2d Civil No. B170079

IN THE COURT OF APPEAL
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION TWO

FULLER-AUSTIN INSULATION COMPANY,

Plaintiff, Respondent, and Appellant,

v.

CERTAIN UNDERWRITERS AT LLOYD'S LONDON, and CERTAIN LONDON MARKET INSURANCE COMPANIES, INTERNATIONAL INSURANCE COMPANY, and HIGHLANDS INSURANCE COMPANY,

Defendants, Appellants and Respondents.

AND RELATED CROSS-ACTIONS

Appeal from the Los Angeles County Superior Court
LASC Case No. BC 116835
Honorable Judith C. Chirlin

APPELLANTS' REPLY BRIEF FOR CERTAIN UNDERWRITERS AT LLOYD'S LONDON, and CERTAIN LONDON MARKET INSURANCE COMPANIES

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INTRODUCTION

Stripped of false accusations of abandonment and wrongdoing, the story in this case is straightforward.

While Fuller-Austin was fully defended and indemnified by its primary insurers, it wanted its excess carriers' policy limits – on the spot – to settle current and potential future asbestos claims. That was years before indemnity might become due for most of the settled claims, and before underlying layers of primary and excess coverage were fully exhausted.

Seeking to bind the excess insurers to its strategy, Fuller-Austin gave them an ultimatum: It would settle without them unless they collectively waived all reservations of rights to deny coverage. When the excess carriers understandably balked, Fuller-Austin entered into a global settlement – a prepackaged bankruptcy plan – without the excess insurers' consent. To obtain plan approval from the bankruptcy court – and to prevent that court from hearing the insurers' objections – Fuller-Austin represented to the court that the insurers' coverage rights and interests would remain unimpaired in this coverage litigation.

Once the bankruptcy court approved the settlement, however, Fuller-Austin changed its tune. In this coverage litigation, it persuaded the trial court of exactly what it had represented it would not: that the stipulated bankruptcy confirmation binds the insurers.

The resulting judgment compels the excess insurers to perform Fuller-Austin's bidding, despite the contrary terms of their policies. They must immediately turn over their policy limits to Fuller-Austin, long before

indemnity could become due – without proof of Fuller-Austin's liability for any claim and without proof that any claim, existing or potential, is within their policies' coverage. Under the judgment, it is Fuller-Austin that will invest the insurers' funds and disburse them under informal procedures, as future asbestos claimants step forward to assert their claims over a 30-year span.

This judgment is fatally at odds with core prerequisites to coverage imposed by California law and the applicable policies. The jury in this case – even though misinstructed on the central legal issues – nevertheless found that Fuller-Austin's settlement did not arise from any wrongdoing on the excess insurers' part. When Fuller-Austin entered into its unilateral settlement, the jury expressly found, the excess insurers had breached no obligations owed under their General policies – no indemnity obligations, no defense obligations, no coverage obligations at all.

The jury's finding there was no pre-bankruptcy breach of the insurers' General policy obligations – unchallenged by Fuller-Austin in this appeal – is dispositive. Without a breach that resulted in the bankruptcy settlement, the judgment lacks any basis on which to impose liability for the settlement's terms. This issue alone resolves the bulk of this appeal, simply and quickly. It compels not only that the judgment must be reversed, but that it must be reversed with directions to enter judgment in the excess insurers' favor.

But the no-breach finding is just the tip of the reversible-error iceberg. The judgment also lacks any adjudication establishing Fuller-Austin's liability to existing or potential future claimants. Under

controlling Supreme Court authority – *Hamilton v. Maryland Casualty Co.* (2002) 27 Cal.4th 718 – Fuller-Austin's unilateral bankruptcy settlement cannot bind its nonconsenting insurers. Nor has Fuller-Austin ever shown that underlying coverage has been fully exhausted, or that the existing or potential future claims against it arise from harms falling within coverage under the excess policies issued by Certain Underwriters at Lloyd's, London and Certain London Market Insurance Companies (collectively LMI). It could not possibly do so, as the majority of the settled claims have yet even to be asserted.

Dodging these dispositive issues, Fuller-Austin's defense of the judgment rests on a parade of falsehoods – baseless claims of abandonment, failure to defend, and waiver – that it repeats as though repetition will make them so. This brief squarely refutes each of these untenable premises.

In another diversion, Fuller-Austin's brief insinuates that public policy justifies the strong-arm tactics it employed in this case to bind the insurers. But the statutory bankruptcy procedures designed to enable fair distribution of resources to deserving claimants are in complete harmony with enforcement of insurers' rights and obligations; this appeal poses no threat to these legitimate interests, as Fuller-Austin would have this Court believe. The real issue here is whether a policyholder can blatantly manipulate its settlement plan with the intention to deprive its insurers of the rights and protections that their policies and established law afford. The answer must be "no."

There is only one lawful solution in this case: the judgment must be reversed with directions for entry of judgment in favor of LMI.

ARGUMENT

I. THE JUDGMENT RESTS ON UNTENABLE PREMISES OF FACT AND LAW.

Six key premises underlie the judgment and Fuller-Austin's appellate position.[1] Not one is tenable.

A. *Untenable Premise No. 1*: That LMI Abandoned, Failed to Defend, or Improperly Denied Coverage to Fuller-Austin Under its General Policies.

Reality: **There Was No Breach and No Abandonment; the Primary Insurers Fully Defended and Indemnified Fuller-Austin Until Its Unilateral Bankruptcy Settlement.**

Fuller-Austin contends that LMI and the other excess insurers abandoned it, leaving it undefended and without coverage for the asserted

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[1] Fuller-Austin's general response is cited "RB"; its separately bound response to issues specific to LMI and another insurer is cited "RB–Spec. Issues."

and unasserted asbestos injury claims against it.[2] The special verdict and the record conclusively refute this accusation.

1. The jury expressly found no pre-bankruptcy breach.

The jury found that until the bankruptcy court confirmed Fuller-Austin's unilateral settlement, LMI had breached no obligation owed under the General policies. (Spec. Verdict, 24 AA tab 129 at 6748.)[3] When the settlement plan was confirmed, Fuller-Austin had been provided with every coverage benefit to which its LMI General policies entitled it. There was no failure to defend, no failure to indemnify, no breach at all.

The Special Verdict conclusively settles the abandonment issue. It precludes as a matter of law the possibility that the insurers' conduct before the settlement could justify Fuller-Austin's unilateral bankruptcy settlement or could bind the insurers to it. Without abandonment, there is no possible implication that the insurers breached, and no basis for the trial court's presumptions of waiver and coverage.

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[2] Fuller-Austin repeats this refrain throughout its response. (E.g., RB 3, 4, 12, 14, 18, 21, 60, 79-89, 91-92 [withheld, disavowed and refused to acknowledge coverage]; 11, 16-17, 22, 23, 26, 27, 60 [refused to provide coverage]; 21 [refused to withdraw reservations of rights]; 79-89, 90, 91-92 [denied coverage, repudiated policies, refused to defend, abandoned insured, failed to accept coverage obligations].)

[3] We separately address the claims specific to the Cities Service policies in Section III, below.

2. The jury's special verdict conclusively defeats Fuller-Austin's abandonment contention.

The record leaves no room to dispute the jury's finding that LMI and the other excess insurers were guilty of no pre-settlement abandonment or breach of their General policy obligations:

- Fuller-Austin's primary insurers fully defended and indemnified it against asbestos injury claims until it entered into its unilateral settlement and filed for bankruptcy.[4]
- LMI's General policies expressly provide no duty to defend.[5]
- LMI had no present indemnity duty, because Fuller-Austin had substantial remaining unexhausted primary and underlying excess

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[4] Fuller-Austin so represented in public filings and in binding judicial admissions. (E.g., 36 RT 7191; TE 9024, 51 ExApp at 14716 ¶ 21; DynCorp 10/1/98 SEC 10-Q filing, TE 8353, 40 ExApp at 11726.)

