IN THE COURT OF APPEALS
OF THE STATE OF NEW MEXICO

NAUTILUS INSURANCE COMPANY,

Plaintiff-Appellee,

v.

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

OHIO SECURITY INSURANCE COMPANY,

Defendant-Appellant.

DEFENDANT-APPELLANT'S REPLY BRIEF

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 2,594 words as calculated by Microsoft Office 2013, the word processing system used to prepare this Reply Brief.

Pursuant to Rule 12-213 NMRA, Defendant-Appellant Ohio Security Insurance Company files this Reply Brief in response to Plaintiff-Appellee Nautilus Insurance Company's Answer Brief. For the reasons states below, Defendant-Appellant requests this Court's reversal of the district court's judgment in favor of Plaintiff-Appellee Nautilus Insurance Company.

ARGUMENT

I. THE DISTRICT COURT ERRED IN CONCLUDING THAT OHIO SECURITY OWED A DUTY TO DEFEND BECAUSE ALL OF THE CLAIMS ASSERTED IN THE LEWINGER COMPLAINT FALL WITHIN THE SCOPE OF THE POLICY EXCLUSIONS AS A MATTER OF LAW.

As Nautilus correctly argues, "'[t]he question presented to the insurer in each case is whether the injured party's complaint states facts which bring the case within coverage of the policy, not whether he can prove an action against the insured for damages.'" *American Employers' Ins. Co. v. Continental Casualty Co.*, 1973-NMSC-073, ¶ 4, 85 N.M. 346, 512 P.2d 674 (quoting 1 Long, *The Law of Liability Insurance* (1973) § 5.02); *see also Foundation Reserve Insurance Co. v. Mullenix,* 1982-NMSC-038, ¶ 6, 117 N.M. 207, 870 P.2d 745.

It is also true, as noted by Nautilus, that "[w]here pertinent allegations of a complaint are ambiguous or incomplete, they are construed in favor of the duty to defend." *Answer Brief, p. 7*, citing *Mullenix,* 1982-NMSC-038, ¶ 8, 97 N.M. 618, 642 P.2d 604. Finally, Nautilus also correctly states that an insurer disclaiming

coverage "must prove as a matter of law that all claims asserted in a complaint fall within the scope of the exclusions relied upon." *Answer Brief, p. 7*, citing *Lopez v. New Mexico Pub. Schs. Ins. Auth.,* 1994-NMSC-017, ¶ 11, 117 N.M. 207, 870 P.2d 745.

A. The Complaint is not Ambiguous Regarding "Subsequent Improvements."

Nautilus also correctly argues that the policy's "Your Work" exclusion does not apply where there is damage to other property, i.e., property not considered to be work performed by or on behalf of the insured, *Answer Brief, p. 8.* Nautilus also argues that the district court correctly ruled in the proceedings below that the Lewinger Complaint was ambiguous regarding whether or not "other property" had been damaged. *Id.* [RP 130, 197-98]. Specifically, Nautilus asserts that the ambiguity arises from the Complaint's reference to "subsequent improvements." *Answer Brief, p. 8.*

However, a fair reading of the Lewinger Complaint does not even remotely suggest that any "subsequent improvements" were damaged. Rather, the only numbered paragraph in the Complaint where "subsequent improvements" is mentioned (paragraph 10) [RP 89] is clearly intended to be descriptive of the nature of the property and the Lewingers' investment in the property; there is no mention in that paragraph (or elsewhere in the Complaint) of any damage to any "subsequent improvements." [RP 89].

Curiously, Nautilus does not argue that the Complaint is also ambiguous because the word "lot" is also mentioned, somehow suggesting the possibility that the lot was also damaged. The fact that the Complaint states that the Lewingers have been damaged in an amount in excess of One Million Dollars [RP 96] also does not suggest that "subsequent improvements" were damaged, nor does that allegation render the Complaint ambiguous, contrary to Nautilus' assertion.

Unlike the facts in *Mullenix, supra,* where the lack of clarity with respect to the allegation concerning how the tractor trailer rig was damaged (i.e., whether it was being towed at the time of the accident, thus bringing the complaint within the applicable exclusion) was directly germane or "pertinent" to coverage, the mere mention of "subsequent improvements" in a single numbered paragraph of the Lewinger Complaint is superfluous and only has relevance in the context of describing the Lewinger's investment in the property and does not create an ambiguity giving rise to a duty to defend.

