IN THE

Supreme Court of Virginia

RECORD NO. 180572

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

Appellants,

v.

ERIE INSURANCE EXCHANGE,

Appellee.

REPLY BRIEF OF APPELLANTS

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Appellants Nationwide Mutual Fire Insurance Company and Nationwide Mutual Insurance Company (together, "Nationwide") respectfully submit this Reply to the Brief of Appellee Erie Insurance Exchange ("Erie").

INTRODUCTION

Nationwide was not the "architect of its own predicament," as Erie states in its brief. **Erie** created this situation when it took the erroneous coverage position that it provided **only** excess liability coverage beyond $3 million and denied its indemnification coverage obligations below that threshold. This Court held in *Nationwide I* that Erie was wrong. It was this error — **Erie's error** — that has led to the current situation. Erie states on page 9 of its brief that "Nationwide made its bed and now must lie in it." Nationwide submits that the reality of this case is quite the opposite. It was Erie's incorrect coverage position, which it did not relinquish until this Court's ruling in *Nationwide I*, that led the parties to where they are now. Erie cannot evade and blame Nationwide for the effect of Erie's wrongful coverage position. Likewise, Erie cannot reap a $1.75 million windfall despite this Court's ruling in *Nationwide I*. It is past time that Erie reckon with the consequences of **its** own erroneous coverage position.

I. Nationwide has alleged a common obligation, such that its claims for equitable contribution can proceed.

Despite Erie's apparent suggestion that the common obligation issue and waiver/estoppel issues are distinct, they are one in the same. Erie now argues that, despite this Court's ruling in *Nationwide I*, there is no common obligation with respect to the settlement because Erie did not provide its "consent." It follows that if Erie's "consent" was not required — *i.e.,* if Erie waived or is otherwise estopped from relying on its consent-to-settlement clause — its argument that there is no common obligation fails. As previously explained, Erie waived its right to insist on its "consent" for any settlement within the $3 million coverage layer by refusing to provide indemnification coverage for that layer and urging Nationwide to unilaterally settle the case. Erie is likewise estopped from relying on its consent-to-settlement clause by changing its position on whether any such settlement should be unilateral.

A. Erie waived its right to rely on its consent-to-settlement clause.

As Erie finally seems to acknowledge, an insurer that denies its coverage obligations waives its right to rely on policy conditions, such as a consent-to-settlement provision. *See* Erie Brief. pp. 22-25; *see also Builders Mut. Ins. Co. v. Dragas Mgmt. Corp.*, 709 F. Supp. 2d 441, 449

(E.D. Va. 2010) (denying motion for summary judgment on the grounds that plaintiff pled facts to support a conclusion that the insurer waived the voluntary payment/consent-to-settlement clauses); *see also Credit Gen. Ins. Co. v. Abateco Servs., Inc.,* No. 3:99CV516, 2000 WL 35792722, at *3 (E.D. Va. Feb. 25, 2000) ("Upon finishing their investigation, Credit General issued a letter denying liability, thereby effectively waiving the contract's consent requirement."), *aff'd in rel. part,* 11 Fed.Appx. 47, 50 (4th Cir. 2001) (affirming waiver by insurer of the policy's consent requirement "on the reasoning of the district court, but vacating summary judgment on other grounds). Erie argues, however, that "its decision not to participate in settlement was not a denial of coverage." Erie Brief at 25. This misses the point. It was not Erie's "decision not to participate" that is the basis of its waiver, but its **insistence that it provided no coverage** in connection with the $2.9 million settlement demand.

Erie continues to mischaracterize Nationwide's argument and engage in revisionist history. It is as if Erie hopes this Court will not remember the very position it took before the Court in *Nationwide I* – that it did not provide any liability coverage within the $3 million coverage layer. **It was Erie's non-coverage position and its subsequent actions based on that erroneous position that waived its consent-to-settlement provisions.**

It is not as if Erie chose not to settle the case because it disagreed with the claimant as to value. As the record unequivocally reflects, and Erie concedes in its brief, Erie refused to participate in settlement negotiations within $3 million **based on** its erroneous denial of its indemnification obligations in connection with such a settlement.