[5] 34 AA tab 153 at 9792, 56 RT 11291 [trial court instructs jury that excess policies provide no duty to defend]; see *FMC Corp. v. Plaisted & Companies* (1998) 61 Cal.App.4th 1132, 1199-1201 [excess policy language contains no defense duty].

coverage when it entered into the bankruptcy settlement,[6] and even when judgment was entered in this case.[7]

- LMI was fully entitled to reserve their rights and to withhold their consent to settlements; they had no obligation to accede to Fuller-Austin's demand that they relinquish those rights. (See section I.C.2, below; *Blue Ridge Ins. Co. v. Jacobsen* (2001) 25 Cal.4th 489 [policyholder could not condition settlement demand on carrier's waiver of reservation of rights].)[8]

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[6] TE 384, 10 ExApp at 2704 [Bankruptcy Disclosure Stmt. represents that in September, 1989 Fuller-Austin had $4 million primary indemnity coverage remaining]; TE 8353, 40 ExApp at 11726 [October, 1998 DynCorp SEC 10-Q filing represents $2.2 million unexhausted primary coverage, plus $39 million 1st tier excess coverage, remained]; TE 7648, 40 ExApp at 11569 [Fuller-Austin filed discovery admission that as of August 18, 1998 it had "at least $2.7 million in unexhausted primary coverage"]; see 37 RT 7364-7367 [Fuller-Austin told LMI to rely on exhaustion information in SEC filing]; see LMI-AOB 60, fn. 28. See also *International Engine Parts, Inc. v. Feddersen & Co.* (1998) 64 Cal.App.4th 345, 352-353 [party is judicially estopped to contradict representations in its bankruptcy disclosure statement]. The record shows without contradiction that when LMI asked about the potential for exhaustion of underlying coverage, Fuller-Austin directed LMI to rely on the SEC filings. (E.g., 37 RT 7364-7367.)

[7] Even when judgment was entered in this case some amounts owed by primary and underlying excess insurers still remained to be paid. (TE 874, 16 ExApp at 4428; TE 878, 16 ExApp at 4569-4571 [underlying carrier's settlement agreement provides for additional future payments before underlying coverage will be exhausted]; see Section I. F., below.)

[8] The record belies Fuller-Austin's claim that it sought the insurers' participation in settlement negotiations with "no strings attached." (RB 19-20.) As its record citations demonstrate (RB 19), its ultimatum to the excess insurers demanded advance written waivers (on just a few days' notice) of all coverage reservations by *all* the excess insurers as a

(continued...)

Without disputing the sufficiency of this evidence (and without benefit of record citations), Fuller-Austin argues "there is substantial evidence" to support an *opposite* conclusion – a conclusion the jury *rejected.* It argues the evidence could have supported a finding that LMI "denied coverage, abandoned their insured, and otherwise failed to accept coverage obligations prior to Fuller-Austin's bankruptcy." (RB § IV.B, p. 86.)

The contention is more than just false and irrelevant; it is frivolous. The jury's findings bind Fuller-Austin as much as they bind LMI. (*Shaw v. Hughes Aircraft Co.* (2000) 83 Cal.App.4th 1336, 1346 [respondent is no more entitled than appellant "to have the favorable verdict credited and the unfavorable one disregarded"].)

The central theme of Fuller-Austin's brief – that the excess insurers' abandonment and failure to defend justified the unilateral bankruptcy settlement – rests on unsupported fantasy. The special verdict conclusively establishes that there was no pre-settlement abandonment or breach of any duty by the insurers.

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[8] (...continued)
precondition to allowing participation by *any* excess carrier. (RB 19-20, 86, citing 43 RT 8484; TE 1429, 23 ExApp. at 6482-6483; see also TE 1430, 23 ExApp. at 6485-6486.)

B. *Untenable Premise No. 2*: That the Excess Insurers Are Bound Because the Bankruptcy Proceedings Adjudicated Fuller-Austin's Liabilities for Asbestos Claims.

Reality: There Was No Adjudication of Fuller-Austin's Asbestos Liabilities – Not in the Bankruptcy Proceedings, Not Anywhere.

The explicit terms of LMIs' policies provide that LMI are not bound by a settlement without their consent. Only an actual adjudication of Fuller-Austin's covered liabilities can bind its insurers. (LMI-AOB 22-29; 31 AA tab 143 at 8886-8888, 8927, fn. 14; see citations to policies at LMI-AOB 23.) California law is the same. (*Hamilton v. Maryland Casualty Co.*, *supra*, 27 Cal.4th 718, 726; *Certain Underwriters at Lloyd's of London v. Superior Court* ("*Powerine*") (2001) 24 Cal.4th 945, 960-966, 974, fn. 13; *Aerojet-General Corp. v. Transport Indemnity Co.* (1997) 17 Cal.4th 38, 56; *Buss v. Superior Court* (1997) 16 Cal.4th 35, 45-46; *Montrose Chemical Corp. v. Admiral Ins. Co.* (1995) 10 Cal.4th 645, 659, fn. 9.)

The judgment violates this controlling precept. Both as a matter of law and as a matter of fact, the nonadversarial bankruptcy proceedings from which the insurers were excluded was not an adjudication of policyholder liabilities that binds the excess insurers. The excess insurers did not consent to, or even participate in, Fuller-Austin's settlement. The judgment must be reversed with directions.

1. Fuller-Austin has no answer to the controlling *Hamilton* and *Wolkowitz* decisions.

Two controlling decisions explicitly define the "actual adjudication" required before insurers can be bound to indemnify their policyholders. (*Hamilton v. Maryland Casualty Co.*, *supra*, 27 Cal.4th at p. 726; *Wolkowitz v. Redland Ins. Co.* (2003) 112 Cal.App.4th 154, 163-166; see LMI-AOB 26-29.) Under these decisions, the bankruptcy proceedings here fall far short.

Hamilton holds unequivocally that a full and fair adjudication of the policyholder's liabilities to claimants is essential before insurers can be bound to indemnify their policyholder, and that a defended policyholder's unilateral settlement does not satisfy the "actual adjudication" requirement – not even if the settlement is fair to its parties and determined to be in good faith. (*Hamilton*, *supra*, 27 Cal.4th at p. 726; LMI-AOB 27; see also *In re Brawders* (9th Cir. B.A.P., 2005) 325 B.R. 405, 411 [claim not within parties' expectations of what was being litigated in bankruptcy proceedings is not entitled to claim preclusion; due process requires fair notice and adversary proceeding].)

Wolkowitz applies *Hamilton* in the setting of our case – bankruptcy. It holds that a bankruptcy court's approval of a policyholder's settlement with claimants – like the bankruptcy court's confirmation in this case – does not satisfy *Hamilton's* "actual adjudication" requirement. (*Wolkowitz*, *supra*, 112 Cal.App.4th at pp. 163-166; LMI-AOB 28-29.)

Fuller-Austin responds only once to these controlling decisions. Some 90 pages into its brief it advances its abandonment mantra as the sole

reason why *Hamilton* and *Wolkowitz*, as well as *Low v. Golden Eagle Ins. Co.* (2003) 110 Cal.App.4th 1532, should be ignored. (RB 91-93.)[9] But there was no abandonment; the jury found the insurers breached no obligation before Fuller-Austin's unilateral settlement.[10] (See *Untenable Premise No. 1*, § I.A., above.) Without abandonment, Fuller-Austin is left with no answer to *Hamilton*, *Wolkowitz*, and *Low*.

Hamilton, *Wolkowitz*, and *Low* establish conclusively that no "actual adjudication" of Fuller-Austin's liabilities occurred here. Under them, Fuller-Austin's unilateral bankruptcy settlement cannot lawfully bind the excess insurers; liability may be imposed only when an insurer unequivocally and *wrongfully* denies policy benefits owed *before* the insured's settlement – not merely for the insurer's reservation of its rights to deny potential future obligations. (*Hamilton, supra,* 27 Cal.4th at p. 726; *Wolkowitz., supra,* 112 Cal.App.4th at pp. 163-166; *Low, supra,* 110 Cal.App.4th at pp. 1546-1547.)

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[9] Remarkably, Fuller-Austin's own discussion of California law's "actual trial" requirement never mentions these controlling cases. (RB 59-60.)

[10] Fuller-Austin's record citations (RB 92), show nothing more than that the insurers made some settlement attempts and declined to waive their reserved rights – no abandonment at all. (E.g., 34 RT 6754-6758; 35 RT 7051-7052; 36 RT 7103-7105, 7165-7169; 37 RT 7385-7394, 7398-7400, 7406-7407; 40 RT 7974-7975.)

2. The bankruptcy court did not adjudicate either the fact or the amount of Fuller-Austin's liabilities.

Fuller-Austin cannot escape *Hamilton*, *Wolkowitz*, and *Low* by characterizing the bankruptcy proceedings as the required liability adjudication. (RB 57-60.) The bankruptcy court undertook no adjudication.

In the bankruptcy court, there was no adversarial presentation of any position; no evidence was offered or admitted of Fuller-Austin's liability to any claimant for any claim; the bankruptcy court allowed just one hour for Fuller-Austin to urge plan confirmation, with no cross-examination. (TE 525, Trans. 10/15/98 pp. 3-4, 14 ExApp. 3988. See record citations, LMI-AOB 13-16, 29-31, 42-44.) The bankruptcy court declared it would make no liability determination: "I am not divining anything in an hour about valuations." (TE 525, Trans. 10/15/98 p. 74:2-4, see pp. 73-74, 14 ExApp at 4006.)

