THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

BEFORE THE COURT-APPOINTED REFEREE
IN RE THE LIQUIDATION OF THE HOME INSURANCE COMPANY
DISPUTED CLAIMS DOCKET

In Re Liquidator Number: 2008-HICIL-39
Proof of Claim Number: INSU700645-01; INSU275296
INSU700638; INSU700640
INSU700641; INSU700642
INSU700655; INSU700657
INSU700658; INSU700659
INSU700660; INSU700662
Claimant Name: Sheldon Holson and Melvin Holson
Insured or Reinsured Name: Holson Company

CLAIMANTS SHELDON HOLSON AND MELVIN HOLSON'S REPLY MEMORANDUM ON COVERAGE

I. INTRODUCTION

This case is about a promise. Melvin and Sheldon Holson purchased insurance from The Home to protect their family business and their retirement savings in the event of a liability claim. In exchange for thousands of dollars in premiums faithfully paid by the Holsons, The Home promised to defend and protect the Holsons against a third-party liability claim. That claim arrived in 1991 when KVL sued the Holsons and their company. When the Holsons asked for the protection they purchased, The Home broke its promise. It broke its promise again when all of the other insurers left the Holsons without any protection. It broke its promise again after KVL applied for a judgment of $25,000,000, an amount far in excess of any underlying insurance. And finally, it broke its promise again when the Holsons settled with the underlying insurers and

exhausted those policies. Ignoring the compelling facts, circumstances, and jeopardy to its insureds, The Home refused to honor its promise to provide the protection the Holsons purchased.

The Liquidator's submission demonstrates the same stubborn refusal to accept its responsibility and address the facts in a forthright and fair manner. Never pausing to consider the facts or the context of this claim, The Home continues to scour the policy and the case law to offer any available excuses to avoid its responsibility. Indeed, even when the Liquidator relies heavily on several cases decided by the Connecticut Supreme Court, it excerpts portions of the ruling without pausing to consider or explain the factual predicate or context for that ruling. But the common law is not simply the rote explication of rules; it is the careful and considered application of law to the facts and circumstances present in a particular controversy or dispute.

Here, the Holsons should prevail on both the law and the facts. The facts demonstrate that The Home broke its promise when it refused to fulfill its responsibility to defend the Holsons and left them vulnerable and exposed to a $25,000,000 verdict. No judgment in this venue can adequately compensate them for the stress and anguish generated by that act. The law demonstrates that The Home had a duty to defend the Holsons because the KVL complaint raised at least the "possibility" that the release was sudden and accidental, and that is all the law – including Connecticut law – requires an insured to prove.

Finally as Justice Benjamin Cardozo once observed:

> Judges are supposed to use all this power to make sure that justice is done, that at some basic level the verdicts issued in their courts display a certain degree of reasonableness. The judge, . . . is under a duty, within the limits of his powers of innovation, to maintain a relation between law and morals, between the precepts of jurisprudence and those of reason and good conscience.

For all of these reasons, the court should enforce The Home's promise to the Holsons.

II. ARGUMENT

A. The Home Had A Duty to Defend the Holsons

The Home policies contain an affirmative, contractual duty in Endorsement 2 that the insurer "defend any suit against" the Holsons "with respect to any occurrence not covered by the underlying policies . . . but which is covered by the terms and conditions of [the Home] policy." See Endorsement 2, Holsons' Merits Brief, at p. 5.[1]

This contractual duty obligated The Home to defend the Holsons if the KVL claim was "not covered" by the underlying policies, but "covered" by The Home policy. As explained in the Holsons' Merits Brief, the KVL claim was "not covered" by the underlying policies because: (1) the amount of the KVL claim exceeded the monetary limits of the underlying policies, (2) the underlying insurers denied coverage of the KVL claim; and (3) the underlying coverage was exhausted through settlement.

