UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WINDERMERE OAKS WATER SUPPLY CORPORATION; DANA MARTIN; WILLIAM EARNEST; THOMAS MICHAEL MADDEN; ROBERT MEBANE; PATRICK MULLIGAN; JOE GIMENEZ; DAVID BERTINO; MIKE NELSON; DOROTHY TAYLOR; and NORMAN MORSE,	§	**CIVIL ACTION NO.: 1:21-CV-258-RP**
Plaintiffs,	§	
v.	§	
ALLIED WORLD SPECIALTY INSURANCE COMPANY	§	
Defendant,	§	

PLAINTIFFS' MOTION FOR PARTIAL SUMMARY JUDGMENT ON THE DUTY TO DEFEND AND BRIEF IN SUPPORT

Pursuant to Rule 56(b) of the Federal Rules of Civil Procedure and in accordance with this Court's Local Rules, Windermere Oaks Water Supply Corporation ("WSC"), Dana Martin, William Earnest, Thomas Michael Madden, Robert Mebane, Patrick Mulligan, Joe Gimenez, David Bertino, Mike Nelson, Dorothy Taylor, and Norman Morse (the "Directors") (collectively with WSC, the "Plaintiffs") file this Brief in Support of their Motion for Partial Summary Judgment on the Duty to Defend (the "Motion") and respectfully would show this Court as follows:

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii
I. Statement of the Issues Presented 1
II. Summary of the Argument 1
III. Summary Judgment Evidence 2
IV. Background 2
A. Factual Allegations in the Underlying Lawsuit 2
B. Request for Coverage and Allied World's Wrongful Denial of Coverage 9
V. Arguments and Authorities 10
A. Standard of Review and Burden of Proof 10
B. The Underlying Lawsuit Implicates the Duty to Defend 11
1. The Duty to Defend, Generally 11
2. The Requirements of the Coverage A. Insuring Agreement are Met 12
a. Insured 13
b. "Damages" 13
c. "Wrongful Act" 14
d. "Claim" and the Related Claims Provision 15
3. No Exclusions Preclude the Duty to Defend 15
a. The Contractual Liability Exclusion is Inapplicable 15
b. The Criminal Acts and Violation of Laws Exclusions are Inapplicable 21
C. Allied World Violated the Prompt Payment of Claims Act by Failing to Defend 24
III. Conclusion 26
CERTIFICATE OF SERVICE 27

TABLE OF AUTHORITIES

Cases

Admiral Ins. Co., Inc. v. Briggs, 264 F. Supp. 2d 460 (N.D. Tex. 2003). 16, 17, 18
Agredano v. State Farm Lloyds, 975 F.3d 504 (5th Cir. 2020) 24, 25
Am. Chem. Soc. v. Leadscope, Inc., No. 04AP–305, 2005 WL 1220746 (Ohio Ct. App. May 24, 2005). 18
Anadarko Petroleum Corp. v. Houston Cas. Co., 573 S.W.3d 187 (Tex. 2019). 22
Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986). 10

Apache Corp. v. Castex Offshore, Inc., No. 14-19-00605-CV, --- S.W.3d ---, 2021 WL 1881213 (Tex. App.—Houston [14th Dist.] May 11, 2021, no pet.) 22

Archon Investments, Inc. v. Great Am. Lloyds Ins. Co., 174 S.W.3d 334 (Tex. App.—Houston [1st Dist.] 2005, pet. denied). 12

Balandran v. Safeco Ins. Co. of Am., 972 S.W.2d 738 (Tex. 1998). 19

Barbara Techs. Corp. v. State Farm Lloyds, 589 S.W.3d 806 (Tex. 2019). 24

Canutillo Indep. Sch. Dist. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 99 F.3d 695 (5th Cir. 1996) 10

Celotex Corp. v. Catrett, 477 U.S. 317 (1986) 10

Church Mut. Ins. Co. v. U.S. Liab. Ins. Co., 347 F. Supp. 2d 880 (S.D. Cal. 2004) 18, 20

Clark Sch. For Creative Learning, Inc. v. Philadelphia Indem. Ins. Co., No. CIV.A. 12-10475-DJC, 2012 WL 6771835 (D. Mass. Dec. 26, 2012). 18