The bankruptcy plan confirms that it creates no "substantive right for any claimant." (Plan CRP, TE 383 ¶¶ 1.3, 1.4(d), 9 ExApp at 2513.) Indeed, Fuller-Austin deleted a provision that plan confirmation would constitute a "judgment of liability" against Fuller-Austin and would determine the amounts Fuller-Austin "shall be legally obligated to pay." (TE 383, 9 ExApp at 2455 ¶ 10.7, 2470 ¶ 7 [proposed plan]; TE 8345, 40 ExApp at 11659 ¶ 6, 11663, see 11666, 11671 [Fuller-Austin modifications]; TE 552, 15 ExApp at 4139 ¶ 79, [bankruptcy court approval].)

Fuller-Austin's counsel represented to the bankruptcy court and the insurers that "there is no language in this plan" that adjudicates "a sum that could be the basis for a direct action against the insurer in the California litigation." (TE 525, Trans. 10/15/98 p. 54, 14 ExApp at 4001.) And Fuller-Austin repeatedly ridiculed the excess insurers for predicting it would seek to use the bankruptcy court judgment to bind its insurers; in the face of the bankruptcy court's probing questions, it positively denied any such intention. (See TE 525, Trans. 10/15/98 pp. 36-62, 14 ExApp at 3996-4003.)

Both the bankruptcy court and Fuller-Austin thus explicitly disclaimed any intention to adjudicate Fuller-Austin's asbestos liabilities to claimants. Based on the settlement and Fuller-Austin's representations, the bankruptcy court ruled that "[t]he actual amounts, numbers and timing" of future claims against Fuller-Austin "cannot be determined." (TE 551, 14 ExApp at 4078 ¶ 120.)[11]

Nor did the bankruptcy plan purport to adjudicate liabilities or amounts. It merely establishes *procedures* under which asbestos claims would be resolved by the trust after they are asserted. (TE 525, Trans. 10/15/98 p. 74:3-4, 14 ExApp at 4006; TE 552, 15 ExApp at 4111 ¶ 22; TE 551, 14 ExApp at 4075 ¶ 96.) It expressly *does not* establish Fuller-

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[11] A bankruptcy judge lacks jurisdiction to make any binding adjudication of pre-petition insurance coverage disputes. (*In re Lawrence Group, Inc.* (Bankr. N.D.N.Y. 2002) 285 B.R. 784.) And a prepackaged bankruptcy settlement trust under Bankruptcy Code section 524(g) cannot bind the bankrupt's non-party insurers. (*In re Combustion Engineering, Inc.* (3rd Cir. 2004) 391 F.3d 190, 223 [affirming insurers' exclusion from proceeding].)

Austin's liability in any amount to any existing or potential future claimant. (TE 383, 9 ExApp at 2513 ¶ 1.3.) As even the trial court in this case recognized, the plan's procedures require no "legally sufficient proof" of the merits of any claim. (31 AA tab 143 at 8917, fn. 8).

The bankruptcy court record contains not a hint of any actual adjudication of Fuller-Austin's liabilities to existing or potential future claimants. (See LMI-AOB 27-29.) The bankruptcy court's disavowal of any such adjudication is binding as a matter of full faith and credit and collateral estoppel; Fuller-Austin's disavowal is equally binding as a matter of judicial estoppel. (See Section II, below and LMI-AOB 36.) The trial court's contrary rulings are unequivocally wrong.

3. The bankruptcy procedure is consistent with, and does not supplant, insurance law.

Fuller-Austin intimates that Bankruptcy Code section 524(g) intended to obviate the liability adjudications or insurer consent to settlements that the policies and California law explicitly require. (RB 38-41.) But nothing in section 524(g) (or anywhere else in the law of bankruptcy) grants Fuller-Austin post-bankruptcy rights against its insurers any greater than its pre-bankruptcy rights. (See *In re Coupon Clearing Service Inc.* (9th Cir. 1997) 113 F.3d 1091, 1099 [the bankruptcy estate has "no greater rights in property than those held by the debtor prior to bankruptcy"].)

Section 524(g) contains no hint that it preempts the California rules of insurance policy enforcement enunciated in *Hamilton*, *Wolkowitz*, and

Low. In any event, construing Bankruptcy Code section 524(g) as Fuller-Austin urges would be forbidden by the McCarran-Ferguson Act, which vests in the states all-but-plenary power over relations between policyholders and insurers. Under it, no federal law may be construed "to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, . . ." unless the federal statute applies expressly to insurance. (15 U.S.C. § 1012(b); *Smith v. PacifiCare Behavioral Health of Cal., Inc.* (2001) 93 Cal.App.4th 139, 153-154.)[12] Nothing in section 524(g) applies expressly to insurance; the McCarran-Ferguson Act therefore prohibits its construction to relieve the prerequisites to insurer liability imposed by *Hamilton*, *Wolkowitz*, and *Low*. (*Smith v. PacifiCare Behavioral Health of Cal., Inc.* (2001) 93 Cal.App.4th 139, 153-154.) It is the insuring agreements, not any implication drawn from section 524(g), that govern Fuller-Austin's rights and the insurers' coverage obligations.

There is nothing in section 524(g) that required circumvention of the prerequisites to coverage. Nothing precludes a bankruptcy plan under section 524(g) from affording coverage for claims as they are adjudicated; nothing precludes insurer-approved settlements. There is no conflict

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[12] The Act bars courts from construing federal statutes to displace even state common law insurance regulation. (E.g., *Doe v. Norwest Bank Minnesota, N.A.* (8th Cir. 1997) 107 F.3d 1297, 1307 [RICO Act could not apply to insurance practices that might interfere with state regulatory scheme]; *Senich v. Transamerica Premier Ins. Co.* (W.D. Pa. 1990) 766 F.Supp. 339, 341 [McCarran-Ferguson Act applies "regardless of whether state law permits a private right of action under common law or statutory theories"].)

between section 524(g) and the governing principles of California insurance law.

The path Fuller-Austin chose in this case was its own tactical decision; it was not required by section 524(g). Fuller-Austin chose to exclude the insurers and to subvert their policy rights, to side-step any liability adjudications, to dispense with proof of coverage, then to argue the bankruptcy procedures as a weapon to force its insurers' acquiescence without the prerequisites to coverage. As architect of that illicit scheme, Fuller-Austin consciously undertook the risk that its plan would fail.[13] And fail it must.

That carriers can and often do agree to settle claims (both individually and by class) does not undo their prerogative to decline such consent and to insist that their contractual rights be honored. (See *Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal.4th 857, 883; *Powerine*, *supra*, 24 Cal.4th at p. 967.) Neither section 524(g) nor any public policy licenses a court to rewrite the parties' insurance

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[13] Both in the bankruptcy court and in this Court, Fuller-Austin consciously embraced the risk that its overbearing tactics might impair its ability to establish coverage. As its counsel conceded to the bankruptcy court:

> "If I settle with a claimant today and I was supposed to have consulted with that carrier and I didn't, then that carrier's rights under this deal are unaffected [because those issues are before the California court]. I can't make the carrier pay if I violate the carrier's rights."

(TE 525, Trans. 10/15/98 p. 94:18-23, 14 ExApp at 4011; see also RB 91 [policyholder that unilaterally settles without its insurers' consent may lose coverage rights].)

contracts in order to validate an insured's overreaching tactics. (See *Powerine*, *supra*, 24 Cal.4th at p. 960.)

4. Estimates of potential future liabilities are no substitute for adjudications of present liabilities; they cannot bind the excess insurers.

Fuller-Austin argues at length that estimates of its existing and potential future liabilities satisfy the "actual adjudication" requirement because (1) insurers and others regularly use estimates for legitimate purposes; (2) bankruptcy courts are required by law to estimate future liabilities; and (3) California law permits recovery of estimated future damages. (RB 5, 36-47, 69-74.) But these arguments are unsupported by authority and devoid of logic.

The fact that estimates can be useful to lenders, courts, and insurers does not mean they can be transformed into present obligations or can substitute for actual liabilities. A lender may be able to predict with accuracy the present value of future loan repayments; but that ability does not entitle it to immediate payment of the full debt. The same is true here. Insurers may estimate potential future liabilities and indemnity obligations, but its insuring agreements – not the estimates – determine whether and when those obligations have actually matured. Bankruptcy court estimates of the number and amounts of existing and potential future asbestos claims are legitimate and useful tools for trust administration, but they do not constitute an actual adjudication of Fuller-Austin's present liabilities.

Fuller-Austin's reliance on California statutes and decisions approving the use of future damage estimates is equally misplaced. (RB 69-74.) Indeed, those authorities confirm that estimates do not establish liability; rather, they are applied only "[o]nce liability is established." (See RB 70 ["*Once liability is established*, damages, including future damages, may be awarded if they are reasonably ascertainable," italics added].)

