IN THE COURT OF APPEALS
OF THE STATE OF NEW MEXICO

NAUTILUS INSURANCE COMPANY,

Plaintiff-Appellee,

v.

COA No. 33,820
District Court No. D-504-CV-2012-00654

OHIO SECURITY INSURANCE COMPANY,

Defendant-Appellant.

DEFENDANT-APPELLANT'S BRIEF-IN-CHIEF

Civil Appeal from the Fifth Judicial District Court
District Court No. D-504-CV-2012-00654
The Honorable Charles C. Currier Presiding

ORAL ARGUMENT REQUESTED

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Certificate of Compliance

As required by rule 12-213(G) NMRA, I certify that this Brief uses a proportionally-spaced type style or typeface, such as Times New Roman, and that this Brief contains 7020 words as calculated by Microsoft Office 2013, the word processing system used to prepare this Brief.

Pursuant to Rule 12-213 NMRA, Defendant-Appellant Ohio Security Insurance Company ("Ohio Security"), files its Brief-in-Chief requesting reversal of the Final Judgment entered by the district court on April 16, 2014. [RP 223]

Pursuant to Rule 12-214 NMRA, Ohio Security requests oral argument on this appeal. Because this case involves important issues in the area of insurance law, oral argument would be helpful to a resolution of this case.

SUMMARY OF PROCEEDINGS

I. NATURE OF THE CASE

This is an appeal from a summary judgment entered in favor of Plaintiff-Appellee, Nautilus Insurance Company ("Nautilus"), wherein the Fifth Judicial District Court, the Honorable Charles C. Currier presiding, concluded that Ohio Security, owed its insured, Norman/Dent Custom Homes, Inc. ("Norman/Dent"), a duty to defend. [RP 197-98, 223-26] The district court further concluded that Ohio Security breached its duty to defend and that, as a result, Ohio Security was estopped from relying on coverage defenses, including policy exclusions, to disclaim or limit its duty to indemnify. [RP 197-98, 223-25] The allegations contained in the underlying complaint clearly fall outside the provisions of the Ohio Security Policy, and therefore, a defense was not required. Ohio Security is not estopped from relying on coverage defenses to avoid or limit its duty to indemnify when it properly denied a defense to Norman/Dent and when,

unlike suits between an insured and its insurer, the doctrines of waiver and estoppel do not apply in a subrogation suit against another insurer.

II. COURSE OF PROCEEDINGS AND DISPOSITION BELOW

On October 15, 2012, Nautilus filed a subrogation action against Ohio Security to recover amounts it paid in the defense and indemnification of its insured, Norman/Dent, in connection with a construction defect lawsuit filed by John Lewinger and Jamie Lewinger against Norman/Dent. [RP 1-7] The Complaint included the following allegations against Ohio Security, all of which are material to this appeal: that Ohio Security owed Norman/Dent a duty to defend in connection with the underlying lawsuit and arbitration filed by the Lewingers; that Ohio Security breached its duty to defend Norman/Dent; that Ohio Security owed Norman/Dent a duty to indemnify against the arbitration award entered against it; that Ohio Security breached its duty to indemnify by failing to pay in connection with the arbitration award entered against Norman/Dent; and that Ohio Security was estopped from relying upon any and all coverage defenses, including policy exclusions, relating to the duty to indemnify because it breached the duty to defend Norman/Dent in the underlying lawsuit and arbitration. [RP 1-7]

On September 27, 2013, Ohio Security filed a Motion for Summary Judgment on its Duty to Defend and Indemnify. [RP 68] Ohio Security argued that it did not owe Norman/Dent a duty to defend in the underlying action because the

Lewinger Complaint was not ambiguous and because the Policy's exclusions applied to bar coverage. [RP 68-79, 115-18] Ohio Security further argued that it was not estopped from relying on coverage defenses to disclaim or limit its duty to indemnify because Ohio Security did not owe Norman/Dent a duty to defend and because, in this context, the respective rights of Ohio Security and Nautilus should be determined by reference to their insurance contracts. [RP 118] On October 8, 2013, Nautilus filed a Motion for Partial Summary Judgment Concerning Insurance Coverage. [RP 121] Nautilus argued that Ohio Security breached its duty to defend Norman/Dent because the Lewinger Complaint was too ambiguous to allow for a determination that all claims fell outside the scope of the Policy's coverage. [RP 121-40] Nautilus further argued that Ohio Security was estopped from relying on coverage defenses to disclaim or limit its duty to indemnify because Ohio Security breached its duty to defend. [RP 136-40] Both motions were heard on November 4, 2013. [RP 197]

The district court entered its "Order Granting Plaintiff's Motion for Partial Summary Judgment Concerning Insurance Coverage and Denying Defendant's Motion for Summary Judgment on its Duty to Defend and Indemnify" on November 6, 2013. [RP 197-98] Shortly after the parties stipulated to additional facts and damages, the district court entered its "Final Judgment" on April 16,

2014. [RP 218-20, 223-25] Ohio Security timely filed a Notice of Appeal in the district court on May 13, 2014. [RP 227] No cross-appeal has been filed.

Ohio Security requests that this Court reverse the district court's Order Granting Nautilus's Motion for Partial Summary Judgment and Final Judgment, and direct that Summary Judgment should be entered in favor of Ohio Security. In the alternative, Ohio Security requests that this Court reverse the district court's order and remand for further proceedings consistent with this Court's opinion.