Colony Nat'l Ins. Co. v. United Fire & Cas. Co., 677 F. App'x 941 (5th Cir. 2017). 12

Federated Mut. Ins. Co. v. Grapevine Excavation Inc., 197 F.3d 720 (5th Cir. 1999). 10

Gore Design Completions, Ltd. v. Hartford Fire Ins. Co., 538 F.3d 365 (5th Cir. 2008). 11, 12

Guaranty Nat'l Ins. Co. v. Vic Mfg. Co., 143 F.3d 192 (5th Cir. 1998). 11, 15

Higginbotham v. State Farm Mutual Auto. Ins. Co., 103 F.3d 456 (5th Cir. 1997) 24

Hussong v. Schwan's Sales Enters., Inc., 896 S.W.2d 320 (Tex. App.—Houston [1st Dist.] 1995, no writ) 17

King v. Dallas Fire Ins. Co., 85 S.W.3d 185 (Tex. 2002). 19

Lamar Homes, Inc. v. Mid-Continent Cas. Co, 242 S.W.3d 1 (Tex. 2007) 24

Lawyers Title Ins. Corp. v. Doubletree Partners, L.P., 739 F.3d 848 (5th Cir. 2014). 11

Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574 (1986) 10

McPeek v. Travelers Cas. & Surety Co. of Am., No. 2:06-CV-114, 2006 WL 1308087 (W.D. Pa. May 10, 2006). 17, 18, 19

Mid-Continent Cas. Co. v. JHP Dev., Inc., 557 F.3d 207 (5th Cir. 2009) 11

Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. CBI Indus., Inc., 907 S.W.2d 517 (Tex. 1995) 19

Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Merchants Fast Motor Lines, Inc., 939 S.W.2d 139 (Tex. 1997) 11

Ooida Risk Retention Group, Inc. v. Williams, 579 F.3d 469 (5th Cir. 2009) 19

Ortiz v. State Farm Lloyds, 589 S.W.3d 127 (Tex. 2019). 24

Pendergest-Holt v. Certain Underwriters at Lloyd's of London, 600 F.3d 562 (5th Cir. 2010). 23

Pine Oak Bldrs., Inc. v. Great Am. Lloyds Ins. Co., 279 S.W.3d 650 (Tex. 2009). 23, 24

Primrose Operating Co. v. Nat'l Am. Ins. Co., 382 F.3d 546 (5th Cir. 2004).....12

Richards v. State Farm Lloyds, 597 S.W.3d 492 (Tex. 2020).....23

St. Paul Reinsurance Co., Ltd. v. Greenberg, 134 F.3d 1250 (5th Cir. 1998).....24

Tovar v. State, 978 S.W.2d 584 (Tex. Crim. App. 1998).....22

Trammell Crow Residential Co. v. Virginia Surety Co., Inc., 643 F. Supp. 2d 844 (N.D. Tex. 2008).....24

Valmont Energy Steel, Inc. v. Commercial Union Ins. Co., 359 F.3d 770 (5th Cir. 2004).....19

Virginia Mason Med. Ctr. v. Executive Risk Indem. Inc., No. C07-0636MJP, 2007 WL 3473683 (W.D. Wash. Nov. 14, 2007).....23

Westport Ins. Corp. v. Hanft & Knight, P.C., 523 F. Supp. 2d 444 (M.D. Pa. 2007).....23

Statutes

TEX. BUS. ORGS CODE ANN. § 20.002 (West 2021).....13

TEX. GOV'T CODE ANN. § 551.144 (West 2021).....22

TEX. INS. CODE ANN. § 542.060 (West 2021).....24

TEX. INS. CODE ANN. § 554.002 (West 2021).....11, 15

Other Authorities

NEW OXFORD AMERICAN DICTIONARY 1978 (Angus Stevenson & Christine Lindberg eds., 3d ed. 2010).....22

Treatises

Elizabeth S. Miller & Robert A. Ragazzo, *The* Ultra Vires *Doctrine*, 20 TEX. PRAC., BUS. ORGS. § 27:9 (3d ed.).....13

I. STATEMENT OF THE ISSUES PRESENTED

1. Under the terms of the Policy (defined *infra*) and Texas law, whether Allied World Specialty Insurance Company ("Allied World") breached and continues to breach its duty to provide Plaintiffs with a defense against the claims made in the underlying lawsuit styled *Rene Ffrench, et al. v. Friendship Homes & Hangars, LLC, et al.*; Cause No. 48292 pending in the 33rd Judicial District Court of Burnet County, Texas (the "Underlying Lawsuit").