Here, Fuller-Austin and the trial court have applied the rule backwards, by using the estimates of future damages as though they could themselves establish liability. They cannot.[14]

5. The excess insurers did not invite error; Fuller-Austin is responsible for inducing the erroneous judgment.

Fuller-Austin blames the excess insurers for preventing adjudication of Fuller-Austin's liabilities in the bankruptcy court, thereby inviting error. (RB 5, 6, 24-25.) The accusation is factually wrong, and it is disingenuous.

It was Fuller-Austin, not the insurers, that drafted and entered into the bankruptcy settlement plan; that successfully induced the bankruptcy court not to hear the insurers' objections; and that represented to the

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[14] Fuller-Austin's discussion of estimates reflects another fundamental error: The estimates of future claims in this case encompass not just claims that will come within coverage under the insurers' policies, but *all* future asbestos claims that are estimated will eventually be asserted against it. Fuller-Austin made no effort to establish – through estimates or any other means – how many of those potential future claims might come within coverage. (See Section I. D., below.)

bankruptcy court that the insurers would not and could not be bound by determinations made in those proceedings. (Order, TE 544, 14 ExApp at 4046; TE 525, Trans. 10/15/98 pp. 40:3-7, 42:9-13, 43:13-19, 44:5-20, 45:21-25, 46:14-17, 54:20-25, 77:6-15, 83:19-23, 84:9-14, 94:3-23, 14 ExApp at 3997-4011.) And it was Fuller-Austin's settlement plan, not the insurers' unheeded objections to it, that channeled all existing and future claims for resolution under plan procedures without adjudicating any actual liabilities. (TE 384, 10 ExApp at 2704-2705, 2779-2781 §§ 1.2(b), 6.1(d)(3), 6.2, 6.3; 11 U.S.C. § 524(g)(1); Plan CRP, TE 383, 9 ExApp at 2516-2518.)[15]

The insurers warned of Fuller-Austin's undisclosed and ill-conceived intention to "rely upon the confirmation of the Plan to establish an element of its California lawsuit," predicting exactly what has come to pass. (TE 441, 13 ExApp at 3577, see 3574-3579.) Fuller-Austin opted to proceed despite the insurers' warnings that its scheme would leave essential elements of its coverage claims without adjudication and without proof.

There has been no adjudication of Fuller-Austin's liabilities to claimants – not in the bankruptcy court, and not in the superior court.[16]

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[15] Fuller-Austin suggests the insurers invited error because their objections led it to modify the bankruptcy settlement plan. (E.g., RB 5, 25.) But in response to the bankruptcy court's inquiry, Fuller-Austin's counsel admitted that "for all intents and purposes from the point of view of the carriers [the plan modification] is unilateral, because I have not heard any of the carriers tell me that they find that, at least today, to be an acceptable solution to the concerns they have and they are worried about." (TE 525, p. 39:19-24, 14 ExApp at 3997.)

[16] The trial court barred any proof of Fuller-Austin's liabilities to asbestos (continued...)

Without an underlying liability adjudication, no indemnity obligation exists and reversal is required with directions to enter judgment in LMI's favor. (Code Civ. Proc., § 629; *Bank of America v. Superior Court* (1990) 220 Cal.App.3d 613, 624 ["a reversal on appeal for insufficiency of the evidence concludes the litigation just as it would have been concluded if the trial court had correctly entered judgment notwithstanding the verdict"]; *McCoy v. Hearst Corp.* (1991) 227 Cal.App.3d 1657, 1663 [CCP § 629 imposes mandatory duty to reverse with directions where directed verdict or JNOV should have been granted].)

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[16] (...continued)
claimants. (E.g., 23 RT 4522 [court will permit no "actual evidence of bodily injury and actual evidence that the bodily injury was caused by an occurrence" under any policy].) But an insurance coverage action cannot be used to adjudicate policyholder liabilities in any event. (*Hamilton, supra*, 27 Cal.4th at p. 734 [trial of policyholder's liabilities in coverage action "threatens to unfairly prejudice the insurer"]; *Smith v. State Farm Mut. Auto Ins. Co.* (1992) 5 Cal.App.4th 1104, 1112 [policyholder's liability to claimants must be adjudicated in proceedings separate from coverage action against insurers].)

C. *Untenable Premise No. 3*: That by Failing to Consent to Fuller-Austin's Settlements, LMI Waived All Rights Under Their Policies and Became Bound by the Bankruptcy Settlement.

Reality: **LMI had the Right Not to Consent to the Settlement; They Did Not Waive Their Reserved Rights By Asserting Them.**

In response to virtually every error raised by the excess insurers' appeals, Fuller-Austin repeats the same response: Waiver. Simply by failing to consent and indemnify Fuller-Austin for its bankruptcy settlement, Fuller-Austin argues, the insurers waived their policy rights to withhold indemnity and consent. (RB 79-82, 85.)[17]

Amazingly, the trial court adopted these specious waiver contentions. It instructed the jury that by exercising the contractual right to withhold consent to a reasonable settlement, an insurer forfeits that right. (Instr., 34 AA tab 153 at 9798-9799; 56 RT 11290.)

Fuller-Austin offers no facts at all showing waiver by the insurers. But even some supporting facts could not justify the erroneous jury

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[17] Fuller-Austin also argues that the insurers waived their rights (1) by failing to participate in discussions before the bankruptcy filing, despite the improper conditions it placed on their participation (RB 18-19); (2) by "abandoning" Fuller-Austin, although Fuller-Austin was fully defended and indemnified by its underlying insurers (RB 83-85); and (3) by offering no defense, although they owed no duty to defend (RB 84-85). These "abandonment" arguments are refuted Section I. A., above.

instructions, which effectively mandate waiver as a matter of law. As both a matter of fact and a matter of law, there was no waiver here.

1. By exercising their contractual right to withhold consent and indemnity for the settlement, LMI did not waive their rights to dispute coverage.

An insurer waives nothing by insisting upon the rights its policies afford. (*State of California v. Pacific Indemnity Co.* (1998) 63 Cal.App.4th 1535, 1556 [insurer's refusal to forego reservation of rights does not forfeit right to dispute coverage]; see *Buss v. Superior Court*, *supra*, 16 Cal.4th at p. 61, fn. 27 [insurer's refusal to abandon coverage rights precludes waiver of those rights].) The reason is simple. Waiver is the intentional relinquishment of a known right. (*Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 31.)[18]

Under their policies, LMI had every right to withhold their consent to Fuller-Austin's settlement, and to insist that both Fuller-Austin's liabilities and coverage under the policies must be established before an indemnity obligation can arise. They "had no obligation to pay for noncovered claims." (*Blue Ridge Ins. Co.*, *supra*, at p. 503.)

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[18] Any waiver evidence would have to satisfy a clear and convincing standard of proof, one that "does not leave the matter to speculation." (*Waller v. Truck Ins. Exchange, Inc.*, *supra*, 11 Cal.4th at pp. 31-32; *J.C. Penney Casualty Ins. Co. v. M. K.* (1991) 52 Cal.3d 1009, 1017-1018 [no waiver without affirmative evidence of insurer's intention to relinquish right]; see *Chase v. Blue Cross of California* (1996) 42 Cal.App.4th 1142, 1157 [party asserting waiver or forfeiture of contractual right must bear burden of proof by clear and convincing evidence].)

It is the insurers' reservations of rights that *prevent* a waiver; their reservations of rights could not at the same time constitute a waiver of those rights. (*Blue Ridge Ins. Co. v. Jacobsen*, *supra*, 25 Cal.4th at pp. 498-499 [reservation of rights prevents waiver of insurer's rights to require proof of coverage].) By definition, the insurers' assertion of their rights does not constitute evidence of any intention to relinquish those rights. The contrary jury instructions were unsupported as a matter of fact, and wrong as a matter of law.

2. *Diamond Heights* does not support Fuller-Austin's waiver theory.

The central pillar of Fuller-Austin's waiver thesis – *Diamond Heights Homeowners Assn. v. National American Ins. Co.* (1991) 227 Cal.App.3d 563 – does not support Fuller-Austin's position. (E.g., RB 83-85; see also RB 3, 10, 32, 79, 89, 92; RB–Spec. Issues 2-3, 13, 14.)

In *Diamond Heights*, the policyholder unilaterally settled with its claimants for more than the primary policy limits. The claimants (as the policyholder's assignees) then sued the nonconsenting excess insurers for amounts due under the settlement. The Court of Appeal held that an excess insurer's unreasonable breach of its coverage obligations by failing to participate in a reasonable settlement or to undertake its policyholder's defense after being offered a fair opportunity to do so, if established, could potentially bind the insurer to the settlement terms. (*Diamond Heights*, *supra*, 227 Cal.App.3d at p. 582.)