III. SUMMARY OF FACTS

This is a subrogation case. In December 2005, John and Jamie Lewinger ("Lewingers") entered into a contract with Norman/Dent, for the construction of a new home. [RP 2, 89, 102] On January 7, 2011, the Lewingers filed suit against Norman/Dent in the Second Judicial District Court. [RP 88] The underlying complaint was a typical construction defect complaint, alleging that the Lewingers' home was damaged by Norman/Dent's failure to adequately prepare the soils and to otherwise competently perform under its construction contract with the Lewingers. [RP 88-100] The underlying complaint also alleged consequential damages as a result of the construction defects. [RP 88-100] The Lewingers did not, however, claim that any subsequent improvements made to the property were damaged by Norman/Dent's work. On April 11, 2011, the Second Judicial District Court referred the action to binding arbitration. [RP 102]

At different times during the construction of the Lewingers' home, Norman/Dent was a mutual insured of Nautilus and Ohio Security. [RP 101 ¶ 1-2] Nautilus had issued to Norman/Dent a Nautilus Commercial Lines Insurance Policy, with a policy period of April 7, 2005 to April 7, 2006. [RP 101 ¶ 1] Ohio Security, had issued to Norman/Dent a Commercial General Liability Policy (hereinafter referred to as "Policy"), with a policy period of April 7, 2007 to April 7, 2008. [RP 101 ¶ 2] The Policy provided that, under some circumstances, Ohio Security would owe Norman/Dent a duty to defend in connection with lawsuits seeking certain damages. [RP 81-84] The Policy also provided that Ohio Security would not owe Norman/Dent a duty to defend in circumstances where the Policy did not apply. [RP 81-87] In addition, the Policy contained numerous policy exclusions, which barred coverage under certain circumstances. [RP 85-87] Those exclusions included a "your work" exclusion; an "Earth Movement" exclusion; and a "Professional Liability" exclusion. [RP 85-87] Importantly, Policy Endorsement CG 2294 10/01, titled, "Damage to Work Performed by Subcontractors on Your Behalf," modified the "your work" exclusion to include any work performed by Norman/Dent's contractors or subcontractors. [RP 86] This meant that the Policy did not provide coverage for the cost of repairing or replacing any faulty work performed by Norman/Dent or any of its subcontractors.

Shortly after the Second Judicial District Court referred the Lewingers' case to binding arbitration, Ohio Security informed Nautilus that, pursuant to the language of the Policy, there was no coverage available in connection with the Lewinger Complaint. [RP 102 ¶ 10] As a result, Ohio Security did not defend Norman/Dent in the underlying lawsuit and arbitration. Nautilus, on the other hand, defended Norman/Dent under a reservation of rights. [RP 102 ¶ 4] The Lewingers ultimately received an arbitration award against Norman/Dent in the amount of $684,629.82. [RP 102 ¶ 11] The award included amounts for attorney's fees totaling $142,422.11 and costs totaling $61,634.36. [RP 4 ¶ 9] Nautilus paid the arbitration award in full. [RP 218 ¶ 2] A Satisfaction was filed with the Second Judicial District Court on March 20, 2012. [RP 218 ¶ 2] On October 15, 2012, Nautilus filed its "Complaint in Subrogation for Damages Resulting from Breach of Insurance Contract" ("Subrogation Complaint") against Ohio Security. [RP 1]

ARGUMENT

I. THE DISTRICT COURT ERRED IN CONCLUDING THAT OHIO SECURITY OWED A DUTY TO DEFEND NORMAN/DENT BECAUSE THE ALLEGATIONS IN THE LEWINGER COMPLAINT CLEARLY FALL OUTSIDE OF COVERAGE UNDER THE OHIO SECURITY POLICY.

Standard of Review

A New Mexico appellate court "reviews *de novo* an order granting or denying summary judgment." *United Nuclear Corp. v. Allstate Insurance Co.*, 2012-NMSC-032, ¶ 9, 285 P.3d 644. Summary judgment is appropriate when "there is no genuine issue as to any material fact and ... the moving party is entitled to summary judgment as a matter of law." Rule 1-056(C) NMRA. "If the facts are not in dispute, and only the legal significance of the facts is at issue, summary judgment is appropriate." *Edwin Smith, LLC v. Synergy Operating, LLC*, 2012-NMSC-034, ¶ 12, 285 P.3d 656.

Preservation

This issue was raised and preserved in Ohio Security's Motion for Summary Judgment [RP 68-79], Ohio Security's Response to Nautilus Insurance Company's Motion for Summary Judgment Concerning Insurance Coverage [RP 111-119] and at the November 4, 2013 hearing.

The district court erred in concluding that Ohio Security owed a duty to defend Norman/Dent because the allegations in the Lewinger complaint clearly fall outside of coverage under the Ohio Security CGL Policy.

In New Mexico, the duty to defend is distinct from the duty to indemnify. *Knowles v. United Servs. Auto. Ass'n*, 1992-NMSC-030, ¶ 4, 113 N.M. 703, 832 P.2d 394 (citing *Insurance Co. of N. Am. v. Wylie Corp.*, 1987-NMSC-011, ¶ 18,

105 N.M. 406, 733 P.2d 854); *see also Windham v. L.C.I.2, Inc.,* 2012-NMCA-001, ¶ 17, 268 P.3d 528. The duty to defend "is a contractual obligation emanating from the insurance policy...and arising when 'the injured third party's complaint states facts which bring the case within the coverage of the policy, not whether [the injured third party] can prove an action against the insured for damages." *Knowles,* 1992-NMSC-030, ¶ 4, 113 N.M. 703, 832 P.2d 394 (citing *American Employers' Ins. Co. v. Continental Casualty Co.,* 1973-NMSC-073, ¶ 4, 85 N.M. 346, 512 P.2d 674 (quoting 1 Rowland H. Long, *The Law of Liability Insurance* § 5.02 (1973)).

