTECTIVE ORDER |
| ECONOMY INSURANCE CO., Defendant, |) | |
| Cause No. 05-CV-104J, District of |) | |
| Wyoming] |) | |
| |) | |

BEFORE THE COURT are third-party Safeco's Motions to Quash subpoena and for Protective Order, submitted to the court following oral argument on December 7, 2005. (Ct. Rec. 1.) Wyoming attorney Timothy J. Bommer appeared *pro hac vice* for third-party Safeco; Wyoming attorney George E. Powers, Jr., of Sundahl, Powers, Kapp & Martin, appeared *pro hac vice*, with local counsel William J. Schroeder, of Paine, Hamblin, Coffin, Brooke & Miller, LLP, for Plaintiffs.

The matter is before the undersigned by operation of LMR 1(9), Local Rules for the Eastern District of Washington. The parties, in compliance with LR 37.1(b), Local Rules for the Eastern District of Washington, have conferred and attempted to settle this matter without court intervention. (Ct. Rec. 4 at 7-8.) All future filings in this matter shall reflect **Cause No. CV-05-396-CI.**

ORDER GRANTING SAFECO'S MOTION TO QUASH
AND DENYING MOTION FOR PROTECTIVE ORDER - 1

THE OREGON LITIGATION

1
2 Plaintiffs, investors in an Oregon company, were sued in the
3 Circuit Court of the State of Oregon, County of Multnomah, *Lezak v.*
4 *Expand Cellular, Inc., et al.*, referenced by Plaintiffs as the *Lezak*
5 litigation. In response to claims made in that litigation,
6 Plaintiffs sought insurance coverage under two policies: a personal
7 homeowners policy issued by Safeco on William Newton's personal
8 residence in Jackson, Wyoming, Policy No. OM552051, and a commercial
9 policy issued by American Economy Insurance Company (AEIC), insuring
10 Mr. Newton's business interests, policy number 02BO904634. Safeco
11 and AEIC are subsidiaries of the same parent company. Both
12 companies denied coverage. The Oregon case was litigated during the
13 spring of 2005. Counsel represented during oral argument that
14 Plaintiffs were exonerated of all claims against them after trial in
15 March and April 2005.

THE WYOMING LITIGATION

16
17 In response to denial of coverage by AEIC, Plaintiffs filed
18 breach of contract / bad faith claims against AEIC¹; Safeco was not
19 included as a party and Plaintiffs continue to represent they do not
20 intend to file a claim against Safeco. The suit initially was
21 filed in state court and removed by AEIC to the United States
22 District Court for the District of Wyoming.

23 On September 27, 2005, Plaintiffs issued an amended subpoena
24 from the United States District Court for the Eastern District of

25 _____
26 ¹*Notwen Corporation, WCH/GAN Partners, LTD. and William C.*
27 *Newton, Plaintiffs v. American Economy Insurance Co., Defendant,*
28 *Cause No. 05-CV-104J, District of Wyoming.*

1 Washington, directing Safeco employee, Neil Jacot, to appear for
2 deposition with the entire Safeco homeowner's claim file. (Ct. Rec.
3 8.) Plaintiffs contend the rationale behind the decision to deny
4 coverage under the homeowner's policy is relevant to AEIC's decision
5 to deny coverage and a defense under its separately issued
6 commercial policy.

7 Plaintiffs advised the court during oral argument that the
8 discovery cut-off for the Wyoming litigation has passed (the
9 Subpoena was issued prior to the cut-off date), but that counsel
10 involved reached an informal agreement that should this court permit
11 access to the Safeco claim file, no objection would be raised as to
12 untimeliness. It appears the issue of extension of the discovery
13 cut-off has not been presented to the federal trial court.

14 **LEGAL ISSUES**

15 Safeco asserts it is entitled to an order quashing the subpoena
16 and/or protective order because the claim file (1) is not relevant
17 to the denial of coverage under the commercial policy issued by
18 AEIC; (2) includes documents protected under attorney/client
19 privilege; and (3) includes documents protected under work product
20 doctrine. Plaintiffs respond the claim file is relevant because
21 Safeco and AEIC are subsidiaries of the same parent company, share
22 office space, access to each other's claim files, policies, and
23 procedures. Thus, Plaintiffs contend Safeco's interpretation of
24 policy language in the homeowner's policy is relevant to the
25 allegations against AEIC with respect to the commercial policy.