That's not our case, nor anything like it. Here are just a few reasons *Diamond Heights* does not apply.

First, here, unlike in *Diamond Heights*, the jury found that the insurers did not breach any coverage obligation before the settlement.

Second, unlike in *Diamond Heights*, LMI had been offered no realistic or fair opportunity to prevent Fuller-Austin's unilateral settlement, nor to undertake its defense. The pre-conditions Fuller-Austin imposed – abandonment by *all* excess insurers of all coverage defenses, all policy limits, and all reserved rights – were both improper and unreasonable. (TE 7683, 40 ExApp at 11636-11637; *Johansen v. California State Auto. Assn. Inter-Ins. Bureau* (1975) 15 Cal.3d 9, 19 [insurer need not abandon reservation of rights to dispute coverage while accepting settlement]; *State of California v. Pacific Indemnity Co., supra*, 63 Cal.App.4th at p. 1556 [insurer cannot be forced to forfeit policy rights]; see also *Blue Ridge Ins. Co. v. Jacobsen, supra*, 25 Cal.4th at p. 503 [insurer's insistence on express contractual rights violates no implied duties].)

Third, in *Diamond Heights*, unlike here, the insurer was afforded full notice of the proposed settlement and an opportunity to contest its reasonableness. (227 Cal.App.3rd at pp. 570, 582.) Here, the terms and timing of the bankruptcy settlement were not disclosed to LMI in advance. (36 RT 7245-7248 [Fuller-Austin did not seek insurer's consent for settlement until after bankruptcy filing]; see also TE 416, 13 ExApp at 3546.) And when they were disclosed, Fuller-Austin actively procured the excess insurers' exclusion from the bankruptcy proceedings – the only forum in which the settlement could or would be considered. (TE 525,

pp. 39-46, 69-70, 14 ExApp at 3997-3999, 4005; TE 544, 14 ExApp at 4045-4047.)

Fourth, *Diamond Heights* does not support the key premise of Fuller-Austin's position: that the insurers waived their rights without having breached any of their obligations. (E.g., RB 9-10, 79, 83-85, 92.) In *Diamond Heights*, it was specifically the insurer's *wrongful* conduct – "conduct constituting a breach of its obligations under the policy" – that gave rise to the waiver. (227 Cal.App.3d at p. 581.) But here, as the jury found, there was *no* pre-settlement breach.

Fifth, *Diamond Heights*' viability is placed in doubt by developments in the law since it was decided in 1991, which reject its thesis that a failure to participate in a reasonable settlement waives the right to withhold consent to a later settlement. (*Hamilton v. Maryland Casualty Co.*, *supra*, 27 Cal.4th at p. 730 [insurer that has breached its settlement obligations does not lose its policy's consent rights]; *Waller v. Truck Ins. Exch., Inc.*, *supra*, 11 Cal.4th at pp. 31-32 [no waiver without affirmative proof that insurer intentionally relinquished known right].) Under these cases, contrary to *Diamond Heights*, a defended policyholder's unilateral settlement – reasonable or not – does not suffice to establish an indemnity obligation. (*Hamilton v. Maryland Casualty Co., supra,* 27 Cal.4th at p. 730; *Travelers Casualty and Surety Co. v. Superior Court* (2005) 126 Cal.App.4th 1131, 1141 [when defended policyholder settles without the carrier's consent, "the insurer has no obligation to pay"].)[19]

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[19] Only if a settlement is both reasonable and essential to protect a (continued...)

Fuller-Austin's thesis that LMI and the other excess insurers waived their consent rights, and that they did so without having breached any coverage obligation, does not conform to the facts and is inconsistent with governing law.

3. The trial court prejudicially erred by instructing the jury that LMI and the other excess insurers lost their consent rights as a matter of law.

Fuller-Austin suggests the jury found as a fact that the insurers had waived their consent rights. (E.g., RB 9-10.) But the jury was given no choice.

The trial court effectively directed the waiver finding. The jury instructions directed that LMI lost their consent rights by refusing "to accept defense or indemnity" of claims against Fuller-Austin – even though the insurers had no defense duty, and no indemnity was yet owed. (Instr., 34 AA tab 153 at 9798-9799.)[20] And the trial court prohibited the excess

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[19] (...continued)
wrongly undefended policyholder does California law excuse the contractual consent requirement. (*Jamestown Builders, Inc. v. General Star Indemnity Co.* (1999) 77 Cal.App.4th 341, 348.) That exception could not possibly apply here. Here, there was no determination that the settlement was reasonable (see LMI-AOB 36-37); and Fuller-Austin was not left undefended by its insurers. (*Ibid.*)

[20] The jury was also instructed to find a waiver of the insurers' rights if the insurers denied liability for covered claims (and it was instructed to presume coverage for all claims); if the insurers failed to accept a reasonable settlement (and the jury was told the bankruptcy court found the settlement to be reasonable); or if the insurers abandoned Fuller-Austin (apparently, simply by denying a present liability). (Instr., 34 AA tab 153 (continued...)

insurers from so much as telling the jury that the policies afforded them a contractual right to withhold their consent. (RT 2/14/03, pp. 167-168 [court rules insurers' consent defense "is out"].)

These jury instructions eviscerated LMI's contractual rights, improperly binding the insurers to a settlement to which they did not consent. Because these instructions were erroneous and highly prejudicial, the judgment cannot stand; and because the record shows no basis for waiver at all, the judgment should be reversed with directions.

D. *Untenable Premise No. 4*: That Coverage Is Presumed Without Proof When an Insurer Refuses to Settle or Defend.

Reality: A Policyholder – Even a Wrongly Abandoned and Undefended Policyholder – Must Prove That Settled Claims Fall Within Policy Coverage.

The trial court instructed the jury that all existing and potential future asbestos claims against Fuller-Austin are (and will be) presumed to be within coverage under each excess policy, unless the insurers affirmatively established *noncoverage*. (31 AA tab 143 at 8948:1-15, 8949, ¶ 6; 34 AA tab 153 at 9790-9791.) That presumption erroneously relieved Fuller-Austin of its burden of proving coverage – a cardinal element of its coverage cause of action.

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[20] (...continued)
at 9798-9799.) These errors likewise compel reversal.

The coverage presumption contradicts the burden of proof imposed by law. Fuller-Austin's response does not even address – much less refute – any of the opening brief's legal and factual challenges to it. (LMI-AOB 44-48.)

1. Controlling law precludes presuming coverage.

"The burden is on an insured to establish that the occurrence forming the basis of its claim is within the basic scope of insurance coverage." (*Aydin Corp. v. First State Ins. Co.* (1998) 18 Cal.4th 1183, 1188, cited at LMI-AOB 45.) This rule is dispositive.

Fuller-Austin's response simply ignores *Aydin Corp.*, and three additional Supreme Court decisions that confirm this rule. (LMI-AOB 44-48, citing *Waller v. Truck Ins. Exchange, Inc.*, *supra*, 11 Cal.4th at p. 16; *Weil v. Federal Kemper Life Assurance Co.* (1994) 7 Cal.4th 125, 148; *Searle v. Allstate Life Ins. Co.* (1985) 38 Cal.3d 425, 437-438.)[21]

Even when an insurer has wrongfully failed to defend and its policyholder is forced to settle rather than suffer a judgment (not the case here, see § I. A), the rule is the same: The policyholder must affirmatively establish coverage. (*Pruyn v. Agricultural Ins. Co.* (1995) 36 Cal.App.4th

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[21] The factual premise for the trial court's coverage presumption – that the insurers failed to provide coverage (defense and indemnity) for the claims against Fuller-Austin – has been conclusively found by the jury's unchallenged special verdict to be spurious. (31 AA tab 143 at 8948- 8949 [trial court rules insurers' coverage denials justify presumption of coverage]; Spec. Verdict, 24 AA tab 129 at 6748; see *Untenable Premise No. 1*, § I.A. above.)

500, 514 [defaulting insurer is liable only for defense fees and *covered* indemnity sums]; *id.* at pp. 527-528, quoting *Lamb v. Belt Casualty Co.* (1935) 3 Cal.App.2d 624, 631 [question whether settling policyholder's liability "was one which the contract of insurance covered" remains to be litigated]; see also *Peter Culley & Associates v. Superior Court* (1992) 10 Cal.App.4th 1484, 1497 [settling indemnitee "must show the liability is covered by the contract . . . ."]; *Walters v. American Ins. Co.* (1960) 185 Cal.App.2d 776, 785 [settlement resulting from insurer's wrongful failure to defend leaves coverage for future adjudication]; *Zurich Ins. Co. v. Killer Music, Inc.* (9th Cir. 1993) 998 F.2d 674, 679-680 [non-defending insurer is not liable for non-covered portion of settlement].)[22]

Rather than addressing these authorities, Fuller-Austin asserts that two other decisions say what they do not. Quoting from *Armstrong World Industries, Inc. v. Aetna Casualty & Surety Co.*, (1996) 45 Cal.App.4th 1, 85-86, and citing *Pruyn v. Agricultural Ins. Co*, *supra*, 36 Cal.App.4th at pp. 527-528, Fuller-Austin misrepresents that they hold "a settlement by an abandoned insured" raises a presumption that claims against it are covered. (RB 65; see also RB 93.) These decisions say no such thing. (Nor was Fuller-Austin "an abandoned insured"; see § I.A, above.)