The "plain meaning" of Endorsement 2 is that The Home agreed to defend the Holsons for claims "not covered" by the underlying policies. The court in American Motorists Insurance Company v. Trane Company, 544 F. Supp. 669, 692 (W.D. Wis. 1982), aff'd, 718 F.2d 842 (7th Cir. 1983) interpreting an identical Endorsement in an excess policy, explained that:

> whether the damage was "covered" by an underlying policy depends on the interplay of two factors: first, whether the monetary limits of the underlying policy are exceeded; and second, whether actual substantive coverage is denied

[1] In pertinent part, Endorsement 2 of The Home policies effective August 12, 1977, through August 12, 1981, states:

> With respect to any occurrence not covered by the underlying policies listed on Endorsement 1 hereof or any underlying insurance collectible by the insured, but which is covered by the terms and conditions of this policy . . . the Company shall:
>
> (a) defend any suit against the insured alleging such injury or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent and the Company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient provided, however, that the settlement of any claim or suit within the retained limit shall be with the consent of the insured;

> by the underlying insurer. If the claim against the insured exceeds the monetary limits set by the underlying insurer, the excess insurer's duty to defend is usually activated.

Here, under Endorsement 2, the KVL claim triggered The Home's defense obligation because the KVL claim of over $25 million was well in excess of the $50,000 and $100,000 limits per occurrence in the Fireman's Fund and Travelers' policies, respectively.

Further, Travelers and Fireman's Fund's refusal to defend also triggered The Home's duty to defend because this denial meant the underlying insurance did not "cover" the insured's liability. Finally, the Holsons' settlements with Fireman's Fund and Travelers also triggered The Home's duty to defend because those settlements also meant that the claim was "not covered" by the underlying insurance. Endorsement 2 placed a fundamental obligation on The Home to provide a defense to the Holsons under each of these circumstances, and The Home's failure to defend breached that obligation. In short, after paying policy premiums for years, the Holsons were entitled to a defense from The Home when KVL filed this significant claim and the underlying insurers ran for the hills. Instead of stepping up to the plate and fulfilling its obligations, The Home followed the underlying insurers up the hill. The Referee should right that wrong.

The Liquidator ignores the facts and the obvious equities implicated here. He never explains why it is right or just to deny a defense here. Instead, the Liquidator offers two "technical" arguments to excuse The Home's failure. Neither excuse has merit.

1. <u>The Liquidator Ignores the Plain Meaning of Endorsement 2's Duty to Defend</u>

The Liquidator acknowledges that Endorsement 2 "added a duty to defend" for certain claims "not covered" by the underlying policies, but contends that this language "is not relevant" because of "the pollution exclusion's limitation of pollution coverage to matters covered in the

underlying policies." Liquidator's Brief, at p. 14. The Liquidator argues that Endorsement 2 does not apply to pollution claims, because The Home policies' contain a provision that "in no event shall coverage provided by this policy for Contamination or Pollution be broader than that provided by the Underlying Insurances . . . ." The Liquidator argues that this provision means that The Home policies "can only provide coverage for pollution claims if the primary policy does. . . ." and that The Home policies do not provide independent coverage for such a claim. The Liquidator summarily concludes this makes its policy a "true excess policy that only sits above scheduled underlying policies." The Liquidator is wrong for several reasons.

First, the pollution exclusion is not applicable here because the KVL complaint did trigger a duty to defend. The Liquidator's argument is circular and adds nothing in the sense that he contends that if he wins on the pollution exclusion he wins here too. The Liquidator's reliance on the pollution exclusion fails, as we discuss in the next section.

Second, the Liquidator ignores the plain meaning of the "covered" and "not covered" language in Endorsement 2. This language refers to the *extent* of coverage rather than the *fact* of coverage under the underlying policies. The underlying policies "covered" these claims – as evidenced by the payments made by the underlying insurers after the Holsons sued them. However, the underlying claim exceeded the amount of the underlying coverage and the primary insurers refused to defend. Both of these conditions placed the Holsons in a position where they were "not covered" by underlying insurance – thus triggering The Home's duty to defend.[2]

[2] As the Trane court explained, whether an underlying policy "covers" the claim depends on whether the underlying policy coverage extends beyond the monetary limit of the underlying claim. As the court noted, where the amount of damage claimed was "clearly in excess" of the underlying policy limits, as it was here, "by itself this fact is sufficient to invoke the [excess insurer's] duty to defend, if there is coverage under the policy." Id. at 692. Furthermore, the court described the underlying insurers refusal to defend to "impose[] and even clearer duty" on the excess insurer, and that "the relevant determination" is not the similarity of the excess policy to the underlying policy, but "whether the alleged occurrence[] [is] potentially covered by the policy, giving rise to [the excess insurer's] duty to defend." Id.