26 **AEIC'S POSITION**

27 AEIC sets forth their position as to coverage in a letter dated
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1 August 17, 2004. (Ct. Rec. 15, Ex. B.) After a review of the
2 claims in *Lezak* lawsuit, AEIC denied coverage noting the claims
3 involved misappropriation of trade secrets, tortious interference,
4 and conversion, and the facilitation of same by corporate board
5 members and investors including Plaintiffs. Under the terms of the
6 AEIC commercial policy, a covered business liability includes any
7 "occurrence" for which there is bodily injury or property damage.
8 Occurrence is defined as an accident. AEIC, referencing Wyoming
9 law, *Reisig v. Union Insurance Company*, 870 P.2d 1066 (Wyo. 1994),
10 concluded claims involving civil conversion and/or misappropriation
11 were not "accidents" that would trigger an occurrence. (Ct. Rec.
12 15, Ex. B at 2, Hormel letter.) Additionally, there were coverage
13 exclusions in the policy excluding coverage for intentional acts.
14 Finally, AEIC denied coverage on grounds they were not promptly
15 notified of the lawsuit.

16 SAFECO'S POSITION

17 Safeco, in a letter dated September 1, 2004, denied coverage on
18 grounds there was no bodily injury or property damage caused by an
19 "occurrence" as alleged in the Complaint and as those terms were
20 defined in the homeowner's policy. (Ct. Rec. 15, Ex. D at 2, Jacot
21 letter.) Additionally, Mr. Jacot noted "it is questionable whether
22 damages alleged were caused by an 'occurrence'" as defined in the
23 policy. Occurrence is defined as an "accident." Mr. Jacot then
24 stated:

25 Further, it is questionable whether the alleged damages
26 were caused by an accident. It is my understanding that
27 the Wyoming Supreme Court discussed the definition of
28 "accident" in the case of *Matlock v. Mountain West Farm
Bureau*, 44 P.3d 73 (Wyo. 2002). Under that recent
decision, there does not appear to be an accident that

1 gives rise to coverage for the intentional torts alleged.
2 **However, we recognize your argument that in some**
3 **jurisdictions an accident refers to whether the damages**
4 **were intended.** We, therefore, do not base our coverage
5 decision solely on whether or not an accident occurred.

6 (Ct. Rec. 15, Ex. D at 3.) (Emphasis added.) It is the emphasized
7 language which Plaintiffs contend they have a right to explore
8 through deposition of Mr. Jacot and review of the claims file. They
9 contend this interpretation is contrary to the interpretation
10 provided by AEIC, creating sufficient ambiguity in the definition of
11 the terms in the AEIC policy to give rise to AEIC's obligation to
12 defend. Additionally, it is argued, the deposition of Mr. Jacot
13 should go forward because it may produce relevant evidence of bad
14 faith and/or breach of contract. Specifically, Plaintiffs argued
15 they intended to secure evidence that, under Mr. Jacot's analysis,
16 an argument could be made Safeco would have recommended tendering a
17 defense because of doubt as to whether the claims constituted an
18 occurrence, but for the absence of property damage. (Ct. Rec. 15,
19 Ex. D at 2.)

20 DISCOVERY

21 Under Rule 26, FED. R. Civ. P., parties to litigation may
22 discover all relevant, non-privileged information. See *United*
23 *States v. Nixon*, 418 U.S. 683, 699-700 (1974). Pursuant to FED. R.
24 Civ. P. 45(c)(1) and 35 U.S.C. § 24, ancillary jurisdiction resides
25 in this court to enforce subpoenas directed to residents in this
26 district and issued by the District Court for the Eastern District
27 of Washington. *In re Sealed Case*, 141 F.3d 337, 341 (D.C. Cir.
28 1998).

District courts addressing such motions must decide whether the

1 testimony or material sought is "relevant to the claim or defense"
2 of any party; additionally, for "[g]ood cause shown, the court may
3 order discovery of any matter relevant to the subject matter
4 involved in the action" if it would be "reasonably calculated to
5 lead to . . . admissible evidence." FED. R. CIV. P. 26(b)(1), as
6 amended April 17, 2000, effective December 1, 2000; see also *Elvig*
7 *v. Calvin Presbyterian Church*, 375 F.3d 951, 967 (9th Cir. 2004).
8 However, issues involving the admissibility of evidence must be
9 directed to the court where the underlying action is pending, in
10 this case, the Wyoming court. "[A] district court whose only
11 connection with a case is supervision of discovery ancillary to an
12 action in another district should be 'especially hesitant to pass
13 judgment on what constitutes relevant evidence thereunder'. Where
14 relevance is in doubt . . . the court should be permissive."
15 *Truswal Systems Corp. v. Hydro-Air Engineering, Inc.*, 813 F.2d 1207,
16 1211-12 (Fed. Cir. 1987) (citation omitted); *Compaq Computer Corp.*
17 *v. Packard Bell Electronics, Inc.*, 163 F.R.D. 329, 335 (N.D. Cal.
18 1995).