The presumption approved by *Armstrong* and *Pruyn* is wholly different: liability of the policyholder *to its claimants* is presumed.

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[22] There is *one* possible exception: where an undefended insured is forced to suffer a default judgment. (*Amato v. Mercury Casualty Co.* (1997) 53 Cal.App.4th 825, 831 (*Amato II*).) Whether that rule is right or wrong, it does not apply here. Fuller-Austin was not undefended (wrongfully or otherwise), nor did it suffer any resulting default judgment.

(*Armstrong, supra*, 45 Cal.App.4th at p. 86; *Pruyn, supra*, 36 Cal.App.4th at pp. 527-528; see also *Isaacson v. California Ins. Guarantee Assn.* (1988) 44 Cal.3d 775, 791 [insurer's wrongful failure to settle raises presumption "that the insured is indeed liable to the claimant"].) Neither *Armstrong* nor *Pruyn* approves a presumption that the policyholder's liability to its claimants is *covered*, or that the insurer must provide indemnity for it. Indeed, *Armstrong* elsewhere confirms that it is the policyholder's burden to prove coverage – that its liabilities arose from "actual exposure to the defendant's product." (*Armstrong, supra*, at p. 59, fn 23.)

2. The erroneous coverage presumption prejudiced LMI.

Erroneously misplacing the burden of proving any element of a party's cause of action is always likely to be prejudicial. (*Buzgheia v. Leaseco Sierra Grove* (1997) 60 Cal.App.4th 374, 393-398 [error placing burden of proof on wrong party is "major instructional error"].) Here, the erroneous ruling effectively eliminated the central element in the entire case – Fuller-Austin's need to prove coverage.[23]

In this case, the resulting prejudice is not just likely – it is certain. Because proof of coverage for not-yet-asserted claims is impossible, the

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[23] The record must be viewed in LMIs' favor, presuming that the jury might have found in their favor under proper instructions. (*Henderson v. Harnischfeger Corp.* (1974) 12 Cal.3d 663, 674; *Mock v. Michigan Millers Mutual Ins. Co.* (1992) 4 Cal.App.4th 306, 322.) Because Fuller-Austin failed to present evidence of coverage (and indeed, the trial court barred any such evidence, see 23 RT 4522), under proper instructions the verdict and judgment would necessarily have absolved LMI of liability.

error eliminated an impossible burden of proof, bestowing on Fuller-Austin a judgment that would otherwise have been unattainable.[24] Under the trial court's erroneous paradigm a policyholder need *never* prove coverage: If the insurer denies coverage, it is presumed. But the policies and the law require Fuller-Austin to prove that the indemnity it seeks arises from injuries within coverage under LMIs' policies.

The erroneous coverage presumption and prejudicial instructions alone compel the judgment's reversal. And the failure of proof of coverage requires that the reversal be with directions to enter judgment in favor of LMI.

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[24] Until a claim is asserted, no indemnity duty can possibly arise. (*Powerine*, *supra*, 24 Cal.4th at p. 968 [until policyholder is sued, "the duty to indemnify cannot arise because 'damages,' i.e., money ordered by a court, cannot be fixed in their amount since they have not been sought in the first place"].)

E. *Untenable Premise No. 5*: That the Insurers Must Presently Indemnify Fuller-Austin for Estimated Potential Future Liabilities and Must Do So in Amounts Greater Than Fuller-Austin Is – or Will Be – Obligated to Pay to Claimants When its Actual Liabilities Are Established.

Reality: The Insurers Owe No Indemnity Obligation Before Fuller-Austin Becomes Obligated to Pay its Claimants, or for Amounts Greater Than Fuller-Austin Is Actually Obligated to Pay.

LMIs' opening brief demonstrates that the judgment impermissibly imposes a present indemnity liability for amounts not yet owed by Fuller-Austin, and for the theoretical amounts recited in the negotiated bankruptcy plan rather than what Fuller-Austin will actually be obligated to pay to resolve asbestos claims. (LMI–AOB 49-59.) Fuller-Austin's response does not address the controlling authorities presented in LMIs' opening brief, nor does it offer any contrary authorities. (RB 50-54.)

1. The bankruptcy plan did not establish or fix the amount of Fuller-Austin's present liabilities for claims against it.

Without supporting authority, Fuller-Austin argues that its "present liability" includes "future liabilities"; that the judgment reflects its "present liability for . . . not-yet-filed claims." (RB 94; see also RB 100; RB–Spec. Issues 10.) But that's doublespeak. "Future" does not mean "present," just

as "yes" does not mean "no." Claims that will not arise until sometime in the future are, by definition, not "present" liabilities.

Nor do the plan's "allowed" amounts represent present payment obligations. Rather, the trust pays each present claimant a *reduced* amount, determined from time to time under plan procedures; it reserves the difference to enable it to satisfy claimants long into the future. (Plan CRP, TE 383, 9 ExApp at 2514-2515, 2523; TE 551 ¶ 79, 14 ExApp at 4072; see LMI–AOB 11.) And Fuller-Austin will not be obligated to pay the plan's nominal allowed amounts even to resolve future claims as they are asserted. The "allowed" amounts recited in the bankruptcy plan are wholly nominal; they do not represent amounts Fuller-Austin is obligated – or ever will be obligated – to pay to its claimants.

2. Adhering to the terms of the policies creates no windfall for the insurers.

Fuller-Austin argues that enforcing the policies according to their written terms would, in light of its bankruptcy, result in a "windfall" to the insurers that would violate public policy. (RB 50-54.) Just the opposite is true. The judgment does provide a windfall, but only for Fuller-Austin: It awards a present indemnity for amounts Fuller-Austin will become obligated to pay (if at all) only in the future, and for amounts greater than what Fuller-Austin will ever be required to pay.

The relevant question is not whether an insurance policy *should* provide coverage for public policy reasons, but whether the policy *does* provide coverage according to its terms: "The answer is to be found solely

in the language of the [insurance] policies, not in public policy considerations." (*Rosen v. State Farm General Ins. Co.* (2003) 30 Cal.4th 1070, 1078, citing *Powerine, supra*, 24 Cal.4th 945; *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 818; *Foster-Gardner, Inc. v. National Union Fire Ins. Co., supra*, 18 Cal.4th at p. 888 [policy language cannot be rewritten to advance public policy].) Public policy is confounded when contract terms are ignored and distorted.

Fuller-Austin correctly contends that Insurance Code section 11580 protects bankrupt policyholders from recovering *less* than their policies provide. (RB 9, 51.) But nothing in section 11580 entitles a bankrupt policyholder to recover *more* in indemnity than it pays to its claimants, or to recover indemnity *sooner* than it would otherwise be entitled to under its policy.

The only windfall here is the one the judgment improperly bestows on Fuller-Austin, affording Fuller-Austin benefits that neither the policies nor the law allows.

3. Neither *UNR Industries, Inc.* nor any other cases help Fuller-Austin.

Fuller-Austin's comparison of this case to *UNR Industries, Inc. v. Continental Casualty Co.* (7th Cir. 1991) 942 F.2d 1101 (RB 52-57) is faulty for the many reasons cited in the opening brief – none of which Fuller-Austin refutes. (LMI-AOB 54-56.)

It is of no consequence what the *UNR* court understood to be the law of Illinois in 1991. California law governs this case. Under California law,

Fuller-Austin's bankruptcy settlement does not establish its liabilities to claimants, and cannot bind its insurers. (*Hamilton v. Maryland Casualty Co.*, *supra*, 27 Cal.4th at p. 726; *Wolkowitz v. Redland Ins. Co.*, *supra*, 112 Cal.App.4th at pp. 163-166, see *In Re Combustion Engineering, Inc.*, *supra*, 391 F.3d at p. 223.) And in this case (unlike in *UNR*), the bankruptcy court expressly ruled that its judgment *did not* establish those liabilities and *could not* bind the insurers. (TE 383, 9 ExApp at 2513 § 1.3 [plan creates no "substantive right for any claimant"].)