2. If Allied World breached and continues to breach the duty to defend by failing and continuing to refuse to provide Plaintiffs with a defense, whether Plaintiffs are entitled to their past and future defense costs incurred in the Underlying Lawsuit, their attorneys' fees in this matter, and statutory damages under the Texas Prompt Payment of Claims Act, codified at Section 542.051 *et seq.* of the Texas Insurance Code.

II. SUMMARY OF THE ARGUMENT

This is an insurance coverage dispute. The insuring agreement of the Policy issued by Allied World imposes upon Allied World a duty to defend the insureds against a "claim" for a "wrongful act," as those terms are defined in the Policy. Under Texas law, an insurer's duty to defend is triggered if any allegation against the insured raises even a mere *potential* for coverage under the Policy. Because, in this case, there were allegations in prior pleadings and there are allegations in the live pleading that trigger the insuring agreement, Allied World has the burden to establish that an exclusion bars coverage. Allied World cannot meet this heavy burden without improperly reading facts into the pleading or without improperly relying on extrinsic evidence in contravention of the established duty-to-defend standards in Texas. Thus, Allied World breached and continues to breach its duty to defend Plaintiffs.

Allied World's breach of contract by its refusal to defend means that it is liable for statutory damages under the Texas Prompt Payment of Claims Act, the amount of which is a factual issue not presented before the Court in this Motion. Rather, once this Court rules that Allied World has a duty to defend, counsel will confer about a potential resolution of the amount of defense costs, expenses, attorneys' fees, and penalties owed because of Allied World's breach.

III. SUMMARY JUDGMENT EVIDENCE

In support of this Motion, Plaintiffs rely on the following evidence:

- Affidavit of Joe Gimenez, a copy of which is attached as Exhibit "A" to this Motion, and the following Documents attached thereto:
  - Document 1: Policy number 5105-0560-03, effective for the policy period of March 17, 2016, to March 17, 2017, issued by Allied World to WSC (the "Policy").
  - Document 2: May 31, 2019, letter tendering the Underlying Lawsuit to Allied World.
- Second Amended Original Petition, attached as Exhibit "B."[1]
- Third Amended Original Petition, attached as Exhibit "C."[2]
- December 19, 2019, letter from Network Adjusters, Inc. to WSC, attached as Exhibit "D."
- August 25, 2020, e-mail tendering the Third Amended Original Petition, attached as Exhibit "E."
- April 12, 2021, letter from Network Adjusters, Inc. to WSC, attached as Exhibit "F."

IV. BACKGROUND

A. Factual Allegations in the Underlying Lawsuit

The Underlying Lawsuit revolves around the acts and omissions by the Directors of WSC as it relates to the ultimate sale by WSC of an approximately 10-acre tract within the Spicewood Airport community (the "Airport Tract").[3] Rene Ffrench, John Richard Dial, and Stuart Bruce

[1] A First Amended Original Petition was filed on November 4, 2019. That pleading was superseded with the filing of the Second Amended Original petition on November 5, 2019.

[2] The Third Amended Original Petition is the "live" pleading and thus the document relevant to whether Allied World has an ongoing duty to defend.

[3] Ex. B, WSC00169; Ex. C, WSC00228. The Airport Tract is identified in the Original Petition in Intervention as "Tract 1" and "Tract 2." Ex. A, Document 2, WSC00144–145.

