SCV: Submitted on 12-02-2016 15:15:54 EST for filing on 12-02-2016

IN THE

Supreme Court of Virginia

RECORD NO. 160805

NATIONWIDE MUTUAL
FIRE INSURANCE COMPANY, *et al.*,

Appellants,

v.

ERIE INSURANCE EXCHANGE, *et al.*,

Appellees.

REPLY BRIEF OF APPELLANTS

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ARGUMENT

I. The Nationwide CGL Policy's auto exclusion bars coverage for this claim.

Erie argues that the auto exclusion in the Nationwide CGL Policy does not apply in this case, even though the case arises from an auto accident. In so arguing, Erie takes the position that an exception to the contractual liability exclusion in the Nationwide CGL Policy somehow renders any other exclusions in the policy, including the auto exclusion, inapplicable. Erie does not, and cannot, point to any authority in Virginia or elsewhere to support its position. In fact, courts addressing this issue have rejected the arguments raised by Erie. *McQuirter v. Rotolo*, 77 So.3d 76 (La.App. 1 Cir. 2011); *Nautilus Ins. Co. v. Johnny Clark Trucking, LLC*, 2014 WL 1365836 (S.D. W.Va. 2014); *Liberty Surplus Ins. Corp. v. Allied Waste Systems, Inc.*, 758 F.Supp.2d 414 (S.D. Tex. 2010). These courts held that the auto exclusion bars coverage for all claims arising from an auto accident (including an indemnification claim) and that the contractual liability exclusion does not override the auto exclusion.

As in the cases cited above, the Nationwide CGL Policy's auto exclusion contains an exception for insured contracts involving "the ownership, maintenance or use of an <u>aircraft</u> or <u>watercraft</u>." JA at 293

(emphases added). Erie fails to acknowledge that the insured contract exception does not apply to contracts involving the ownership, maintenance or use of "autos." JA at 293 (emphasis added). The evident purpose of the standard auto exclusion in a CGL policy is to exclude coverage for risks covered under an auto policy. Erie's position that the insured contract exception to the contractual liability exclusion overrides the auto exclusion would render the auto exclusion's own limited insured contract exception meaningless.[1] Erie's argument also ignores the fundamental distinction between risks insured under a CGL policy and the risks insured under an auto policy (as noted in the cases cited above).[2]

The sole claim in the Tort Action is the wrongful death claim against Manzur arising from his alleged negligent operation of an automobile. The clear intent of the auto exclusion in the Nationwide CGL Policy is to bar coverage for auto claims. Thus, the Nationwide CGL Policy does not

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[1] An exception to an exclusion does not extend coverage, but merely limits the application of the exclusion itself. *Nationwide Mut. Ins. Co. v. Wenger*, 222 Va. 263, 267, 278 S.E.2d 874, 876 (1981).

[2] Further, the insured contract provisions of the Nationwide CGL Policy are not implicated. The claim asserted in the Tort Action is against Manzur alone and does not include any claim for indemnification that would otherwise implicate the insured contract provisions of that policy.

provide coverage to Manzur.[3]

II. The Erie Auto Policy provides the sole, primary layer of liability coverage to Manzur, followed by secondary coverage under the Nationwide Auto Policy.

The Erie and Nationwide Auto Policies contain standard provisions regarding priorities of coverage under Virginia auto policies. It is undisputed that the Erie Auto Policy specifically insures the East Coast vehicle operated by Manzur and that the policy's "other insurance" provision states that its coverage is primary for vehicles owned by its named insured, East Coast. JA at 275, 415-16, 447. It also is undisputed that the Nationwide Auto Policy's "other insurance" provision states that its coverage is excess, because the East Coast vehicle operated by Manzur is a non-owned auto under that policy.[4] JA at 375. In this situation, long-

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[3] Erie argues that application of the Nationwide CGL Policy's limit of liability provisions renders this issue moot. However, for purposes of a future action between Nationwide and Erie for reimbursement of Nationwide's settlement payment, it is vital that the parties obtain judgment declaring which policies apply, so that the parties may reference only the terms of the applicable policies in support of their respective positions.