19 BREACH OF CONTRACT CLAIM

20 The underlying cause of action for breach of contract is being
21 litigated in Federal District Court for the District of Wyoming.
22 Under federal law, issues of insurance contract interpretation are
23 governed by state law. *Stanford Univ. Hosp. v. Federal Ins. Co.*,
24 174 F.3d 1077, 1083 (9th Cir. 1999). Thus, this court looks first
25 to Wyoming law governing insurance contract interpretation.

26 Review of the breach of contract claim against AEIC requires
27 the court to interpret the AEIC policy under the usual rules of
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1 contract interpretation. *Doctors' Co. v. Insurance Corp. of*
2 *America*, 864 P.2d 1018, 1023 (Wyo. 1993). As set forth in *Arnold v.*
3 *Mountain West Farm Bureau Mut. Ins. Co., Inc.*, 707 P.2d 161, 166
4 (Wyo. 1985):

5 If a contract is clear on its face, we must assume it
6 reflects the intent of the parties. *Schacht v. First*
7 *Wyoming Bank, N.A.-Rawlins, Wyo.*, 620 P.2d 561 (1980). We
8 are not free to rewrite contracts under the guise of
9 interpretation. *Adobe Oil & Gas Corp. v. Getter Trucking,*
Inc., Wyo., 676 P.2d 560 (1984). So long as there is no
ambiguity, we are bound to apply the contract as it is
written. *Rouse v. Munroe*, 658 P.2d 74 (Wyo. 1983).

10 See also *Farmers Ins. Exchange v. Dahlheimer*, 3 P.3d 820, 821-822
11 (Wyo. 2000). If the contract is "clear and unambiguous," inquiry
12 is limited to the four corners of the document. *Principal Life*
13 *Insurance Company v. Summit Well Service, Inc.*, 57 P.3d 1257, 1261
14 (Wyo. 2002); *Evans v. Farmers Insurance Exchange*, 34 P.3d 284, 285
15 (Wyo. 2001); *In re Sierra Trading Post, Inc. v. Hinson*, 996 P.2d
16 1144, 1148 (Wyo. 2000). To establish breach of an insurance
17 contract, the insured must show the existence of a contract, breach
18 and damages. Here, there is no issue as to the first; as to the
19 second and third, the breach and damages are limited to AEIC's
20 refusal to defend.

21 The Wyoming courts have held the duty of an insurer to defend
22 a claim is broader than the duty of the insurer to indemnify. *Aetna*
23 *Ins. Co. v. Lythgoe*, 618 P.2d 1057, 1061 (Wyo. 1980) (citing *Lanoue*
24 *v. Fireman's Fund American Ins. Cos.*, 278 N.W.2d 49 (Minn. 1979);
25 *Boston Ins. Co. v. Maddux Well Serv.*, 459 P.2d 777 (Wyo. 1967)).
26 Analysis of the duty to defend is not made based on the ultimate
27 liability of the insurer to indemnify the insured or on the basis of
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1 whether the underlying action is groundless or unsuccessful.
2 *Lythgoe*, 618 P.2d at 1061 (citing *Employers' Fire Ins. Co. v. Beals*,
3 240 A.2d 397 (R.I. 1968); *Burger v. Continental Nat'l American*
4 *Group*, 441 F.2d 1293 (6th Cir. 1971)). Instead, the duty to defend
5 is based on an examination of the facts alleged in the complaint
6 upon which the claim is based. *Lythgoe*, 618 P.2d at 1061 n.2. The
7 analysis of those facts is undertaken in the light of the language
8 of the insurance policy. To determine whether AEIC owed a duty to
9 defend, the Wyoming court will compare the terms of the insurance
10 policy with the allegations set forth in the Oregon complaint.