This case is not nearly as complicated as Erie suggests. **An insurer cannot require its consent for a settlement that it claims is outside its scope of coverage.** This is not only black-letter law and common sense, but to hold otherwise would have startlingly negative consequences. According to Erie, an insurer can claim not to provide indemnity coverage in connection with a settlement demand but still rely on its consent-to-settlement clause. If that is the case, insurers are incentivized to wrongly deny coverage and hope that its insureds are under enough pressure to settle the case unilaterally. Once settled, according to Erie, the insurer that erroneously denied coverage is in the clear. That is not the law, and Erie's suggestion otherwise turns insurance law on its head while raising troubling public policy considerations.

Further, the fact that Erie did not issue a blanket coverage denial and would apparently have been willing to entertain a settlement demand over $3 million is of no moment in this case, in which the settlement was for less

than $3 million. Make no mistake: **Erie denied its primary indemnification coverage obligations.** *See* Compl. ¶ 17 and Ex. H, JA 5, 253-54 (letter from Erie's counsel stating that "Nationwide Insurance Company pays the first $3 million towards any settlement or judgment that might be entered against your insured, Moises Manzur Rodriguez"). The fact that Erie was providing a defense to the insured (under protest and only to a point[1]) does not mean it met its coverage obligations. A liability insurer has a duty to **indemnify** as well as defend.[2] *See*, *e.g., Nautilus Ins. Co. v. Strongwell Corp.*, 968 F. Supp. 2d 807, 823 (W.D. Va. 2013) (under Virginia law, "the duty to defend and the duty to indemnify are separate and distinct obligations"). Defense obligations are not at issue here. This case is about indemnification obligations, and here, Erie **wrongfully denied** its indemnification obligations within the $3 million coverage layer.[3]

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[1] It is also clear from the letter from Erie's counsel that Erie's position was that Nationwide was required to reimburse Erie for defense costs. *See* Compl. ¶ 17 and Ex. H, JA 5, 253-54

[2] An insurer also has a duty prior to a judgment to negotiate settlement in good faith. *Reisen v. Aetna Life & Cas. Co*., 225 Va. 327, 335 (1983). Here, Erie refused to negotiate at all with respect to the $2.9 million demand.

[3] Although indemnification coverage obligations are not generally triggered before a judgment, an insurer can plainly **deny** such coverage prior to judgment.

Erie is engaging in sophistic semantics when it claims it did not "deny" coverage and could not have waived its consent-to-settlement clause. A simple example makes this clear: Imagine a homeowner who is sued for $2 million when a mailman slips and falls on her broken front steps. The homeowner submits the claim to her liability insurer, who incorrectly informs her that she has a $1 million self-insured retention, meaning it will provide a defense but the homeowner would be personally responsible for any judgment **or settlement** for less than $1 million. In reality, this coverage position is entirely erroneous, and there is no such self-insured retention. The mailman then makes a settlement demand for $500,000. The homeowner's insurer informs its insured that it will not consider the demand because it is not within its coverage layer, and suggests that the homeowner strongly consider the ramifications if she chooses not to accept the demand; *i.e.*, she potentially faces a full $1 million in personal exposure. Of course the insurer is incentivized to encourage her to accept the settlement because it forecloses the possibility of a judgment for over $1 million. Under pressure and with trial approaching, she agrees to the $500,000.

Now imagine that she turns around and sues her insurer for its erroneous coverage position. Further imagine that this Court agrees with

her and rules that the insurer actually was required to provide first-dollar coverage. According to Erie's argument, she wasted her time suing her insurer. She settled the case without its consent and therefore cannot seek reimbursement from the insurer. According to Erie, the insurer did not really "deny" coverage anyway, as it never said it would not provide any coverage at all — just not provide payment for any settlement or judgment of less than $1 million. The fact that the homeowner agreed to settle for less than $1 million was just a "bad bet" on her part. According to Erie, the homeowner has no recourse and it would be ***unfair to the insurer*** to make it reimburse her for a settlement to which it did not "consent." According to Erie, she "made her own bed" and now "she must lie in it."

There is no meaningful distinction between the foregoing example and the case at bar. If Erie's argument is correct in this case, so too must it be the case that the homeowner in the example is without recourse. This is clearly not the law, nor should it be the law. Erie's argument is not only wrong, but it belies the very basic tenets of insurance and contract law.