[4] Erie states, without explanation, that coverage is primary for the subject vehicle under the Nationwide Auto Policy as a "borrowed" vehicle. Erie Brief at 8. The basis for that statement is unclear. However, to the extent that Erie is referring to the "Employee Hired Autos" endorsement, even if the subject vehicle could be classified as "borrowed," that endorsement's

(footnote continued)

standing Virginia law and practice establish that the policy covering the vehicle involved in the accident provides the sole, primary layer of liability coverage to the driver, while any non-owned auto coverage is secondary. *American Motorists Ins. Co. v. Kaplan*, 209 Va. 53, 58, 161 S.E.2d 675, 679 (1975).[5]

Erie argues that an indemnification provision in the Subcontract between Rodriguez and East Coast overrides the terms of its own policy and alters the priority of coverage rules recognized by Virginia courts and practitioners for decades. Erie takes this position even though this case does not involve a claim for indemnification and does not implicate the indemnification provisions in the Subcontract. Further, Erie misstates the terms of the Subcontract itself. Specifically, Erie states that the

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provision applies only to physical damage coverage for hired autos and does not apply to liability coverage. *See* JA at 250.

[5] Erie states on page 3 that Nationwide did not respond in its Trial Brief to Erie's argument that the Subcontract controlled the priorities of coverage. However, paragraph 40 of Nationwide's Trial Brief stated, in part:

> The language of the Nationwide Auto Policy [addressing insured contracts] proves this provision does not apply. One, neither Erie nor Moises Rodriguez Manzur were parties to the [Subcontract] and East Coast Insulators, Inc. is not seeking coverage here….

It has always been Nationwide's position that applicable Virginia law and the terms of the policies themselves govern the priorities of coverage.

Subcontract required Rodriguez to obtain "primary insurance." Erie Brief at 1. While similar contracts often contain provisions requiring that insurance be primary and/or noncontributory, the Subcontract at issue here does not contain any such provision. Indeed, the Subcontract nowhere addresses priorities of coverage under any insurance policies.

Erie relies heavily on *St. Paul Fire and Marine Insurance Co. v. American International Specialty Lines Insurance Co.* 365 F.3d 263 (4th Cir. 2004), which held that prior to determining priorities of coverage under the applicable policies, the ultimate liability of the insured defendants needed to be determined based upon an indemnification clause between them. *Id.* at 268. The court found that final responsibility for the claim rested with a defendant that had agreed to indemnify another defendant. Thus, the defendant/indemnitor's insurance was primary, while the defendant/indemnitee's insurance was secondary.

The *St. Paul* analysis is based on a determination of liability between two defendants, one of which was entitled to indemnification from the other. Unlike the present case, the indemnitee in *St. Paul* was a party to the underlying tort suit, which triggered the indemnification agreement that drove the court's analysis. With only one exception (discussed below),

each case cited by Erie involves an indemnitee that was sued in the underlying tort case and is thus readily distinguishable.

For example, in *Wal-Mart Stores, Inc. v. RLI Ins. Co.*, 292 F.3d 583, 585 (8th Cir. 2002), Cheyenne, a Wal-Mart lamp distributor, entered into an indemnification agreement in Wal-Mart's favor. *Id.* After a lamp caused a fire, *both* Cheyenne and Wal-Mart were sued. *Id.* Thus, the indemnification agreement was triggered.

The same inapposite fact pattern is found in *Star Ins. Co. v. Cont'l Res., Inc.*, 89 F. Supp. 3d 1015 (D.N.D. 2015), *appeal dismissed*, No. 16-1921 (8th Cir. June 28, 2016), in which Cyclone Drilling, an oil drilling subcontractor, agreed to indemnify the operator of the well, Continental Resources. *Id.* at 1019-20. After an explosion, injured employees of Cyclone Drilling sued Continental Resources. *Id.* at 1019. Yet again, the indemnitee, Continental Resources, was a defendant in the tort suit, bringing the indemnification agreement into play. As with the other cases cited by Erie, *Star Ins. Co.* is inapposite, as the indemnitee in the instant case, East Coast, is not a defendant to the Tort Action, such that the indemnification agreement in the Subcontract is of no moment.