Third, The Home is wrong because, when it added Endorsement 2's duty to defend obligation to its excess policy, it converted the policy from a "true excess" policy to an umbrella policy specifically intended to fill gaps by promising to defend for occurrences "not covered" by the underlying policy. With the addition of Endorsement 2, The Home sold the Holsons a policy in which it agreed to not only indemnify the Holsons for amounts in excess of the underlying primary policies, but to also provide a defense for claims "not covered" by those underlying policies. For those "not covered" claims, The Home policy provides additional "umbrella" coverage, because it drops down to act as the primary insurer to fill in the gaps in coverage for claims not covered by the primary or underlying insurance. See Hocker v. New Hampshire Insurance Company, 922 F.2d 1476 (10th Cir. 1991)(after primary insurer wrongfully failed to defend, excess insurer was obligated to drop down and defend); American Family Assurance Company of Columbus, Georgia v. United States Fire Company, 885 F.2d 826, 832 (8th Cir. 1989) (in excess policy with defense obligation, once the primary denied coverage, excess insurer "is obligated to defend once it became clear [primary insurer's] policy would not cover [insured's] liability").

2. The Home Policies' Provisions on Payment of Defense Expenses Are Not Relevant To Its Duty to Defend Obligations in Endorsement 2

In its second argument, The Liquidator addresses provisions in the Home policies other than Endorsement 2 that relate to the circumstances where The Home may be obligated to pay defense costs of an insured. This argument does not address or respond to The Home's duty to defend under Endorsement 2, and the Liquidator does not contend that it does. In fact, the Liquidator never refers to its defense obligation in Endorsement 2 in the eight pages it uses to attempt to "excuse" The Home's failure to defend. But because neither of The Home's arguments addresses the issue at hand -- whether the primary insurers' denials of coverage, or their

settlements, triggered the Home's duty to defend under Endorsement 2 -- they are beside the point.

Thus, the Liquidator's arguments that The Home can only become "liable" for indemnity costs (including defense expenses) to the Holsons when the primary limits are exhausted does not answer whether The Home breached its duty to defend the Holsons under Endorsement 2. Similarly, the Liquidator's claim that the Holsons' settlements did not trigger a *duty to pay defense expenses* under other policy provisions does not address whether those settlements triggered its *duty to defend* under Endorsement 2.

As explained in the Holsons' Merits Brief, there is no language in Endorsement 2 that makes The Home's duty to defend contingent on the exhaustion of the "limits" of the underlying primary insurance. Under Endorsement 2, The Home's duty to defend is triggered when the claim is "not covered" by the underlying policies. Here, the settlements with Fireman's Fund and Travelers triggered that duty because the settlements functionally exhausted these policies.[3] The Home's contention that these underlying insurers were required to have paid out all defense costs and fully litigate the KVL claim to judgment before The Home's duty to defend is triggered would render that duty meaningless, because there would be no scenario left in which it would ever arise. The Home refused to defend, and chose to sit by for years and not participate in this case while the Holsons were forced to defend the KVL claim. The Home cannot refuse to defend now because the Holsons decided to seek to recoup some of these defense costs in bona fide settlements with the primary insurers. "The guiding principle [for requiring excess insurer to defend where primary limits have been exhausted] is that the insured, having purchased both

[3] The Home has a copy of the Fireman's Fund settlement and a copy of the March 28, 2001 letter from Travelers, which demonstrate that these underlying policies were exhausted. If the fact of exhaustion of the Travelers' policies is an issue, the Holsons would welcome the opportunity to obtain an appropriate order and disclose the terms of the Travelers' settlement.

primary and excess coverage, cannot be abandoned by its insurers." 1 Ostrager & Newman, Insurance Coverage Disputes § 6.03[b] at 403. See also Hocker v. New Hampshire Ins. Co., 922 F.2d 1476 (10th Cir. 1991) (denying equitable subrogation to umbrella insurer for damages incurred because of primary insurer's bad faith refusal to defend when umbrella insurer has "unclean hands" due to its own failure to defend); Pacific Employers' Insurance Company v. Servco Pacific Inc., 273 F.Supp.2d 1149, 1154 (D.Ct. Hawaii 2003)(requiring the primary carrier first to litigate the underlying claim to judgment, or make the payments in settling the claim, would mean the excess carrier would then have nothing left to defend and the excess carrier's duty to defend would be illusory).