11 The discovery sought by Plaintiffs neither involves the
12 production of relevant evidence, nor is it reasonably calculated to
13 lead to evidence which would assist the Wyoming court in
14 interpreting the terms of the AEIC policy or determining whether
15 those terms are rendered ambiguous by the language in that contract.
16 An ambiguous contract "is an agreement which is obscure in its
17 meaning, because of indefiniteness of expression, or because a
18 double meaning is present." *Amoco Production Co. v. Stauffer*
19 *Chemical Co.*, 612 P.2d 463, 464 (1980), citing *Bulis v. Wells*, 565
20 P.2d 487, 490 (Wyo. 1977). Ambiguity justifying extraneous evidence
21 is not generated by the later disagreement of the parties concerning
22 the meaning of the contract or its terms. *Homestake-Sapin Partners*
23 *v. United States*, 375 F.2d 507 (10th Cir. 1967). Thus, although
24 extraneous evidence may be admissible to interpret the parties'
25 intent, that evidence is limited to the contemporaneous or later
26 negotiations between the parties. *Polo Ranch Company v. City of*
27 *Cheyenne*, 969 P.2d 132, 140 (Wyo. 1998) (the court must look to all

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1 the surrounding circumstances and extrinsic evidence pertaining to
2 the context within which the contract was formed to determine the
3 parties' intent).

4 Evidence from Mr. Jacot and the Safeco claims file would add
5 nothing to the contractual relationship between AEIC and Plaintiffs
6 with respect to the commercial policy. Differing interpretations of
7 a contract alone will not create an ambiguity requiring the
8 admission of extrinsic evidence. *Moncrief v. Louisiana Land and*
9 *Exploration Company*, 861 P.2d 516, 524 (Wyo. 1993). To the extent
10 extrinsic or parole evidence does not exist to clarify an ambiguity,
11 the ambiguity will be construed against the drafter, the insurance
12 company. *Prudential Preferred Properties v. Underwood Ranch*
13 *Company*, 873 P.2d 598, 600 (Wyo. 1994). Therefore, the evidence
14 sought from Mr. Jacot and/or facts or rationale related to
15 interpretation of Safeco's separately issued homeowner's policy is
16 not relevant to interpretation of the AEIC commercial policy.
17 Finally, the evidence sought would not assist the Wyoming court in
18 determining the nature of the claims alleged in the Oregon lawsuit.

19 **BAD FAITH CLAIM**

20 Additionally, Plaintiffs have sued AEIC for bad faith. A
21 breach of the implied covenant of good faith and fair dealing gives
22 rise to an independent actionable tort and damage relief. A
23 recovery in tort is premised upon the existence of the special
24 relationship created by the unequal bargaining power between an
25 insurer and the insured. *State Farm Mutual Auto. Ins. Co. v.*
26 *Shrader*, 882 P.2d 813, 825 (Wyo. 1994). The tort imposes an
27 obligation that "neither party will do anything to injure the right
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1 of the other to receive the benefits of the agreement." *Shrader*,
2 citing *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973).
3 Liability is imposed not for a bad faith breach of contract, but for
4 the failure to comply with the duty of good faith and fair dealing.
5 That duty is not referenced in the terms of the policy; it is an
6 independent obligation imposed by law under which the insurer must
7 act fairly and in good faith in discharging its contractual
8 responsibilities. As noted earlier, Wyoming case law has
9 established an insurer's duty to defend is broader than its duty to
10 provide coverage. *Shoshone First Bank v. Pacific Employers Insurance*
11 *Co.*, 2 P.3d 510, 513-14 (Wyo. 2000). If the policy potentially
12 covers one or more claims, the insurer has a duty to defend all
13 claims, and any doubts about coverage should be resolved against the
14 insurer. *Alm v. Hartford Fire Insurance Company*, 369 P.2d 216, 219
15 (Wyo. 1962).

16 Additionally, Wyoming has adopted an objective standard of care
17 as a measure of the required conduct of insurers. *Shrader*, at 825,
18 citing *Anderson v. Continental Ins. Co.*, 271 N.W.2d 368 (Wis. 1978).
19 Under this standard, "where a claim was not fairly debatable,
20 refusal to pay would be bad faith and, under appropriate facts,
21 could give rise to an action for tortious refusal to honor the
22 claim." *Id.* A claim is "fairly debatable" when a reasonable
23 insurer would have denied or delayed payment of the claim for
24 benefits under the facts and circumstances. *Shrader* at 825, citing
25 *McCullough*, 789 P.2d at 860; *Anderson*, 271 N.W.2d at 376. Therefore,
26 to establish a breach of the duty of good faith and fair dealing,
27 the insured must show: (1) the absence of any reasonable basis for
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1 denying a claim for benefits; and (2) the insurer's knowledge or
2 reckless disregard of the lack of a reasonable basis for denying the
3 claim for benefits. *Id.*, citing *Darlow v. Farmers Ins. Exchange*,
4 822 P.2d 820, 824 (Wyo. 1991); *McCullough*, 789 P.2d at 860 (quoting
5 *Anderson*, 271 N.W.2d at 376).