Fuller-Austin's reliance on *Webster v. Superior Court* (1988) 46 Cal.3d 338, 345-346 (RB 51-52) is equally misplaced. Nothing in *Webster* suggests a carrier can be required to pay an insured more than the insured must pay the injured party. Rather, *Webster* suggests that the insurers of an insolvent tortfeasor must pay the claimant *exactly* the amount of the tortfeasor's liability, measured by an actual judgment adjudicating the tortfeasor's liability to its claimants and *not* by any artificially determined amount, just as *Hamilton* requires. That's exactly our point.

LMIs' obligations to indemnify Fuller-Austin arise, if at all, only after Fuller-Austin is obligated to pay fixed amounts to its claimants, and then only in the amounts Fuller-Austin is legally obligated to pay. The erroneous judgment must be reversed.

F. *Untenable Premise No. 6*: That the Excess Insurers Are Bound Because the Bankruptcy Settlement Exhausted Underlying Coverage and Triggered Their Coverage Obligations.

Reality: The Record Indisputably Shows that Primary and Underlying Excess Coverage Layers Were Not Fully Exhausted.

The opening brief demonstrates that the trial court erred by ruling and instructing the jury that underlying coverage was exhausted as a matter of law. (See Instr., 31 RT 6158:7-9 [underlying coverage exhausted as a matter of law]; 34 AA tab 153 at 9785, 56 RT 11280-11281 [exhaustion occurs when insurer has settled with Fuller-Austin].) Fuller-Austin's primary and underlying excess coverage was *not* yet exhausted when Fuller-Austin entered into its bankruptcy settlement, or anytime before judgment was entered. And even if the record could support a finding that underlying coverage was at some point exhausted, it was error for the trial court to withdraw the issue from jury consideration. (LMI-AOB 59-62.)

Fuller-Austin offers no tenable response. By arguing only that the record contains *substantial evidence* of exhaustion, it effectively concedes error in requiring the jury to find that all of the underlying policies were exhausted as a matter of law. And by arguing only that underlying coverage was exhausted *after* judgment was entered, it effectively concedes that underlying coverage was not exhausted anytime *before* entry of judgment. (RB 94-98.)

Fuller-Austin also ignores the opening brief's demonstration that no exhaustion finding can be inferred from the verdict because, no matter what evidence the jury might have believed, the instructions precluded it from reaching the issue. (LMI-AOB 61; see RB 32.)[25] It does not refute the fact that substantial coverage owed by primary and underlying excess insurers remained unpaid even when judgment was entered – precluding full exhaustion as a matter of law. (LMI-AOB 60 & fn. 28.) And it dodges the California decisions that require actual *payment* of the underlying limits as a precondition to exhaustion. (E.g., *Farmers Ins. Exchange v. Hurley* (1999) 76 Cal.App.4th 797, 804; see citations LMI-AOB 59 fn. 27, 61.)

Fuller-Austin is not aided by *Phoenix Ins. Co. v. United States Fire Ins. Co.* (1987) 189 Cal.App.3rd 1511, 1530.) (RB 32) *Phoenix* was an equitable action for indemnity between insurers; it does not address or purport to apply to the contract-based legal rights of parties to an insurance policy. (*Phoenix Ins. Co.*, *supra*, at p. 1524.) Nor does *Phoenix* purport to hold that the underlying insurers' payment of less than all underlying policy limits in settlement suffices to trigger an excess insurer's obligation to indemnify its policyholder.[26]

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[25] By instructing the jury that underlying coverage was exhausted as a matter of law (31 RT 6158:7-9), and that settlements – whether paid or not – constitute exhaustion (34 AA tab 153, at 9785-9786; 56 RT 11280-11281), the challenged instructions prevented any such determination. (See LMI-AOB 60-62.) And even if (as Fuller-Austin wrongly argues, RB 32) the jury had found that *primary* coverage was exhausted, that still could not establish exhaustion of the multi-layers of underlying *excess* coverage.

[26] The statement in *Phoenix* that the other insurers' policies were exhausted "in effect" does not announce a legal ruling, but merely

(continued...)

Phoenix's premise (that underlying coverage is exhausted when all underlying insurers have "fully paid" their settlement amounts) supports LMI, not Fuller-Austin. (RB 32; see SOD Ph. 2B, 34 AA tab 153, at 9750-9752.) The record indisputably shows that the underlying settlements *were not* "fully paid" anytime before entry of judgment.[27] A policyholder cannot unilaterally accelerate its right to indemnity from its excess policies by contractually excusing and delaying its underlying insurers' coverage obligations. (See authorities, LMI-AOB 61-62.)[28]

Because the rulings and instructions erroneously relieved Fuller-Austin's burden of proving exhaustion – an essential element of its cause of action – reversal of the judgment is required. And because uncontroverted evidence shows that underlying coverage *was not* exhausted even when judgment was entered (much less when the bankruptcy

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[26] (...continued)
acknowledges that the exhaustion issue had been resolved by the previous arbitration decision in that case. (*Id.* at pp. 1529-1530.)

[27] The record shows indisputably that some primary and underlying excess insurers did not fully settle their liabilities to Fuller-Austin until long after Fuller-Austin's bankruptcy settlement. And even when judgment was entered years later, some primary and underlying excess insurers still had yet to pay some underlying settlement amounts – conclusively negating full exhaustion even then. (TE 874, 16 ExApp at 4428; TE 878, 16 ExApp at 4569-4571 [settlement provides for future exhaustion of underlying insurer's coverage only after payments in 2004 or 2006; see record citations, LMI-AOB 60 & fn. 28.)

[28] Because it is undisputed that the bulk of the funding for the Baggett settlement was neither paid, nor even due, when Fuller-Austin entered into its bankruptcy settlement (see LMI-AOB 63 & fn. 31), the erroneous jury instructions also improperly directed the jury to find exhaustion of the Cities Service coverage. (See Section III, below.)

settlement was confirmed), the reversal should be with directions to enter judgment for LMI.

II. FULLER-AUSTIN DOES NOT ADDRESS – AND THEREBY EFFECTIVELY CONCEDES – LMIs' FULL FAITH AND CREDIT, DUE PROCESS, AND COLLATERAL AND JUDICIAL ESTOPPEL CHALLENGES.

Fuller-Austin's utter silence on the issues of full faith and credit, due process, collateral estoppel, and judicial estoppel tacitly acknowledges that it has no answers to the judgment's violations of these principles. (See *Shoemaker v. County of Los Angeles* (1995) 37 Cal.App.4th 618, 633, fn. 17 [court will not consider points not argued].)

The judgment must be reversed: As a matter of full faith and credit, as well as collateral estoppel, the trial court is bound by the bankruptcy court's rulings that Fuller-Austin's liabilities to claimants could not be determined (see LMI-AOB 38-40); as a matter of due process and collateral estoppel, the bankruptcy court's non-adversarial proceedings from which the insurers were excluded cannot bind LMI and the other excess insurers (LMI-AOB 40-41); and as a matter of judicial estoppel (and fundamental fairness), Fuller-Austin cannot be permitted to game the system, as it has intentionally done here.

Fuller-Austin has thus far triumphed in a shell game in which no pea is ever produced. The judgment rests on duplicity – making one representation to the bankruptcy court and the opposite to the trial court.

(LMI-AOB 42-44.) At stake is not just the multi-million-dollar judgment in this case, but the integrity of the judicial system.

III. THE VERDICT AGAINST LMI ON THE CITIES SERVICE POLICIES IS FATALLY DISCREDITED BY THE RECORD.

LMIs' appeal challenges the $17.6 million Cities Service verdict against LMI upon four grounds, each independently requiring reversal. (LMI-AOB § VI, at 62-68.)[29] Fuller-Austin does not respond at all to two of the reasons; as to the other two, it asserts only that the undisputed errors were harmless. (RB–Spec. Issues § VI, pp. 42-47.)

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[29] The Cities Service award against LMI is also vitiated by the issues raised in this appeal with respect to the General policies. For example: (1) Fuller-Austin's Baggett settlement without any adjudication of Fuller-Austin's liabilities or the insurers' consent; (2) the absence of any special verdict that the Baggett settlement was fair and reasonable; (3) the erroneous presumption (as to the portion of the Baggett settlement subsumed within the bankruptcy settlement) that potential future claims are within coverage; (4) the improper requirement that LMI must indemnify Fuller-Austin for more, and sooner, than Fuller-Austin must pay its Cities Service claimants, and (5) the erroneous jury instructions that underlying coverage was exhausted as a matter of law, and was exhausted by settlements whether paid or not.

A. Fuller-Austin's Response Fails to Identify Any Facts That Support the Jury's Finding that LMI Breached Its Cities Service Policies' Obligations Before Fuller-Austin's Bankruptcy Confirmation.