"The duty of an insurer to defend arises from the allegations on the face of the complaint or from the known but unpleaded factual basis of the claim that brings it arguably within the scope of coverage." *Am. Gen. Fire & Cas. Co. v. Progressive Cas. Co.*, 1990-NMSC-094, ¶ 11, 110 N.M. 741, 799 P.2d 1113. In deciding whether an insurer is obligated to defend the insured, a court must determine whether the injured party's complaint states facts that bring the case within the coverage of the policy. *See Bernalillo County Deputy Sheriffs Ass'n v. County of Bernalillo*, 1992-NMSC-065, ¶ 8, 114 N.M. 695, 845 P.2d 789 (citing *Wylie Corp.*, 1987-NMSC-011, ¶ 19, 105 N.M. 406, 733 P.2d 854); *see also City of Albuquerque v. BPLW Architects & Eng'rs, Inc.,* 2009-NMCA-081, ¶ 9, 146 N.M. 717, 213 P.3d 1146 ("[I]n disputes stemming from insurance contracts, the

'duty to defend arises out of the nature of the allegations in the complaint...[,] and is determined 'by comparing the factual allegations in the complaint with the insurance policy.'" (citations and internal citations omitted).

"If the allegations of the complaint clearly fall outside the provisions of the policy, neither defense nor indemnity is required." *Bernalillo County Deputy Sheriffs Ass'n,* 1992-NMSC-065, ¶ 8, 114 N.M. 695, 845 P.2d 789 (citing *Wylie Corp.*, 1987-NMSC-011, ¶ 19, 105 N.M. 406, 733 P.2d 854); *see also Guaranty Nat'l Ins. Co. v. C de Baca*, 1995-NMCA-130, ¶ 14, 120 N.M. 806, 907 P.2d 210; *Marshall v. Providence Washington Ins. Co.,* 1997-NMCA-121, ¶ 13, 124 N.M. 381, 951 P.2d 76 ("where allegations are completely outside policy coverage, the insurer may justifiably refuse to defend.") (citations omitted). "Where there is no potential for coverage under a contract of insurance, there is no duty to defend." *Marshall,* 1997-NMCA-121, ¶ 13, 124 N.M. 381, 951 P.2d 76 (citing *State Farm Fire & Cas. Co. v. Geary,* 699 F.Supp. 756, 760 (N.D.Cal.1987)). The complaint must actually "'state [ ] facts' that suggest the case falls within the policy's coverage,...abstract and completely unsubstantiated allegations will not do.'" *State Farm Fire & Cas. Co. v. Mhoon,* 31 F.3d 979, 985 (10th Cir.1994) (citing *Foundation Reserve Ins. Co. v. Mullenix*, 1982-NMSC-038, ¶ 6, 97 N.M. 618, 642 P.2d 604) (internal citation omitted).

A. The Ohio Security Policy Contains Three Separate Exclusions Which Operate to Exclude Coverage for the Claims in the Lewinger Complaint.

The Ohio Security CGL Policy ("Policy") issued to Norman/Dent contains three separate exclusions which operated to exclude coverage for the claims in the Lewinger complaint: the "Earth Movement" exclusion, the "Professional Services" exclusion and the "your work" exclusion. These exclusions are clear and unambiguous and are enforceable under New Mexico law. *Chavez v. State Farm Mut. Auto Ins. Co.,* 1975-NMSC-011, ¶ 6, 87 N.M. 327, 533 P.2d 100 87 N.M. 327, 329 ("'[E]xclusionary (provisions) in insurance contracts shall be enforced so long as their meaning is clear and they do not conflict with statutory law.'") (citing *Willey v. Farmers Ins. Group,* 86 N.M. 325, 326, 523 P.2d 1351, 1352 (1974); *Castorena v. Colonial Life and Acc. Ins. Co.,* 1988-NMSC-070, ¶ 6, 107 N.M. 460, 760 P.2d 152. All of the allegations in the Lewinger complaint undeniably fall within one or more of these exclusions, meaning that they fall outside of coverage. Therefore, no duty to defend Norman/Dent was owed by Ohio Security. Each of the three exclusions is discussed in detail below.

1. Ohio Security owed no duty to defend Norman/Dent in the underlying lawsuit because the claims for property damage and consequential damages were clearly excluded from coverage.

Ohio Security owed no duty to defend Norman/Dent in the underlying lawsuit because the claims for property damage and consequential damages

contained in the Lewinger complaint were clearly excluded from coverage under the Ohio Security Policy. The Ohio Security CGL Policy ("Policy") issued to Norman/Dent provides coverage for, in relevant part, "property damage" caused by an "occurrence," as those terms are defined in the Policy. Specifically, the Ohio Security Policy provides in relevant part:

> **COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY**
>
> **1. Insuring Agreement**
>
> **a.** We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies.
> ...
>
> **b.** This insurance applies to "bodily injury" and "property damage" only if:
>
> **(1)** The "bodily injury" or "property damage" is caused by an "occurrence...."

[RP 81].