6 The AEIC commercial policy set forth the following provisions:

7 1. Business Liability

8 a. We will pay those sums that the insured becomes
9 legally obligated to pay as damages because of "bodily
10 injury", "property damage", "personal injury" or
11 "advertising injury" to which this insurance applies. We
12 will have the right and duty to defend the insured against
13 any "suit" seeking those damages. However, we will have
14 no duty to defend the insured against any "suit" seeking
15 damages for "bodily injury", "property damage", "personal
16 injury" or "advertising injury" to which this insurance
17 does not apply. We may at our discretion, investigate any
18 "occurrence" and settle any claim or "suit" that may
19 result.

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21 b. This insurance applies:

22 (1) To "bodily injury" and "property damage" only if:

23 (a) The "bodily injury" or "property
24 damage" is caused by an "occurrence" that takes
25 place in the "coverage territory"; and

26 (b) The "bodily injury" or "property
27 damage" occurs during the policy period."

28 The policy defined "occurrence" as "an accident, including
continuous or repeated exposure to substantially the same general
harmful conditions." (Ct. Rec. 15, Ex. B at 2.) AEIC noted the
Oregon allegations involved statutory trade secrets violations,
specifically that Plaintiffs assisted other defendants to
misappropriate assets and approved of that misappropriation, as well
as claims of tortious interference and conversion. The declination

1 letter then concluded, after referring to *Reisig v. Union Insurance*
2 *Co.*, 870 P.2d 1066 (Wyo. 1994): "it is clear that a claim for civil
3 conversion and/or misappropriation in Wyoming is not an 'accident'
4 such that it would trigger an 'occurrence' pursuant to the policy."
5 (Ct. Rec. 15, Ex. B at 2.) Additionally, the letter noted certain
6 policy exclusions may apply, including the following:

7 1. Applicable to Business Liability Coverage -
8 This insurance does not apply to:

9 a. Expected or Intended Injury

10 "Bodily injury" or "property damage" expected
11 or intended from the standpoint of the insured.
12 This exclusion does not apply to "bodily
injury" resulting from the use of reasonable
force to protect persons or property.

13 In contrast to AEIC's position, Safeco refused to tender a
14 defense on a theory of damages--that the Oregon complaint did not
15 allege property damage as defined under the terms of the policy;
16 alternatively, Mr. Jacot admitted some room for argument "in some
17 jurisdictions" with respect to Safeco's obligation to defend based
18 solely on the theory of liability alleged in the Complaint. (Ct.
19 Rec. 15, Ex. D at 3.) However, with respect to coverage in Wyoming,
20 he noted the dispositive case was *Matlock v. Mountain West Farm*
21 *Bureau*, 44 P.3d 73 (Wyo. 2002) (coverage for damages resulting from
22 intentional tort of conversion did not constitute an "occurrence"
23 to give rise to duty to defend).

24 AEIC refused coverage on a theory of liability--that the Oregon
25 complaint did not allege an "occurrence" or "accident" as defined
26 under the terms of its policy; rather, the claims alleged
27 intentional acts which (1) did not meet the definition of occurrence
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1 and (2) fell within policy exclusions. Even assuming extrinsic
2 evidence would be relevant with respect to creating an ambiguity as
3 to the definition of "occurrence," there is no showing the evidence
4 would be relevant or reasonably calculated to rebut AEIC's position
5 the claims fell within the policy exclusions. (Ct. Rec. 15, Ex. B
6 at 2.) It follows this court cannot say production of Mr. Jacot or
7 the Safeco claim file would produce relevant evidence of AEIC's
8 alleged unreasonable or reckless decision to deny a defense.
9 However, the ultimate issue of whether AEIC's evidentiary showing is
10 sufficient to support its decision to deny a defense is for the
11 Wyoming court to decide. Accordingly,

12 1. Third-party Safeco's Motion to Quash (Ct. Rec. 1) is
13 **GRANTED**; Safeco's Motion for Protective Order is **DENIED AS MOOT**.

14 2. The District Court Executive is directed to file this
15 Order and provide a copy to counsel of record.

16 DATED December 15, 2005.

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18 S/ CYNTHIA IMBROGNO
19 UNITED STATES MAGISTRATE JUDGE
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