Sorgen (the "Underlying Claimants") allege that Texas statutes, WSC's certificate of formation, and WSC's bylaws prevent WSC from engaging "in activities or us[ing] assets in a manner that is not in furtherance of the legitimate business of a 'water supply cooperative' or 'sewer service cooperative[4].'"[5] As a "Cooperative," year-end revenues not needed for operations of the enterprise must be returned to the "Owners," which are WSC's member/customers.[6] The Underlying Claimants allege that WSC—as a non-profit corporate instrumentality—is not a stakeholder in the Cooperative and is prohibited from making profit.[7] WSC also "cannot operate at a loss"; rather, Owners must make up any shortfall through increases in rates, fees, and assessments.[8]

The Owners elect a Board of Directors, who operate and manage the Cooperative's assets. Officers elected by the Board carry out day-to-day operations.[9] The Directors and Officers have fiduciary duties that must be discharged in good faith, with ordinary care, and in a manner reasonably believed to be in the best interest of the Owners of the Cooperative.[10] The Board allegedly has no power to approve or effectuate any conveyance that is contrary to this expressed limitation, give away a valuable Cooperative asset, or to transfer an asset for a fraction or none of its market value.[11] Rather, in keeping with its agency/managerial role, the Board has a duty to

[4] Whether WSC is actually a Cooperative is in dispute in the Underlying Lawsuit. Nothing asserted in this lawsuit against Allied World shall be deemed an admission, concession, or argument that WSC is a Cooperative. Rather, the assertions herein and any references to WSC as a Cooperative in this pleading and this lawsuit are setting forth and identifying the factual allegations made against WSC in the Underlying Lawsuit by the Underlying Claimants.

[5] Ex. B, WSC00163; Ex. C, WSC00221.

[6] Ex. B, WSC00151, n. 1; WSC00163; Ex. C, WSC00222.

[7] Ex. B, WSC00165; Ex. C, WSC00223.

[8] Ex. B, WSC00165; Ex. C, WSC00223.

[9] Ex. B, WSC00166; Ex. C, WSC00225.

[10] Ex. B, WSC00166; Ex. C, WSC00225.

[11] Ex. B, WSC00167; Ex. C, WSC00226.

secure the highest price obtainable for assets that are no longer needed for Cooperative purposes.[12] The power to convey real property interests in the WSC's name is allegedly triggered only when such conveyance is authorized by "appropriate resolution" of the Board.[13] The Board can only approve or adopt a resolution by majority vote at a duly noticed open meeting and otherwise in compliance with the WSC's governing documents and applicable law.[14]

In 2013, the Board allegedly voted to upgrade the WSC's wastewater treatment facilities and relocate them away from the Airport Tract.[15] This relocation would allow for the "highest and best use" of the Airport Tract, freeing it to be sold, which was a key component for funding/defraying the costs of the upgraded wastewater treatment plant improvements and other Cooperative needs.[16] Following an August 2013 meeting, the Directors claimed to have gathered deeds and other records in preparation to engage a real estate professional to market the Airport Tract.[17] At the Board's February 18, 2014 meeting, Mulligan allegedly was directed to obtain a survey and appraisal of the land to be sold. The Directors allegedly did none of these things and never actually listed, advertised, or marketed the Airport Tract for sale or otherwise fielded offers or negotiated the sale of the Airport Tract to the highest bidder.[18]

In late 2014, the TCEQ approved the WSC's Closure Plan for the old wastewater treatment plant. This, according to the Underlying Claimants, should have cleared the way for prompt and

[12] Ex. B, WSC00167; Ex. C, WSC00226.

[13] Ex. B, WSC00167; Ex. C, WSC00226.

[14] Ex. B, WSC00167; Ex. C, WSC00226.

[15] Ex. B, WSC00169; Ex. C, WSC00228.

[16] Ex. B, WSC00169–170; Ex. C, WSC00228–229.

[17] Ex. B, WSC00170; Ex. C, WSC00229.

[18] Ex. B, WSC00170, 174; Ex. C, WSC00229, 233.

aggressive marketing and sale of the Airport Tract.[19] The Directors, however, allegedly never followed through with any listing or other marketing.[20] Martin was subsequently elected to WSC's Board in 2015.[21] Shortly thereafter, she allegedly took actions associated with the purchase of a portion of land known as Tract G, a Cooperative-owned hangar lot across from the Airport Tract, for $95,000, which equaled $12.75 per square foot.[22] The Underlying Claimants allege that there is no record the Board ever voted on, or even considered, any transaction involving Tract G.[23]