The Home's duty to defend the Holsons arises under Endorsement 2, which the Liquidator agrees "added a duty to defend" claims that are "not covered" by the primary insurers. The Home had a duty to defend, and it breached that duty. That breach is what gives rise to the insurer's liability for the full costs of the defense, plus the resulting judgment or settlement, plus any attorneys' fees incurred by the insured in pursuing an action against the insurer for breach of its duty to defend. Missionaries of the Co. of Mary, Inc. v. The Aetna Cas. and Surety Co., 155 Conn. 104 (1967).

B. The Holsons Have Demonstrated the Applicability of the Sudden and Accidental Exception to the Pollution Exclusion, and Therefore The Home Had a Duty to Defend the Holsons.

The allegations in the KVL Complaint set forth claims for covered property damage that occurred during the extended period in which The Home policies were in effect. The facts alleged in the KVL Complaint fall squarely within the coverage terms of The Home's policies. The Home therefore wrongfully breached its duty to defend the Holsons against the KVL action.

"If an allegation of the complaint falls *even possibly* within the coverage, then the insurance company must defend the insured." Schilberg Integrated Metals Corp. v. Continental Cas. Co, 819 A.2d 773, 783 (Conn. 2003), citing Community Action for Greater Middlesex County, Inc. v. American Alliance Ins. Co., 757 A.2d 1074 (Conn. 2000) (emphasis added); Palace Laundry Co. v. Hartford Accident & Indem. Co., 234 A.2d 640, 645 (Conn. C. P. 1967)(finding that the insurer breached duty to defend where "although the allegations of the complaint on the issue of bodily injury caused by accident [were] gossamer thin, there was at least the possibility that the plaintiff" in the underlying suit would prove that her injury resulted from a covered accident).

The Liquidator relies entirely on the court's decision in Schilberg, but his own references to the holding in that case demonstrate that his reliance is misplaced [see p. 12 of the Liquidator's Submission].[4] The Connecticut Supreme Court did not hold – as the Liquidator sometimes implies – that an insured must demonstrate that the complaint definitively establishes that the alleged occurrence could only have been sudden and accidental. To the contrary, the court in fact held that an insurer's duty to defend is triggered when "the plaintiff has demonstrated that a reasonable interpretation of the substance of the [Complaint] would bring the claims within the purview of the sudden and accidental discharge exception to the policies."[5] All the insured must do is demonstrate that the allegations within the four corners of the complaint "raise the *possibility* that the event which caused the pollution-related property damage was sudden and accidental." Schilberg, 819 A.2d at 787. Finally, the court noted that an insured cannot succeed

[4] The Liquidator's criticism of the Holsons' brief for not citing Schilberg is neither fair nor accurate for at least two reasons. First, properly understood, Schilberg confirms the well-established principle that if the complaint raises the possibility of coverage, it triggers the insurer's duty to defend. Second, the Liquidator's Notice of determination makes no mention of or reference to Schilberg, implicitly acknowledging the first point.

[5] The quote refers to "the department's allegations" which in this case is the functional equivalent of the KVL Complaint.

"through a strained implausible reading of the complaint that is linguistically conceivable but tortured and unreasonable." Id. at 785. Here, the allegations of the Complaint certainly "raise the possibility" that the release was sudden and accidental – and that is all that Schilberg and the other Connecticut cases require to trigger the insurer's duty to defend.