It is simply not reasonable to infer that "subsequent improvements" were damaged simply because that term appears once in the Complaint. *See e.g. Western Commerce Bank v. Reliance Insurance 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 with the policy's "personal injury" coverage provisions

and insurer had no duty to defend). Additionally, contrary to Nautilus' assertion, this Court did not hold in *Computer Corner, Inc. v. Fireman's Fund Insurance Co.*, 2002-NMCA-054, 132 N.M. 264, 46 P.3d 1264 that the "Your Work" and "Impaired Property" exclusions are ambiguous as a matter of law and unenforceable.

Although this Court found that the "Property damage to your work arising out of it or any part of it and included in the products-completed operations hazard" exclusion in the Fireman's Fund policy was "'confusing and open to numerous interpretations[.]'", the exclusion was not applied because this Court concluded that "a reasonable insured in Computer Corner's position would [not] have understood 'property damage to *your* work' to include property damage to a customer's preexisting property." *Computer Corner, Inc. v. Fireman's Fund Insurance Co.*, 2002-NMCA-054, ¶¶ 15, 16, 132 N.M. 264, 46 P.3d 1264 (citation omitted) (italics in original).

Furthermore, this Court held in *Computer Corner, Inc.* that the "Impaired Property" exclusion in the Fireman's Fund policy was too vague and indefinite to be enforceable under the facts of that case, not as a universal or blanket proposition that all such exclusions are unenforceable in every case. *Id.*, 2002-NMCA-054, ¶¶ 21, 132 N.M. 264, 46 P.3d 1264.

B. The District Court Erred in Concluding that Ohio Security Owed a Duty to Defend Norman/Dent Because the Allegations in the

Lewinger Complaint Fall Squarely Within the "Earth Movement Exclusion" Under the Policy.

Nautilus concedes in its Answer Brief that "[t]he Lewingers' Complaint can be read to allege that at least some of the construction defects were caused by subsidence or movement of land." *Answer Brief, p. 13.* Nautilus also concedes that "allegations relating to inadequate soil preparation and compaction testing may very well have implicated the Subsidence exclusion." *Id.* In truth, the entire Complaint basically alleges that earth movement or subsidence was the cause of the damages. [RP 88-100]. No other cause of the damage is alleged, despite Nautilus' contention that the Complaint is replete with "patent ambiguities." *Answer Brief, p. 16.*

The clear thrust of the Lewinger Complaint is that the cracking and other structural defects and damage alleged were caused by subsidence, which is excluded under the "Earth Movement Exclusion" [RP 87]. However, even if not all of the damage alleged in the Complaint was caused by subsidence, the other alleged causes of damage (e.g., "failure to construct the home in accordance with the plans and specifications," "inadequate preparation of the soils at the construction site," "inadequate compaction testing," "deficient plans and specifications," and "failure to exercise ordinary care and competence with respect to the construction") implicate the "Professional Liability Exclusion" under the Ohio Security Policy [RP 85], [RP 88-100, ¶¶ 16, 19, 20, 21, 36, 45 and 64].

Nautilus' strained attempt to create an ambiguity in the Complaint where none exists in order to render the "Professional Liability Exclusion" inapplicable, similar to its arguments regarding the "Your Work" and "Earth Movement" exclusions is unavailing. What is critical to the analysis on the duty to defend issue is not whether a single exclusion applies "across the board" as Nautilus asserts, but rather, whether there is no duty to defend based on all of the applicable exclusions. Clearly, the district court erred in concluding that Ohio Security breached the duty to defend.

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.

A. Ohio Security Preserved the Estoppel Issue in the District Court.

As a starting point, Ohio Security disagrees with Nautilus' assertion that it (Ohio Security) failed to preserve the estoppel issue in the district court. In fact, Ohio Security filed a response in opposition to Nautilus' Motion for Summary Judgment Concerning Insurance Coverage [RP 111-119]. In its response, Ohio

Security did contest this issue ("Nautilus concludes its arguments that Ohio Security owed a duty to defend with a request that the Court strip Ohio Security of the exclusions in its policy. This is putting the cart before the horse....") [RP 118].

Although the exact same argument was not raised in Ohio Security's response to Nautilus' motion for summary judgment that it now advances, the issue was clearly joined. *Id.* Moreover, the fact that Ohio Security filed its own competing motion for summary judgment [RP 68-100] clearly indicates by implication its opposition to Nautilus' estoppel argument. The estoppel issue was clearly preserved in the district court.