B. Erie is estopped from relying on its consent-to-settlement clause.

The only coverage layer at issue in the instant case is the first $3 million layer in which the Tort Suit was resolved. Nevertheless, Erie

asserts that it "has never taken inconsistent positions and **never maintained that it did not provide coverage.**" Erie Brief at 27 (emphasis added). It is as if Erie does not recall that it strenuously argued before this Court in *Nationwide I* that it did **not** provide coverage for the $3 million layer. Rather than point to every instance in which Erie claimed not to provide coverage within the first $3 million, Nationwide will simply cite to this Court's opinion in *Nationwide I*: "Erie argued that the indemnification agreement required **Nationwide's policies to provide primary liability coverage.**" *Nationwide Mut. Fire Ins. Co. v. Erie Ins. Exch.*, 293 Va. 331, 335 (2017) (emphasis added). Despite Erie's assertion, it is a historical fact that Erie maintained that it did not provide liability coverage within the first $3 million coverage layer.[4]

Nationwide's estoppel argument is straightforward. Erie took the position that it did not provide liability coverage within the first $3 million coverage layer. Expressly based on this erroneous position, Erie refused to participate in any settlement negotiations for less than $3 million and told

[4] Erie also states in its brief that "[t]hroughout the Tort Suit, the coverage case, and this litigation, Erie has always maintained that its insurance coverage applied to the Tort Suit. That is why Erie defended Manzur in the Tort Suit." Erie Brief at 28. Erie again ignores that, in reality, it took the position that it did not have a duty to defend Manzur, the mutual insured. *See, e.g.,* Compl. ¶ 10, JA 3.

Nationwide that that coverage layer was Nationwide's unilateral responsibility. In other words, it was Erie's position that a $2.9 million settlement was **Nationwide's sole and unilateral obligation**. Based on Erie's assertion that it would not extend coverage in connection with the settlement demand, Nationwide settled the case, as Erie had urged it to do.[5] After this Court held that Erie's position was wrong, Erie now argues that **because its policies did apply to the $3 million layer**, its "consent" was required. The doctrine of equitable estoppel prevents parties, like Erie, from having it both ways.

Further, Erie's argument that the doctrine of estoppel cannot be applied because "priority of coverage" is a legal question is incorrect. The case cited by Erie in support of this proposition, *Bentley Funding Group, L.L.C. v. SK&R Group, L.L.C.*, 269 Va. 315 (2005), dealt with judicial estoppel. Here, Nationwide is not arguing judicial estoppel. Erie sent two letters to Nationwide regarding the settlement demand and made it clear in

[5] Erie's argument that Nationwide did not rely on Erie's denial of indemnification coverage for less than $3 million is clearly belied by the Complaint and record and this case. Moreover, this appeal is from a ruling on a demurrer, and Erie's argument regarding reliance goes well beyond proper considerations on demurrer. *See Assurance Data, Inc. v. Malyevac*, 286 Va. 137, 143 (2013) (on demurrer, a trial consider must "consider as true all the material facts alleged . . . all facts impliedly alleged, and all reasonable inferences that may be drawn from such facts").

both letters that it was Nationwide's unilateral responsibility to settle the case. In other words, Erie's position of non-coverage for the first $3 million coverage would serve as grounds of estoppel even if *Nationwide I* had not been litigated. Moreover, implicit in this Court's decision in *Maxey v. Doe*, 217 Va. 22 (1976) is that estoppel can be applied to coverage determinations, and not just representations of fact. *See id.* at 25.[6] Finally, Erie's incorrect position went beyond mere legal theories when it actively refused to contribute to the settlement based on its erroneous coverage position. That refusal was a concrete and factual position.

C. The cases relied upon by Erie are inapposite.

In support of its argument that its consent was still required for a settlement for which it disavowed coverage obligations, Erie continues to rely primarily on two cases: *Midwest Mut. Ins. Co. v. Aetna Cas. & Sur. Co.*, 216 Va. 926 (1976) and *Allstate Ins. Co. v. United Servs. Auto. Ass'n*, 249 Va. 9 (1995). As explained in Nationwide's Opening Brief, both cases are readily distinguishable for the same fundamental reason — in neither of those cases did the non-settling insurer wrongfully deny its (primary)

[6] Although the Court ultimately determined that estoppel was not established in that case, that was only because the insurer was not aware that an uninsured motorist claim was being made, not because the position was legal and not "factual."

coverage obligations, nor did the non-settling insurer in those case expressly urge the other insurer to unilaterally settle the underlying claims. Accordingly, the waiver and estoppel issues that are central to this case were non-existent in *Midwest Mutual* and *Allstate*, such that they do not support Erie's position in the instant matter.