The Ohio Security Policy contains Exclusion CG 8597 07/06, *Custom Homebuilders Exclusion – Subsidence* ("Earth Movement Exclusion") [RP 87] which states in pertinent part:

> This insurance does not apply to "bodily injury", "property damage" or "personal and advertising injury" arising out of:

> Any loss, claim, "suit" or other proceeding arising out of, caused by, resulting from, contributed to, or aggravated by subsidence, settling, slipping, falling away, caving in, shifting, eroding, mud flow, rising, tilting, or any other movement of land or earth, whether such movement of land or earth occurs alone, in combination with, before, after or concurrently with any other cause, contributing condition, or aggravating factor.
>
> We are not obligated to defend any loss, claim, "suit" or other proceeding which is excluded above.

In their complaint [RP 91 ¶¶ 23, 25, 26, 28], [RP 92 ¶ 29 and [RP 94 ¶¶ 33, 34], the Lewingers alleged interior and exterior cracking of their home, cracking of a concrete patio slab, the collapse of an outside patio slab, and structural damage due to inadequate soil preparation and inadequate compaction testing.[1] These allegations plainly relate to shifting of the earth beneath the home site and the consequences of such movement, and nothing else. Because such claims relate to "movement of land or earth", coverage for such claims is clearly barred by the "Earth Movement" exclusion under the Policy. [RP 87]

Although no New Mexico appellate court has addressed the enforceability of such an exclusion, it has been upheld by courts in other jurisdictions. *See, e.g.*, *City of Carlsbad v. Ins. Co. of the State of Pennsylvania*, 180 Cal. App. 4th 176,

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[1] The allegations in the Lewinger complaint were based on soil movement from the beginning of the project ("Norman Dent (sic) was responsible for conducting compaction testing at the construction site.... Norman Dent (sic) did not adequately prepare the soils at the construction site") to the end ("Norman Dent has failed to address the structural and drainage issues...to mitigate further damage to the Home"). [RP 90 ¶¶ 19, 20]

102 Cal.Rptr.3d 535 (2009), and *Blackhawk Corp. v. Gotham Ins. Co.*, 54 Cal. App. 4th 1090, 63 Cal.Rptr.2d 413 (1997).

2. Ohio Security had no duty to defend Norman/Dent because the "Professional Liability" exclusion" bars coverage for alleged failure to test the soil or to provide other engineering or architectural services.

Ohio Security also owed no duty to defend Norman/Dent because coverage for alleged failure to perform proper and adequate compaction testing and for alleged failure to adequately prepare the soils at the construction site as set forth in the Lewinger complaint [RP 90 ¶¶ 19, 20] is excluded under the "Professional Liability Exclusion" Endorsement CG 2279 07/98, *Exclusion – Contractors – Professional Liability* ("Professional Liability Exclusion"). The exclusion [RP 85] provides:

EXCLUSION – CONTRACTORS – PROFESSIONAL LIABILITY

***

1. This insurance does not apply to "bodily injury", "property damage" or "personal and advertising injury" arising out of the rendering or failure to render any professional services by you or on your behalf, but only with respect to either or both of the following operations:

a. Providing engineering, architectural or surveying services to others in your capacity as an engineer, architect, or surveyor; and

b. Providing, or hiring independent professionals to provide, engineering, architectural or surveying services in

connection with construction work you perform.

2. Subject to Paragraph **3.** below, professional services include:

a. Preparing, approving, or failing to prepare or approve, maps, shop drawings, opinions, reports, surveys, field orders, change orders, or drawings and specifications; and

b. Supervisory or inspection activities performed as part of any related architectural or engineering activities.

3. Professional services do not include services within construction means, methods, techniques, sequences and procedures employed by you in connection with your operations in your capacity as a construction contractor.

This exclusion bars from coverage any damage resulting from "[p]roviding, or hiring independent professionals to provide, engineering, architectural or surveying services in connection with construction work you perform." [RP 85] The Lewinger complaint alleged that the root cause of the problems with the home was inadequate soil preparation coupled with inadequate compaction testing, [RP ¶¶ 19, 20] which Norman/Dent subcontracted to Florentino Engineering. [RP 90 ¶ 18] ("The number of tests conducted and the location of the compaction tests conducted were inadequate and not in accordance with standard industry practice.") [RP 90 ¶ 19]; ("Norman Dent (sic) did not adequately prepare the soils at the construction site"). [RP 90 ¶ 20]

To the extent that the Lewinger complaint alleged that Norman/Dent failed to properly supervise the compaction testing performed by Florentino Engineering, coverage for such claim is likewise excluded by the "Professional Liability" exclusion. [RP 85] This exclusion is unambiguous, and New Mexico courts uphold clear professional services exclusions in liability policies. *See, e.g., Millers Casualty Ins. Co. v. Flores,* 1994-NMSC-058, 117 N.M. 712, 876 P.2d 227; *see also New Mexico Physicians Mut. Liab. Co. v. LaMure*, 1993-NMSC-048, 116, N.M. 92, 860 P.2d 734. Therefore the "Professional Liability" exclusion clearly excludes from coverage any claims that the soil was not adequately tested or engineered.[2]

3. Ohio Security owed no duty to defend Norman/Dent because the allegations in the Lewinger complaint were excluded from coverage under the "your work" exclusion."