B. The Doctrine of Estoppel is Inapplicable to the Facts of this Case.

Nautilus has failed to cite *any* reported New Mexico decision applying the doctrine of estoppel in the context of a subrogation action filed by one insurer against another insurer, or any New Mexico authority holding that the doctrine of estoppel should be applied in this context. Moreover, *Am. Gen. Fire & Cas. Co. v. Progressive Cas. Co.,* 1990-NMSC-094, 110 N.M. 741, 799 P.2d 1113 does not aide Nautilus. The holding in that case - that a subrogated insurer is not estopped from bringing a subrogation action against a breaching insurer - does not support the argument advanced by Nautilus in this case.

In fact, the New Mexico Supreme Court in *Am. Gen. Fire & Cas. Co.* expressly held that any omission by American General in regard to its insured in

no way implicated Progressive; rather, American General's fiduciary duty flowed to its insured only and not to Progressive. *Id.,* 1990-NMSC-094, ¶ 16, 110 N.M. 741, 799 P.2d 1113. That is the very point here. If Ohio Security breached a duty to defend Norman Dent, that duty flowed to the insured only and does not implicate Nautilus, as subrogee. Any consequences flowing from that breach should inure to the benefit of the insured, Norman Dent, and not to Nautilus. As in *Am. Gen. Fire & Cas. Co.,* the doctrine of estoppel simply has no application here, in a suit between two insurers, where there is no presumptive potential for prejudice.

As such, if it is determined that Ohio Security breached a duty to defend Norman/Dent, Nautilus is subrogated only to the extent of one-half of its fees and costs incurred in defending the underlying lawsuit and this case should be remanded to the district court for a determination of whether Ohio Security owes a duty to indemnify based on the policy exclusions raised in the proceedings below.

Although Nautilus asserts that a subrogated insurer "stands in the shoes of the insured," *Answer Brief, pp. 25-26,* this argument fails to acknowledge the strong public policy articulated by our courts for protecting insureds from overreaching by insurers. *See e.g. Bourgeous v. Horizon Healthcare Corp.*, 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. v. Allstate Ins. Co.,* 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). This public policy clearly does not apply in the context of a suit by a subrogated insurer, who is not a party to the insurance contract, against another insurer, nor are there any compelling policy reasons to afford such protections to a subrogated insurer.

Collier v. Union Indemn. Co., 1934-NMSC-030, 38 N.M. 271, 31 P.2d 697, involved a suit between an insured and an insurer, rather than a suit between two insurance companies and is therefore inapposite. Similarly, *State Farm Fire & Cas. Co. v. Price,* 1984-NMCA-036, 101 N.M. 438, 684 P.2d 524, cited by Nautilus in its Answer Brief, involved a declaratory judgment action filed by an insurer against its insured seeking to establish that it had no obligation to defend or indemnify its insured, and the insured counterclaimed.

Price did not involve a suit by a subrogated insurer against another insurance company, unlike the present dispute. Although Nautilus cites *Price* for the proposition that a breaching insurer should suffer "serious consequences" for its inaction, *Answer Brief, p. 31,* the clear intent of this Court in *Price* was to fashion a remedy designed to protect the unsophisticated insured from a breaching insurer, and not to protect a subrogated insurer who is a stranger to the insurance

contract. *Aetna Cas. & Surety Co. v. Coronet Ins. Co,* 358 N.E.2d 914 (Ill.App.1976) and the other cases cited by Nautilus in its Answer Brief from other jurisdictions are not controlling precedent.

The district court therefore erred in concluding that Ohio Security is estopped from raising policy exclusions based on a finding that it breached its duty to defend, as such a ruling is not supported by New Mexico law or public policy, and the Final Judgment [RP 223] should be reversed.

CONCLUSION

This is not a case in which Ohio Security seeks to "set itself free by so simple a device" as Nautilus claims. Rather, Ohio Security owed no duty to defend Norman/Dent in the underlying lawsuit because the allegations stated in the Lewinger Complaint clearly were within the enumerated policy exclusions under the Ohio Security Policy as a matter of law, including 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. Nautilus' attempt to invent "ambiguities" in the Lewinger Complaint where none exist in order to avoid the application of these exclusions is clearly misplaced. The fact that Nautilus chose a different course of action when presented with a demand to defend Norman/Dent in the underlying action is immaterial. Nautilus' conduct is not at issue, nor is the fact that Nautilus

voluntarily chose to defend Norma/Dent in the underlying action determinative of the issues before this Court.

The district court erred in concluding that Ohio Security owed a duty to defend Norman Dent in the underlying action and the judgment entered by the district court should be reversed.

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. This issue was preserved in the district court in the briefing on the motions for summary judgment. Further, 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 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. 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.

Accordingly, Ohio Security prays that the Court reverse the district court's judgment and remand this case for further proceedings consistent with this Court's opinion.

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 29th day of April, 2015:

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