The KVL Complaint alleged that there was "severe environmental contamination on the Wilton Site, concentrated in but not limited to the areas surrounding several large underground concrete 'vaults' which are adjacent and connected to the building on the Wilton Site through a network of underground piping." First Amended Complaint, ¶ 17. Quoting from an environmental assessment performed at the request of KVL, the complaint alleges that the contamination resulted from "disposal practices at the facility," which introduced the contaminant into the sump and vaults 1 and 2 and which in turn resulted in contamination of soils and groundwater. Id. at ¶ 19. This contamination, according to the complaint, was the result of "negligence or other actions" on the part of the Holson Company and the Holsons individually. Id. at ¶¶ 37, 41.

As demonstrated in the Holsons' Merits Brief, the Complaint does not specify how the contamination itself occurred, at what point it occurred, or with what frequency it occurred. The allegations do not specify whether the contaminating event or events occurred over time or as a sudden and accidental event. They certainly do not establish that the contaminating events were not sudden or accidental, and at a minimum they "raise the possibility" that the damage was sudden and accidental. Perhaps most important, KVL did not limit its opportunity to recover to underlying events that *did not fit* the sudden and accidental definition, and that is really the critical inquiry because the Holsons remained exposed to those covered claims.

The Liquidator's mistaken reliance on Schilberg results from his failure to consider the extraordinary facts of that case. In Schilberg, the plaintiff was conducting a waste reclamation activity at a waste disposal site. The plaintiff was in the business of treating and disposing of hazardous waste at that site – as alleged by the Pennsylvania Department of Environmental Resources in its administrative action. The department alleged that the plaintiff was a "generator of much of the waste unlawfully processed and disposed of at the site" and that its "business dealings consist[ed] of arranging for treatment and disposal of waste containing hazardous substances." Id. at 785, fn. 7. The complaint described the use of a wide range of hazardous substances – including ash containing high levels of lead, polychlorinated biphenys, polycyclic aromatic hydrocarbons, dioxin and tetrachloroethylene – at various locations at the property, including the site soil, water creek sediments, and in five residential wells around the site. These alleged facts conclusively undermined even the possibility that the release was sudden and accidental.

Further, the court rejected the 'strained, implausible, and tortured' reading advanced by the insured. The plaintiff made two arguments to demonstrate these allegations fell within the sudden and accidental exception. First, that the allegation regarding the "treatment" portion of the recycling activities involving insulated wire did not include disposal of waste and thus left open the possibility of a sudden and accidental event. The court rejected this argument, because it concluded that the alleged "treatment" activities did not necessarily exclude the disposal of waste, and the definition of "treatment" and the complaint allegations did not contain any information to support that it did.

Second, the insured argued that, since its recycling activities "hypothetically" gave it an economic incentive to remove all of the processing by-products from the site, there was a

possibility that those by-products that contaminated the site could have been the result of a sudden and accidental event. The court rejected this argument as well, because it relied on "mere speculation" rather than a "reasonable interpretation" of the allegations in the complaint. The court noted that the complaint "alleged that plaintiff's discharge of pollutants occurred over a span of five years and was the result of plaintiff's ongoing business relationship with Cardinale" and there was "nothing accidental about such an arrangement, which is characteristic of an ordinary course of business." Schilberg, 819 A.2d at 788.

These facts in Schilberg are nothing like the facts present in this case. The Holsons were in the business of manufacturing photo albums – not disposing of hazardous waste. The Holsons did not run their business on a hazardous waste disposal facility, and they did not contract with third parties to treat their hazardous wastes. And they never intentionally disposed of hazardous waste on their property. The Holsons do not quibble with the court's ruling in Schilberg -- they dispute the Liquidator's attempt to misapply the holding in Schilberg to the facts present in this case. Schilberg was in many respects the unusual case where the insured could not "raise the possibility" of a sudden or accidental event, and could not offer a "reasonable interpretation [that] [ ] the [Complaint] potentially would bring the claims within the purview of the sudden and accidental discharge exception to the policies." The department's allegations precluded such a finding. By contrast, the KVL Complaint leaves open the "possibility" that the damage was caused by a sudden and accidental event, and makes it at least as likely as not that the precipitating event was sudden and accidental.[6]