Ohio Security also did not owe a duty to defend Norman/Dent because the allegations in the Lewinger complaint were excluded from coverage under the "your work" exclusion under the Policy. Exclusions l. and m. in the Policy [RP 82] provide:

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[2] The "Earth Movement" exclusion also encompasses all claims to which the Professional Liability Exclusion applies, as the claims relate to "subsidence, settling, slipping, falling away, caving in, shifting, eroding, mud flow, rising, tilting, or any other movement of land or earth." [RP 87]

EXCLUSION – DAMAGE TO WORK PERFORMED BY SUBCONTRACTORS ON YOUR BEHALF

l. Damage to Your Work

"Property damage" to "your work" arising out of it or any part of it and included in the "products completed operations hazard".

***

m. Damage To Impaired Property Or Property Not Physically Injured

"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" or "your work;"

...

Exclusion l., known as the "your work" exclusion [RP 82], applies to "[p]roperty damage to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard.'" Because the products-completed operations hazard applies to completed work, and all of the allegations in the Lewinger complaint concerned the time period following issuance of the Certificate of Occupancy of the home [RP 91 ¶ 22], exclusion l. eliminates

coverage for the cost of repairing or replacing Norman/Dent's faulty work. *See United Capital Insurance Co. v. Special Trucks*, 918 F.Supp. 1250 (N.D. Ind. 1996).

Exclusion l. typically does not exclude damages due to work performed on the insured's behalf by a subcontractor. However, Endorsement CG 2294 10/01, *Damage to Work Performed by Subcontractors on Your Behalf*, modifies the "your work" exclusion to include any work performed by Norman/Dent's contractors or subcontractors. [RP 86] Therefore, the combination of the "your work" exclusion and Endorsement CG 2294 10/01 eliminates coverage for the cost of repairing or replacing any faulty work performed on the home.

Although the Lewinger complaint alleged that a "subcontractor, selected by Norman Dent, came to the Home and attempted to patch the cracks and to seal a large crack that had developed in the concrete patio slab," [RP 91 ¶ 26], a plain reading of this allegation suggests that the stucco subcontractor was *Norman/Dent's* subcontractor. Any different interpretation of this allegation is simply unreasonable, is not substantiated by the Lewinger complaint, and requires a court to engage in rank speculation, which is not permitted.

New Mexico courts do not permit speculation of what may be claimed in the case, and rely on known facts or pled facts for a coverage analysis. *Mhoon,* 31 F.3d at 985 (holding that where there were no stated facts in civil complaint

tending to show that shooting had been accidental (versus intentional), the insurer had no duty to defend, and noting that *Mullenix* requires the complaint to state facts that suggest the case falls within the policy's coverage); *see also Western Commerce Bank v. Reliance Ins. Co.,* 1987-NMSC-009, ¶ 9, 105 N.M. 346, 732 P.2d 873 (cannot imply allegations as pled stated defamatory material was published or spoken, and, therefore, pleadings as filed did not give notice of facts potentially within the policy's "personal injury" coverage provisions and insurer had no duty to defend).

Further, the Lewinger complaint stated: "[p]ursuant paragraph 7 of the Contract, Norman Dent was responsible for providing 'all labor and materials and shall do all things necessary for the proper construction' of the home." [RP 89 ¶ 11] This allegation clearly indicates that Norman/Dent was responsible for providing *all* labor, including subcontractors. [RP 89 ¶ 11] Nothing in the Lewinger complaint even remotely suggests that someone other than Norman/Dent's subcontractors performed any work on the home. Paragraph 26 of the Lewinger complaint therefore does not trigger a duty to defend under the Ohio Security Policy.

A New Mexico court will not strain or torture words to encompass meanings they do not clearly express or to create an ambiguity where none exists. *Battishill v. Farmers Alliance Ins. Co.,* 2006-NMSC-004, ¶ 17, 139 N.M. 24, 127 P.3d 1111

(citing *Safeco Ins. Co. of Am. v. McKenna*, 1977-NMSC-053, ¶ 20, 90 N.M. 516, 565 P.2d 1033); *United Nuclear Corp. v. Allstate Ins. Co.*, 2012-NMSC-032, ¶ 10, 285 P.3d 644 ("Reviewing courts should not 'create ambiguity where none exists....'") (citations omitted).[3]

Ohio Security also owed no duty to defend Norman/Dent in the Lewinger lawsuit because Exclusion m. – *Damage to Impaired Property or Property Not Physically Injured* – eliminates coverage for resultant loss of use of the home as well. [RP 82] The Lewinger complaint mostly made claims of defective construction but also claimed that those defects rendered the entire home unusable, even the parts of the home that were not poorly built. [RP 94 ¶ 34] (alleging that "due to the severity of the structural problems and the nature of the required repairs, the home would likely be uninhabitable); [RP 95 ¶ 38] ("The structural issues with respect to the Home are now so severe that Lewingers have been constructively evicted...") and [RP 96 ¶ 47] ("Lewingers have suffered...loss of enjoyment and use of the Home because of the structural damages;...devaluation

[3] Even assuming, *arguendo,* that the stucco subcontractor in paragraph 26 of the Lewinger complaint was not Norman/Dent's subcontractor, the complaint would still have had to allege that there was damage to the subcontractor's work: the patch and seal. The Lewinger complaint does not do so. Rather, it only alleges damage to Norman/Dent's work. It does not allege that the subcontractor's patch and seal were damaged. Furthermore, the Lewinger complaint did not allege damage to any improvements to the home that were made after Norman/Dent completed its work.

of the Home; and...potential damages associated with vacating the home because it is no longer safe to occupy....").