Likewise, in *KBS, Inc. v. Great Am. Ins. Co. of NY*, No. 3:04 CV 730, 2006 WL 3538985 (E.D. Va. Dec. 7, 2006), M&E, a subcontractor, agreed to indemnify KBS, the general contractor. *Id.* at *1. *Both* KBS and M&E were sued for property damage arising from a fire. *Id.* The indemnification agreement was triggered because KBS, the indemnitee, was sued. *See id.*; *see also Chandler, Jr. v. Liberty Mut. Ins. Grp.*, No. CIVA 2005-71 WOB, 2005 WL 5629027 (E.D. Ky. Nov. 3, 2005), *aff'd sub nom*. *Chandler v. Liberty Mut. Ins. Grp.*, 212 F. App'x 553 (6th Cir. 2007) (indemnitee sued in wrongful death action); *Am. Indem. Lloyds v. Travelers Prop. & Cas. Ins. Co.*, 335 F.3d 429 (5th Cir. 2003) (indemnitee sued in personal injury action); *Occidental Fire & Cas. Co. of N. Carolina v. Int'l Ins. Co.*, 804 F.2d 983 (7th Cir. 1986) (indemnitee sued in wrongful death action).

The only case cited by Erie in which the indemnitee was not sued is *Clarendon Nat. Ins. Co. v. United Fire & Cas. Co.*, 571 F.3d 749 (8th Cir. 2009). Significantly, however, that case involved a specific vehicle lease that went far beyond the standard hold-harmless agreement in the present case. In *Clarendon*, McCormick Painting Company leased a vehicle to Arkansas Painting and Specialties. *Id.* at 750. As part of the lease, in addition to a hold-harmless agreement, Arkansas Painting agreed to

assume "any and all liability for injury… caused by the operation, use, control, handling, or transportation of the equipment during the Rental Period." *Id.* In holding that the lease agreement shifted the priorities of coverage, the court did not look to the basic hold-harmless provisions, but instead relied upon Arkansas Painting's agreement to assume all liability arising out of the use of the leased vehicle, stating:

> It is enough to recognize that, under the terms of the broad indemnity clause in the lease agreement, Arkansas Painting assumed responsibility for "*any and all liability* for injury... caused by the operation, use, control, handling, or transportation of the [truck]." … This broad assumption language encompasses not only any liability McCormick may have as the owner of the truck, but also any liability Arkansas Painting may have as the lessee of the truck, as well as any liability Dixon may have as the driver of the truck.

Id. at 753 (emphasis added in opinion).

Here, the "broad" language relied upon by the *Clarendon* court is not present. The Subcontract in this case contains a basic hold harmless provision, which requires Rodriguez to "indemnify, hold harmless, and defend" East Coast <u>for claims against East Coast</u>. JA at 281. By contrast, in *Clarendon*, Arkansas Painting agreed to assume *all* liability arising out of the use of the vehicle, and thus the lease agreement was triggered <u>regardless of whether a claim was made against McCormick</u>. Thus,

Clarendon is distinguishable and provides no guidance to this Court.

Moreover, even if *Clarendon* were not otherwise distinguishable, that case would be contrary to the Fourth Circuit's decision in *Travelers Prop. Cas. Co. of Am. v. Liberty Mut. Ins. Co.*, 444 F.3d 217, 224-25 (4th Cir. 2006), in which the court explained that the *St. Paul* analysis does not apply where, as here, coverage for a party to be indemnified is not at issue. The present case concerns insurance coverage for a single individual – i.e., Manzur. As in *Travelers v. Liberty Mutual*, this is not a case where the Court must determine the ultimate liability between Manzur and East Coast. There is no claim against East Coast. East Coast cannot be liable for the actions of Manzur, who was an employee of Rodriguez, not East Coast. East Coast has never asserted a claim for indemnification, as there is no basis for such a claim. Thus, the indemnification provision of the Subcontract is not applicable.