LMIs' appeal advanced a straightforward substantial-evidence challenge to the $17.6 million Cities Service judgment. It demonstrated the total absence of evidence to support the jury's special verdict that sometime before the bankruptcy confirmation LMI had breached some obligation – arising apparently from the pre-bankruptcy Baggett settlement – owed under the Cities Service policies. (LMI-AOB 62-63.)[30]

Fuller-Austin offers no response. It cites no evidence that supports the special verdict, and it disputes none of the key facts: that the Baggett settlement called for two payments; that a primary insurer had paid the first installment; and that the second installment did not become due until after Fuller-Austin's bankruptcy settlement. (See record citations at LMI-AOB 5-7, 59-60.)[31]

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[30] As discussed in section I.B, above, even an insurer's failure to consent to a reasonable settlement does not justify a policyholder's unilateral settlement of claims.

[31] The Baggett settlement contracted to resolve, in two stages, 100 existing and 558 potential future claims allegedly arising from asbestos exposures at the Cities Service worksite. Fuller-Austin's later bankruptcy settlement subsumed the 558 potential future Baggett claims for which payment was not yet due under the previous settlement. (TE 384, 10 ExApp at 2716-2717 & fn. 3, 2721; TE 551, 14 ExApp at 4085 ¶ 143; TE 552, 15 ExApp at 4135, ¶ 74; TE 2116, 24A ExApp at 6874.4; 36 RT 7191; 52 RT 10348, 10445, 10447; 17 RT 3004.)

Nor does Fuller-Austin challenge the irrefutable inferences compelled by these facts:

First, the fact that a primary insurer made the initial Baggett settlement payment conclusively confirms that, at least until then, underlying coverage had not yet been fully exhausted. LMIs' obligation to provide indemnity therefore could not yet have arisen and there could not yet have been any breach by LMI.

Second, LMIs' failure to make the second Baggett settlement payment before the bankruptcy settlement constituted no breach, because the second payment was not yet even due when the bankruptcy settlement was adopted.

The record thus conclusively shows no breach before the Baggett settlement, and no breach after the Baggett settlement but before the bankruptcy settlement. Together, they compel a dispositive conclusion: The special verdict finding and the $17.6 million Cities Service award against LMI have no support in the record. The Cities Service judgment must be reversed with directions to enter judgment for LMI.

B. By Its Silence, Fuller-Austin Effectively Concedes Its Failure to Prove Coverage under the Cities Service Policies.

LMI challenged the absence of evidence to meet Fuller-Austin's burden of proving coverage under the Cities Service policies – that the claimed injuries arose from exposure to asbestos at the insured Cities Service site during coverage under a particular policy or policies.

(LMI-AOB § VI.C, at 66.)[32] Fuller-Austin has no response; it effectively concedes its failure to meet its admitted burden of proof.

Fuller-Austin's silence on this issue is hardly surprising. The settled Cities Service claims that remained unpaid when Fuller-Austin filed for bankruptcy consisted entirely of *potential future* claims – claims anticipated to be asserted during the next 40 years – for which proof of coverage (or noncoverage) was impossible.

Fuller-Austin's failure to offer evidence to meet its unquestioned burden of proving coverage – proof that is indispensable to the $17.6 million Cities Service verdict – requires the judgment's reversal with directions to enter judgment for LMI on the Cities Service claims.

C. The Trial Court's Erroneous Refusal to Follow Louisiana Law Prejudiced LMI.

The controlling law with respect to the Cities Service policy obligations is that of Louisiana. But the trial court refused to apply the "exposure" trigger that Louisiana law requires, instead applying a "continuous" trigger to the Cities Service claims. It did so explicitly in order to enlarge the award. (LMI-AOB 64-66; see Ph. 1B SOD,

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[32] The jury was instructed (erroneously, we contend, see LMI-AOB 44-48 & § I.E, above) that for the General policies, the excess insurers had the burden to prove the absence of coverage. But for claims under the Cities Service policies that were resolved by the first Baggett settlement payment, the trial court did not reverse the normal burden of proof, ruling and correctly instructing the jury that Louisiana law placed the burden on Fuller-Austin to prove coverage. (Instr., 34 AA tab 153 at 9790, 56 RT 11278:6-9.)

31 AA tab 143 at 8920 [continuous trigger "should apply" to Cities Service policies in order to fulfill policy of "maximizing insurance coverage"].)[33]

But the Louisiana Supreme Court has *rejected* the continuous trigger. It held in *Cole v. Celotex Corp.* (La. 1992) 599 So.2d 1058, that Louisiana applies an exposure trigger for coverage of asbestos claims. (See Ph. 1B SOD, 31 AA tab 143 at 8920 [trial court rules that "[t]he Supreme Court of Louisiana adopted an 'exposure' trigger of coverage in asbestos insurance coverage cases"].) The trial court's result-driven decision constitutes error as a matter of law. (See controlling authorities cited LMI-AOB 65.)

Fuller-Austin argues that the error is harmless because its expert at trial actually applied an exposure trigger in reaching his conclusions (despite the trial court's contrary ruling). (RB–Spec. Issues, 43.) But its evidence shows exactly the opposite. The expert projected future liabilities not just for exposures arising in each listed year, but for exposures in *and after* each year, and beginning decades before LMIs' first coverage of Cities Service liabilities. (RB–Spec. Issues p. 43, citing 46 RT 9261-9262.)[34] The record thus confirms that the error was not harmless – that the Cities

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[33] As we noted in the opening brief (LMI-AOB 64, fn. 32), a "continuous" coverage trigger maximizes coverage because under it, all policies in effect from the date of the claimant's first exposure to any asbestos-containing product until the date of death or claim, whichever is first, provide coverage for the claim. Under an "exposure" trigger, however, a claim is covered only by policies on the risk during a claimant's exposure to asbestos; earlier and later policies provide no coverage. (Ph. 1B SOD, 31 AA tab 143 at 8922; *Cole v. Celotex Corp.*, *supra*, 599 So.2d at pp. 1075-1077.)

[34] The testimony and correspondence about settlement negotiations that Fuller-Austin cites (RB–Spec. Issues pp. 43-44 & fn. 13) contain no admissions that coverage had been triggered, or that the appropriate trigger was continuous.

Service judgment rests on the erroneous continuous trigger standard, prejudicially imposed in order to inflate the judgment.

D. There Is No Evidence that the Cities Service Policies' Minimum Coverage Threshold was Triggered in any Policy Year.

In the trial court and in this appeal, LMI showed that their Cities Service policies provide coverage only above unambiguous attachment points of $100,000 per person or $300,000 per accident (or $100,000 per occurrence if there were no underlying coverage) for three of its policies, and above $1 million per person for the fourth. (TE 62, 64, 4 ExApp at 1111, 1135, 1137; TE 65, 66, 5 ExApp at 1157, 1160, 1200.) LMIs' appeal challenged the absence of evidence that any existing or future claim had reached or would reach these attachment points under any Cities Service policy. (LMI-AOB 67.)

Fuller-Austin's response makes no attempt to show any such evidence exists. (RB–Spec. Issues, pp. 44-47)[35] In place of evidence showing trigger of coverage under any Cities Service policy, Fuller-Austin suggests only that an LMI witness admitted as much. (RB–Spec. Issues,

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[35] The record is clear that Fuller-Austin offered no evidence showing what policy or policies might cover any particular claim. (56 RT 11344-11353.) Fuller-Austin's response cites a blank page and an irrelevant non-Cities Service policy. The remaining three cited policies support LMIs' challenge. (RB–Spec. Issues p. 45.)

pp. 46-47.) But the cited testimony shows nothing of the sort. It refers only to settlement positions and discussions; it contains no admissions.[36]

Because there is no proof that any claim would reach the attachment point or would come within coverage under any Cities Service policy, the Cities Service portion of the judgment must be reversed with directions to enter judgment in favor of LMI.

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[36] The cited discussions arose from Fuller-Austin's generalized representations about the existence of potential future claims; there was no proof of those claims, nor any admission that any claims (when and if they might be asserted) would be valid or would suffice to trigger coverage under any policy. (52 RT 10315-10316 [erroneously cited at RB–Spec. Issues p. 47 as 52 RT 10309-10310].)

CONCLUSION

Fuller-Austin has had its day in court, but failed to prove its case. LMI was not provided the same opportunity, but has shown that as a matter of law the judgment against it must be reversed in its entirety, and the reversal must be with directions to enter judgment in favor of LMI.

Dated: August 3, 2005

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CERTIFICATION

Pursuant to California Rules of Court, rule 14(c), I certify that this **APPELLANTS' REPLY BRIEF FOR CERTAIN UNDERWRITERS AT LLOYD'S LONDON, and CERTAIN LONDON MARKET INSURANCE COMPANIES** contains 10,857 words, not including the tables of contents and authorities, caption page, signature blocks, or this Certification page.

Dated: August 3, 2005

Peter O. Israel