Significantly, the Lewinger complaint did not allege damage to subsequent improvements (for example, loss of use of a hypothetical basketball court constructed after Norman/Dent finished its work) but, even if it had, those claims would fall under operation of Exclusion m. [RP 82] This is because any such damage would have been due to the structural damages associated with Norman/Dent's allegedly shoddy work.

Moreover, there is no allegation in the Lewinger complaint that any such hypothetical improvements were made by someone other than Norman/Dent or by one of its subcontractors. A court should not imply facts that are not pled or otherwise substantiated in the complaint. *Western Commerce Bank,* 1987-NMSC-009, ¶ 9, 105 N.M. 346, 732 P.2d 873. Therefore, the combination of the "your work" exclusion [RP 82] and Endorsement CG 2294 10/01 [RP 86] eliminates coverage for the cost of repairing or replacing any faulty work performed on the home.

Because Exclusion m. [RP 82] excludes damage to property that is not physically injured whether such damage was caused by Norman/Dent's work or the work of any of its contractors, it excludes coverage for the Lewingers' claims for constructive eviction, loss of use, and other consequential damages.

For the reasons stated above, the allegations contained in the Lewinger complaint clearly fall outside the provisions of the Ohio Security Policy, and therefore, a defense of Norman/Dent was not owed by Ohio Security. The Final Judgment [RP 223] should therefore be reversed and judgment should be entered in favor of Ohio Security.

II. THE DISTRICT COURT ERRED IN CONCLUDING THAT OHIO SECURITY IS ESTOPPED FROM RELYING UPON OR ASSERTING POLICY EXCLUSIONS TO AVOID OR LIMIT ITS INDEMNITY OBLIGATIONS.

The district court erred in concluding that Ohio Security is estopped from relying upon or asserting coverage defenses to avoid or limit its indemnity obligations because (1) Ohio Security did not owe a duty to defend or indemnify Norman/Dent in the *Lewinger* case and (2) the doctrines of waiver and estoppel do not apply in the context of a dispute between two insurers.

Standard of Review

The same standard of review applies as with respect to Issue No. I.

Preservation

In its Response to Nautilus Insurance Company's Motion for Partial Summary Judgment, Ohio Security argued that it was not estopped from relying on coverage defenses to disclaim or limit its duty to indemnify because Ohio Security did not owe Norman/Dent a duty to defend and because, in this context, the

respective rights of Ohio Security and Nautilus should be determined by reference to their insurance contracts. [RP 118]

A. Ohio Security is Not Estopped from Relying on Coverage Defenses to Avoid or Limit its Indemnity Obligations Because it did not Owe a Duty to Defend or Indemnify Norman/Dent in the Underlying Lawsuit.

As argued above, Ohio Security did not owe a duty to defend Norman/Dent in the underlying lawsuit because the allegations in the Lewinger complaint clearly fell outside of coverage under the CGL Policy issued by Ohio Security to Norman/Dent. *Bernalillo County Deputy Sheriffs Ass'n,* 1992-NMSC-065, ¶ 8, 114 N.M. 695, 845 P.2d 789 (citing *Wylie Corp.*, 1987-NMSC-011, ¶ 19, 105 N.M. 406, 733 P.2d 854); *see also Guaranty Nat'l Ins. Co.,* 1995-NMCA-130, ¶ 14, 120 N.M. 806, 907 P.2d 210; *Marshall,* 1997-NMCA-121, ¶ 13, 124 N.M. 381, 951 P.2d 76 ("where allegations are completely outside policy coverage, the insurer may justifiably refuse to defend.") (citations omitted).

Because the allegations in the Lewinger complaint completely fell outside of coverage under the provisions of the Policy, Ohio Security also did not owe a duty to indemnify Norman/Dent. *See LaMure*, 1993-NMSC-048, ¶ 8, 116 N.M. 92, 860 P.2d 734 (stating that if the allegations of the underlying complaint fall outside the provisions of the policy, indemnification by the insurer is not required); *see also Bernalillo County Deputy Sheriffs Ass'n,* 1992-NMSC-065, ¶ 8, 114 N.M. 695, 845

P.2d 789 ("if the allegations of the complaint clearly fall outside the provisions of the policy, neither defense nor indemnity is required.") (citation omitted).

B. Ohio Security is Not Estopped from Relying on Coverage Defenses to Avoid or Limit its Indemnity Obligations Because the Doctrine of Estoppel Applies Between an Insured and an Insurer Only and is Inapplicable to a Dispute Between Two Insurers.

The district court erred in concluding that Ohio Security is estopped from relying on coverage defenses to avoid or limit its indemnity obligations because the doctrine of estoppel applies only in the context of the insurer/insured relationship and should not operate to estop one insurance carrier from relying upon policy provisions in an insurance agreement in a subrogation action brought by another insurer.

"The relationship between insurer and insured is a special relationship under New Mexico law." *Dellaira v. Farmers Ins. Exchange* , 2004-NMCA-132, ¶ 11, 136 N.M. 552, 102 P.3d 111 (citing *Bourgeous v. Horizon Healthcare Corp.*, 1994-NMSC-038, ¶ 17, 117 N.M. 434, 872 P.2d 852). New Mexico appellate courts have acknowledged that the reasons a special and unique relationship between an insurer and an insured is recognized is due to "the inherent lack of balance in and adhesive nature of the relationship, as well as the quasi-public nature of insurance and the potential for the insurer to unscrupulously exert its unequal bargaining power at a time when the insured is particularly vulnerable."