The fact that Rodriguez agreed to indemnify East Coast <u>in the event of a claim against East Coast</u> does not absolve Erie of its independent contractual and statutory obligation to insure Manzur as a permissive user of a vehicle owned by East Coast and specifically insured under the Erie Auto Policy. If this case somehow involved a determination of ultimate

liability as between Manzur and East Coast, then the case would be analogous to *St. Paul*. But Erie, which issued the sole policy insuring the vehicle operated by Manzur, provided coverage to Manzur not because of any indemnity clause running in favor of its insured, East Coast, but because of its independent obligation to Manzur under Virginia's Omnibus Statute and the terms of its own policy, which clearly and unambiguously states that coverage under the Erie Auto Policy is primary for all owned vehicles. JA at 447.

Even if this Court attempted to apply the *St. Paul* analysis by first determining the ultimate liability of the defendant in the Tort Action, the result would be the same. Because this case concerns coverage for Manzur alone and does not involve any claim for indemnification, Manzur is the only potentially liable party. Once Manzur's liability is determined, as *St. Paul* instructs, the Court would then look to the insurance policies and applicable law to determine priority of coverage for Manzur. Consistent with the Omnibus Statute, the "other insurance" provisions of the Erie Auto Policy and the Nationwide Auto Policy are completely consistent in stating that coverage is primary for vehicles owned by the named insured and

excess for non-owned vehicles.[6] JA at 447, 375. Because the vehicle operated by Manzur was an owned auto under the Erie Auto Policy and a non-owned auto under the Nationwide Auto Policy, the "other insurance" provisions dictate that the Erie Auto Policy provides primary coverage to Manzur, while the Nationwide Auto Policy's coverage is secondary. *See Kaplan,* 209 Va. at 58, 161 S.E.2d at 679.[7]

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[6] The Omnibus Statute, Code § 38.2-2204, requires the insurer of a specific vehicle to furnish permissive users the same coverage as is afforded the named insured. *American Motorists Ins. Co. v. Kaplan*, 209 Va. 53, 58, 161 S.E.2d 675, 679 (1975). Thus, both Nationwide and Erie are statutorily obligated to provide coverage for vehicles owned by their respective named insureds. However, there is <u>no</u> obligation under the Omnibus Statute for an insurer of a <u>non-owned</u> vehicle to provide coverage to permissive users. *Id*. While the Nationwide Auto Policy, by its terms, does indeed provide coverage to Manzur as a permissive user of a non-owned vehicle, Nationwide's coverage is secondary, per the policy's "other insurance" provision. Only Erie is statutorily obligated to provide coverage to Manzur as a permissive user of an auto owned by its named insured and specifically insured under the Erie Auto Policy.

[7] As discussed in Nationwide's opening brief at 19 n.9, while the "other insurance" provisions in the Erie Auto Policy and Nationwide Auto Policy provide that coverage is primary for "any <u>liability assumed</u> under an 'insured contract,'" the insured contract provisions do not apply here. JA at 447, 375 (emphasis added). Rodriguez's indemnification obligations under the Subcontract are limited to East Coast, which was dismissed from the Tort Action. Rodriguez did not assume the tort liability of any party to the Tort Action. Thus, the insured contract provisions in the subject policies are not implicated as they were in *Clarendon.*

In essence, Erie is treating itself as if it is a party to the Subcontract, and that it is entitled to indemnification. However, the only contracts to which Erie is a party are the Erie policies. It is those policies, and applicable Virginia law, that govern Erie's obligations in this case. Erie's attempt to obtain benefits for itself under the Subcontract is particularly curious in light of the fact that its insured, East Coast, has suffered no loss in this matter, and the Tort Action does not involve a claim either by or against East Coast. Erie may not rely upon a Subcontract to which it is not a party, and which is not implicated under the facts of this case, to escape its coverage obligations under Virginia law and the terms of its own policies.

Finally, Erie's argument pertaining to potential subrogation issues on pages 18-19 of its brief is misplaced. Erie continues to ignore the fact that East Coast has no right of indemnification because there is nothing to indemnify. Erie is not a subrogee of East Coast's "indemnification rights" here – no such rights are present.