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[6] Similarly, in Stamford Wallpaper Company v. TIG Insurance, 138 F.3d 75 (2d Cir. 1998), the court found that the allegations of Stamford's CERCLA liability at a Superfund Site as a result of Stamford's "arrange[ment] with carters for the treatment or disposal of hazardous substances" which were "generated by Stamford [and] disposed of at the site" did not fall within the sudden and accidental exception. Id. at 79. The court concluded the complaint did not "allege or contemplate that Stamford's CERCLA liability arises from any activity other than the deposit of waste materials turned over to the carters by Stamford in the ordinary course of business." Id. The court found nothing "accidental" about this business arrangement, and no allegation suggesting "that the property damage for which

Here, the allegations in the KVL Complaint certainly raise "the possibility" that the contamination came from a sudden and accidental discharge into or from the vaults and/or the underground piping. Whether it got there as a result of a break or rupture in one of the underground structures or a spill inside the facility is not specifically alleged, but that is one of the only two likely ways it got there.[7] This is certainly a "reasonable interpretation" that can be inferred from the general allegations, and that is all that Schilberg and the other Connecticut cases require before imposing a duty to defend on the insurer.

The rationale for requiring insurers to defend where the allegations raise even the possibility of coverage is demonstrated in part by the unique circumstances here. KVL complained of the presence of Freon-113 in the soil and groundwater at the site. Through discovery and the testimony at trial it became clear that this Freon-113 was migrating onto the property from an adjacent site owned by Perkin Elmer. Neither the Holsons nor KVL knew that this contamination came from Perkin Elmer in 1991 when KVL filed the complaint – yet it is clearly a claim that is and should be covered under the policy. However, under the unduly strict approach advanced by the Liquidator, the Holsons would not receive the defense they are entitled to – even for contamination migrating from an adjacent site and resulting from the activities of an unrelated third party. This is an example of why the KVL Complaint cannot be read narrowly as

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Stamford may be liable resulted from anything other than the disposal of its wastes in the ordinary course of business over an extended period of time." Id. at pp. 80 – 81. Under these clear allegations that it was the business practices of the insureds that led to the discharge, the courts in both Shilberg and Stamford Wallpaper found such allegations did not "even possibly" fall within the sudden and accidental exception.

[7] In EDO Corp. v. Newark Insurance Co., 898 F. Supp. 952, 962 (D.Conn. 1995), the court rejected the insurer's claim that the relevant allegations did not bring the dispute within the exception for "sudden and accidental" discharges:

> [b]ecause the Letter [from the EPA] is couched in general terms, and is silent as to the nature of the polluting releases, whether abrupt or slow, short term or long term, expected or unexpected, intentional or unintentional, it allows for the possibility that the pollution referred to occurred both suddenly and accidentally – and therefore that it was covered by the policies.

The Home urges. It is usually the case that plaintiffs do not have all of the facts when they institute an action, and why the KVL Complaint contains broad allegations and theories of liability. This contamination could also "possibly" have been the result of a sudden and accidental event, and until all the facts are established, insurance companies have a duty and obligation to defend, since the facts uncovered in discovery often demonstrate covered causes.

In sum, a reasonable interpretation of allegations in the KVL Complaint raise the potential and the possibility of coverage, and therefore The Home breached its duty to defend when it rejected each of the Holsons' demands for defense and coverage.

III. CONCLUSION

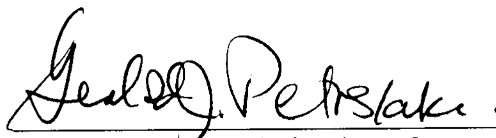
For the reasons set forth above, the Holsons are entitled to (1) the defense costs they incurred in defending the KVL claim; (2) the full amount of their settlement with KVL; and (3) reasonable attorney's fees incurred in the prosecution of this action.

Respectfully submitted,

SHELDON HOLSON AND MELVIN HOLSON

By their Attorneys,

Dated: June 30, 2009



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CERTIFICATE OF SERVICE

I hereby certify that I sent via electronic and first class mail a true and accurate copy of the within Merits Brief to Eric A. Smith, Esq., Rackemann, Sawyer & Brewster P.C., 160 Federal Street, Boston, MA 02110-1700 on June 30, 2009.

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