Dellaira, 2004-NMCA-132, ¶ 14, 136 N.M. 552, 102 P.3d 111 (internal quotation marks and citations omitted); *Bourgeous,* 1994-NMSC-038, ¶ 17, 117 N.M. 434, 872 P.2d 852 (discussing the inherent imbalance in relationships between insurers and insureds and the superior bargaining position of insurers); *See also United Nuclear Corp.,* 2012-NMCA-032, ¶ 10, 285 P.3d 644 ("[I]nsurance policies almost always are contracts of adhesion, meaning that 'the insurance company controls the language' and 'the insured has no bargaining power.'") (citations omitted). The Insurance Code is based on many of these concerns. *See, e.g.*, NMSA 1978, §59A-16-20 (1997).

Here, there is no inherent disparity in the bargaining power of the parties, two insurance companies. Further, the insurance contract at issue was not entered into between the two insurers, but rather, between Ohio Security and Norman/Dent; Nautilus is a stranger to that contract. As such, no contract of adhesion was entered into between Ohio Security and Nautilus. The nature of the relationship between Ohio Security and Nautilus as co-insurers simply does not warrant application of the protections arising from an insurer-insured relationship, as Ohio Security owed no duty to Nautilus. *See Am. Gen. Fire & Cas. Co.,* 1990-

NMSC-094, ¶ 16, 110 N.M. 741, 799 P.2d 1113 (holding that a dispute between two insurers over coverage does not come within the scope of the estoppel rule.)[4]

In *Am. Gen. Fire & Cas. Co.,* the New Mexico Supreme Court explained that the reason for the rule estopping an insurer from denying coverage where the insurer fails to expressly reserve its rights "is the presumptive potential of prejudice *to the insured* caused by the insurer's total control of the litigation, the insured's reliance on the insurer, and the insurer's fiduciary duty *vis-à-vis the insured.*" *Id.* (Italics in original). Again, the estoppel rule is not warranted in this case where there was no presumptive prejudice *to the insured* because Nautilus provided a defense and indemnification. According to Nautilus' argument, the only possible prejudice is to it, not to its insured.

Collier v. Union Indem. Co., 1934-NMSC-030, 38 N.M. 271, 31 P.2d 697, the case cited by the Court in its proposed disposition, involved a suit by an insured against its insurer. In *Collier*, the insurer failed to provide a defense in the underlying action. *Id.* ¶ 5. The plaintiff-insured sued its insurer seeking to recover the amount it paid out in a judgment in the underlying action. *Id.* ¶¶ 3, 5, 7, 8. The Court in *Collier* stated that because the insurer breached its duty to defend its

[4] Nautilus voluntarily defended and indemnified Norman/Dent in the Lewinger lawsuit. Whether or not Ohio Security had valid defenses to coverage arises from the insurance contract entered into between Ohio Security and Norman/Dent and does not implicate Nautilus. *See Am. Gen. Fire & Cas. Co.,* 1990-NMSC-094, ¶ 16, 110 N.M. 741, 799 P.2d 1113.

insured, it "left plaintiff enmeshed in litigation ... casting plaintiff irrevocably in damages greatly exceeding the amount of his indemnity." *Id.* ¶ 25. The court held that "[w]e merely interpret the contract and hold the insurer to its obligations. It cannot claim its benefits after having refused its burdens." *Id.* ¶ 38.

Collier and other cases involving suits between an insured and its insurer are distinguishable from the instant case which involves an action by one insurer against another insurer for equitable subrogation. There is no a "special relationship" between the two insurers in this case, as is present in the insured/insurer relationship which would justify application of a rule of estoppel. Both insurers have equal bargaining power and are equally sophisticated. There is absolutely no basis for courts to protect one insurance company in a suit for subrogation brought against another insurance company by invoking a rule of estoppel which was created to protect *insureds* from the potential for prejudice caused by the misdeeds of an insurer with which the insured has entered into a contractual relationship. *See Am. Gen. Fire & Cas. Co.*, 1990-NMSC-094, ¶ 16.

Many other state and federal courts have also held that the doctrines of waiver and estoppel do not apply to cases involving disputes between two insurers. *See, e.g., St. Paul Mercury Ins. Co. v. Lexington Ins. Co.,* 78 F.3d 202, 208 (5th Cir. 1996) ("the waiver rule ... is simply not intended to be applied to the relationship among insurers."); *Alliance Gen. Ins. Co. v. Ins. Co. of State of Pa.,*

134 F.3d 362 (4th Cir. 1998) ("The estoppel rule is to protect the insured once she has given up all control of her defense in the lawsuit, and as such does not apply between insurers."); *Iowa Nat. Mut. Ins. Co. v. Liberty Mut. Ins. Co.,* 464 N.W.2d 564, 568 (Minn. Ct. App. 1990) ("The general rule estopping an insurance company from denying liability is not applicable where estoppel is asserted by one insurer against another insurer."); *Western Casualty and Surety Co. v. American National Fire Insurance Co.,* 318 N.W.2d 126 (S.D.1982) ("Only the parties to the contract of insurance, or their privies, can claim the benefit of a waiver or an estoppel").

While Ohio Security may have been precluded from asserting coverage defenses to limit or avoid its indemnity obligations in a suit brought by its insured, Norman/Dent, based on the application of the estoppel rule if it was determined that Ohio Security breached its duty to defend, there is simply no valid or compelling policy reason nor legal basis under New Mexico law supporting the application of the estoppel rule in a circumstance where one insurer is suing another insurer in subrogation.