Simply put, in order for a court to rely on an indemnification provision to shift the priorities of coverage, that indemnification must be triggered. The indemnification agreement in the Subcontract is of no moment

because there is nothing to indemnify. Accordingly, Erie may not rely on a dormant contractual provision to override the express terms of its own insurance contract and Virginia law.

III. The Erie Excess Policy and the Nationwide Umbrella Policy apply on a co-excess, *pro rata* basis.

Contrary to Erie's argument, the "other insurance" provision in the Erie Excess Policy does not contain an escape provision similar to the escape clause in *GEICO v. Universal Underwriters Ins. Co.*, 232 Va. 326, 350 S.E.2d 612 (1986). In *GEICO*, one of the applicable policies contained an escape clause (based on a Virginia statute), which stated that the policy <u>did not provide coverage at all</u> if certain other insurance existed.

The Erie Excess Policy's "other insurance" provision is patently dissimilar to the provision at issue in GEICO. The Erie Excess Policy does not contain an escape clause. Indeed, Erie has never argued that its Excess Policy does not apply at all. Rather, the Erie Excess Policy's "other insurance" provision provides that its coverage is "excess over, and shall not contribute with any of the other insurance, whether primary, excess, contingent or on any other basis." JA at 513. Similarly, the Nationwide Umbrella Policy's "other insurance" provision states that "the insurance under this policy is excess and we will not make any payments until the

‘other insurance’ has been exhausted by payment of claims” and that “[t]his insurance is not subject to the terms or conditions of any ‘other insurance,’” which includes the “other insurance” provision in the Erie Excess Policy. JA at 349.

Contrary to the provisions at issue in GEICO, the “other insurance” provisions in the Erie Excess Policy and Nationwide Umbrella Policy are standard “excess clauses” stating that their coverage is excess to any other insurance. Neither policy contains an escape clause. Because the “other insurance” provisions in the Erie Excess Policy and Nationwide Umbrella Policy are mutually repugnant, the two policies provide coverage on a co-excess, *pro rata* basis, after application of the primary Erie Auto Policy and the secondary Nationwide Auto Policy. *Aetna Cas. & Sur. Co. v. Nat’l Union Fire Ins. Co.*, 233 Va. 49, 54, 353 S.E.2d 894, 897 (1987); *State Capital Ins. Co. v. Mutual Assurance Soc’y*, 218 Va. 815, 820, 241 S.E.2d 759, 762 (1978).

IV. The proper priorities of coverage.

For the reasons stated in Nationwide's briefs, the trial court erred in ruling that the Nationwide policies apply before the Erie policies.[8] The proper priorities are as follows:

1) Erie Auto Policy – $1 million

2) Nationwide Auto Policy – $1 million

3) Erie Excess Policy – $5 million/Nationwide Umbrella Policy – $1 million; applicable on a co-excess, *pro rata* basis.

Respectfully submitted,

Nationwide Mutual Fire Insurance Company
and
Nationwide Mutual Insurance Company

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[8] Erie states that Nationwide's "voluntary payment" in settling the Tort Action "moots this appeal." Erie Brief at 6. The trial court ruled, however, that the "voluntary payment" issue "is a separate matter for a separate proceeding." JA at 567. Neither party challenges that ruling on appeal. Further, Erie's representation that there was "no written funding agreement between Nationwide and Erie" is notable, in that Nationwide will present evidence in its subsequent reimbursement case against Erie that counsel for Erie orally represented to counsel for Nationwide prior to the settlement that the settlement would in no way waive, prejudice, or otherwise affect the instant coverage dispute and that all defenses to coverage are preserved. Erie Brief at 6 (emphasis added); JA at 539.

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CERTIFICATE

I hereby certify that the foregoing Reply Brief complies with Va. Sup. Ct. Rule 5:26.

I further certify that on this 2d day of December, 2016:

The correct number of true and accurate copies of this Reply Brief were hand-filed with the Supreme Court of Virginia and an electronic copy was filed via VACES in PDF format; and

A copy of the foregoing Reply Brief in PDF format has been emailed to counsel for appellees, and three copies of the foregoing Reply Brief have been transmitted by US First Class Mail to counsel for appellees, named below.

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