II. Nationwide did not act as a volunteer.

Erie's arguments in its brief regarding the "volunteer doctrine" fail for the reasons explained in Nationwide's Opening Brief; specifically, the volunteer doctrine is inapplicable because it would result in an inequitable outcome and because Nationwide did not act as a volunteer. It is worth noting here, however, that Erie twice suggests in its brief that Nationwide should have moved for a stay in the Tort Suit rather than "voluntarily" settle the Tort Suit. The suggestion is perplexing, as nothing in Virginia law permits a liability insurer, a non-party to tort suits, to move trial courts presiding over such actions to do anything at all. Nationwide would have no standing to make such a motion. Indeed, the fact that Erie's proposed solution to this problem is a legal impossibility illustrates the weakness in Erie's volunteer argument.

III. Equitable subrogation does not require a "common obligation."

Erie's myopic focus on the "common obligation" issues, especially in Part II.D of its brief,[7] ignores Nationwide's claim for equitable subrogation. As this Court has stated, "[e]quitable subrogation is subrogation that arises by operation of law. It is not based on contract or privity of parties, but is 'purely equitable in nature,' **dependent on the facts and circumstances of each particular case.**" *XL Specialty Ins. Co. v. Com., Dep't of Transp.*, 269 Va. 362, 369 (2005) (citing *Centreville Car Care, Inc. v. North Am. Mortgage*, 263 Va. 339, 345 (2002)) (emphasis added). This Court has further stated that "no bright-line rule for the resolution of claims for subrogation can be formulated." *Centreville Car Care, Inc.*, 263 Va. at 345. Generally, however, individuals who act in performance of a legal duty **or non-legally bound individuals who might suffer loss if they do not discharge an obligation are entitled to subrogation.** *See Richmond v. Hanes*, 203 Va. 102, 108, 122 S.E.2d 895, 900 (1961).

[7] In Part II.D. of its brief, Erie argues that Nationwide's status as a co-insurer as opposed to the insured means it is without recourse. This ignores the principles of subrogation, which permit a subrogee to "step into the shoes" of the subrogor.

Here, at the very least, Nationwide risked suffering loss if it refused to participate in settlement negotiations based on the coverage dispute,[8] such that it is generally entitled to subrogate. Moreover, as this Court has stated, there is no "bright-line rule" for equitable subrogation. Nationwide submits that if ever there were circumstances that justified application of equitable subrogation, it is those at issue in this case. To be clear, Erie's position is that it owes $0 for the settlement, notwithstanding the fact that its refusal to contribute to the settlement that resulted in the release of its insured (to whom it owed primary liability coverage obligation in accordance with *Nationwide I*) was based on an erroneous coverage position. If Erie is right and Nationwide is without recourse, Erie receives a **boon** from its erroneous coverage position and it is for Nationwide to suffer the **consequences**. Such a result is contrary to principles of equity; and given that the insured (here, the equitable subrogor) would certainly have cause for complaint for Erie's refusal to negotiate based on an erroneous coverage position, so too may Nationwide seek redress in its claim for equitable subrogation.

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[8] Lest there be any doubt as to Nationwide's risk of suffering loss, the Court need go no further than review the letters Erie's counsel sent Nationwide regarding the settlement, wherein counsel all but explicitly stated that Nationwide's failure to settle would be treated as bad faith. *See,* Compl. ¶ 15 and Ex. G, JA 4, 252; Compl. ¶ 17 and Ex. H, JA 5, 253-54.

CONCLUSION

The ultimate question in this case is which party bore the risk of Erie's incorrect coverage position. Erie argues, against common sense, public policy, and Virginia precedent, that **Nationwide** "made a bad bet" and bore the risk that **Erie** was wrong. Nationwide submits that it is Erie that bore the risk of **Erie** being wrong and that accountability on the part of Erie is long overdue.

For the reasons stated above and those stated in Nationwide's Opening Brief, this Court should reverse the judgment of the trial court sustaining Erie's Demurrer as to Nationwide's claims for equitable contribution (Count I) and equitable subrogation (Count III) and remand the case to the trial court for continued proceedings.

Respectfully submitted,

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CERTIFICATE

I hereby certify on this 18th day of December, 2018, that I have complied with Rule 5:26 and that this Reply Brief of Appellant has been filed with the Supreme Court of Virginia and a copy has been served on opposing counsel via email this same day.

/s/ *Robert F. Friedman*