Rather than waiver or estoppel, what should control are the obligations that each company assumed in their respective insurance contracts. In a suit "in which there are two insurers each with a duty to defend, one of which refuses to defend, the defending insurer has a right of apportionment of expenses and outlays with the

other insurer *in proportion to the insurance carried.*" *American Employers' Ins. Co.,* 1973-NMSC-073, ¶ 15, 85 N.M. 346, 512 P.2d 674 (emphasis added). When there is "double or concurrent insurance, all insurers are liable and the loss falls on them equitably in proportion to the insurance carried." *United Servs. Auto. Ass'n v. Agric. Ins. Co. of Watertown, N.Y.*, 1960-NMSC-093, ¶ 10, 67 N.M. 333, 355 P.2d 143. When two insurers are primarily liable, the loss should be pro-rated in proportion to the insurers respective policy limits. *CC Hous. Corp. v. Ryder Truck Rental, Inc.*, 1987-NMSC-117, ¶ 15, 106 N.M. 577, 746 P.2d 1109.

In *American Employers' Ins. Co.*, 1973-NMSC-073, ¶ 3, one insurer defended the insured in the underlying suit while the other carrier denied a defense. The Supreme Court of New Mexico found that each insurer had a duty to defend the insured and that the loss came within the coverage of both policies. *Id.* ¶ 13. The Court held that each insurer was liable for the cost of defense in proportion to their insurance contracts, based on the maximum coverage of each insurer. *Id.* ¶ 14.

Here, as in *American Employers' Ins. Co.*, if the Court concludes that Ohio Security owed a duty to defend Norman/Dent in the *Lewinger* case, then both Nautilus and Ohio Security should be held liable for 50% (or a pro rata share) of the cost of defense as the two insurers on the risk.

However, just as the Court in *American Employers' Ins. Co.* did not apply an estoppel rule to preclude the non-defending insurer, American Employers Insurance Company, from asserting policy defenses to limit or avoid its indemnity obligations, no such rule should be applied here. Both Nautilus and Ohio Security agreed to certain rights and obligations in their respective insurance contracts with the insured, including coverage clauses and exclusions, and the relevant policy language should control the rights, duties and obligations of each insurance company.

Finally, application of an estoppel rule in this circumstance would result in an unjust and unwarranted reallocation of Nautilus' indemnity obligations under its policy to Ohio Security in a suit in which Nautilus's rights are based solely on subrogation rather than contractual rights, and to which no valid reason to apply an estoppel rule exists. The operation of an estoppel rule would also inure to the benefit of Nautilus in the form of a windfall, which is not permitted. *See Rummel v. Lexington Ins. Co.*, 1997-NMSC-041, ¶ 41, 123 N.M. 752, 945 P.2d 970 (insurer should not receive a windfall).

For the foregoing reasons, the district court erred in concluding that Ohio Security is estopped from relying upon coverage defenses to avoid or limit its indemnity obligations and the Final Judgment [RP 223] should be reversed. Should this Court conclude that Ohio Security breached its duty to defend, but that

the district court erred in applying an estoppel rule, this matter should be remanded to the district court for determination of whether Ohio Security owed a duty to indemnify Norman/Dent based on the provisions of the Ohio Security CGL Policy.

CONCLUSION

The district court erred in concluding that Ohio Security Insurance Company owed a duty to defend Norman/Dent in the underlying lawsuit because the allegations in the Lewinger complaint clearly fall outside the provisions of the Ohio Security CGL Policy. All of the allegations in the Lewinger complaint are excluded by three separate exclusions in the Ohio Security Policy: the "Earth Movement" exclusion, the "Professional Services" exclusion and the "your work" exclusion. These exclusions are clear and unambiguous and are enforceable under New Mexico law. As such, Ohio Security did not owe a duty to defend Norman/Dent in the Lewinger lawsuit.

The district court further erred in concluding that Ohio Security is estopped from relying upon or asserting policy exclusions to avoid or limit its indemnity obligations because (1) Ohio Security did not owe a duty to defend or indemnify Norman/Dent in the *Lewinger* case and (2) the doctrine of estoppel does not apply in the context of a dispute between two insurers.

New Mexico law does not support the application of an estoppel rule where one insurer has sued another insurer in subrogation, nor are there any valid or

compelling policy reasons to apply such a rule in this circumstance. The estoppel rule only applies in the context of the insured/insurer relationship due to the unequal bargaining power of an insurer and the presumptive potential for prejudice *to the insured* because of the adhesive nature of insurance contracts.

Nautilus should not be allowed to benefit from a rule of estoppel that was clearly designed to protect *insureds* given the special and unique nature of the insured/insurer relationship. The application of estoppel in this circumstance would result in an unjust and unwarranted reallocation of Nautilus' indemnity obligations under its policy to Ohio Security in a suit in which Nautilus' rights are based solely on subrogation rather than contractual rights. The rights, duties and obligations of each insurer should be controlled by the provisions of their respective policies.

For the foregoing reasons, Ohio Security respectfully requests this Court reverse the Final Judgment and remand this case to the district court and direct that Summary Judgment should be entered in favor of Ohio Security. In the alternative, Ohio Security requests that this Court reverse the district court's order and remand for further proceedings consistent with this Court's opinion.

REQUEST FOR ORAL ARGUMENT

Pursuant to Rule 12-214 NMRA, Ohio Security requests oral argument on this appeal. Because this case involves important issues in the area of insurance law, oral argument would be helpful to a resolution of this case.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing pleading was served via e-mail and United States first class mail on the following this 23rd day of February, 2015:

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