Martin was then involved with efforts by the Windermere Oaks Property Owners' Association ("POA") to purchase a 30,000-square-foot portion of the Airport Tract being used for storage (the "Storage Tract").[24] The POA's proposed price was around $20,000 - $25,000, or in the range of $0.66 - $0.83 per square foot.[25] The minutes of the Board's July 16, 2015 meeting reflect that the Directors (at that time, Martin, Mebane, Earnest, Madden, and Mulligan) discussed the POA's offer in executive session but rejected it.[26]

In March 2016, Martin allegedly began efforts to purchase the Airport Tract for herself or her own entity.[27] The Underlying Claimants allege that she was involved as seller (in her capacity as WSC fiduciary) and purchaser (for her own personal financial gain).[28] Martin allegedly claimed that Mebane (then-President of the Board) decided that the Airport Tract should not be sold as a

[19] Ex. B, WSC00171; Ex. C, WSC00230–231.

[20] Ex. B, WSC00171; Ex. C, WSC00231.

[21] Ex. B, WSC00171; Ex. C, WSC00231.

[22] Ex. B, WSC00171–172; Ex. C, WSC00231.

[23] Ex. B, WSC00172; Ex. C, WSC00231.

[24] Ex. B, WSC00170, 172; Ex. C, WSC00230–231.

[25] Ex. B, WSC00172; Ex. C, WSC00232.

[26] Ex. B, WSC00172; Ex. C, WSC00232.

[27] Ex. B, WSC00174–175; Ex. C, WSC00234.

[28] Ex. B, WSC00174; Ex. C, WSC00234.

single parcel, as the Board had planned for years. Rather, Martin claimed that Mebane determined that the Board should dispose of the "most valuable and desirable 3.8 acres of the Airport Tract with all of the Airport Tract's frontage along the Piper Lane taxiway to a sitting WSC Director for a fraction of its market value."[29] Martin claimed that the March 2016 transaction was "negotiated" and that she made a "good faith" offer to purchase, which was countered by other Directors.[30] The Underlying Claimants assert that the Board's records are devoid of any such negotiations.[31]

According to the Underlying Claimants, the "disinterested Directors" were the same ones that had acknowledged a duty to market the Airport Tract as a whole to obtain the best possible offer and were aware that the Board had conveyed a comparable property for $12.75 per square foot.[32] Allegedly, none of the Directors disclosed to the Owners prior to the Board's December 19, 2015 meeting that they intended to authorize the piecemeal transfer of the Airport Tract and all of the taxiway frontage for a fraction of the comparable property.[33] The proposed transaction was never mentioned as a discussion or action item on any posted meeting agenda for any Board meeting.[34] Instead, the Board allegedly raised the topic out of the blue at its regular meeting on December 19, 2015, and, after a five-minute executive session, Mebane, Madden, and Mulligan unanimously voted to accept an offer from Martin on behalf of Friendship Homes & Hangars, LLC ("FFH, LLC") to carve off the frontage and separate the remainder of the Airport Tract from all taxiway access for a "net price" of $200,000, or $1.19 per square foot.[35] The Underlying Claimants

[29] Ex. B, WSC00174–175; Ex. C, WSC00234.

[30] Ex. B, WSC00175; Ex. C, WSC00234.

[31] Ex. B, WSC00175; Ex. C, WSC00234.

[32] Ex. B, WSC00175; Ex. C, WSC00235.

[33] Ex. B, WSC00175; Ex. C, WSC00235.

[34] Ex. B, WSC00175; Ex. C, WSC00235.

[35] Ex. B, WSC00175–176; Ex. C, WSC00235.

allege that there was no "appropriate resolution" to approve this sale. Moreover, the Board allegedly did not fulfill the special conditions required to approve an interested-Director transaction.[36] Mebane allegedly executed two deeds, each of which conveyed one platted hanger to Friendship Homes & Hangars, LLC ("FHH, LLC").[37] The Underlying Claimants allege that WSC failed to reserve a taxiway for the remainder of the Airport Tract as part of this transaction.[38] The Underlying Claimants assert that, if the Board had marketed the Airport Tract as a whole and sold it for the best possible price, WSC could have retired all of its outstanding debt in March 2016 and had additional amounts left over to pay facility costs and upgrade equipment.[39] Instead, the Owners allegedly sustained an immediate loss of $500,000 in cash when the Board sold the most desirable portion of the Airport Tract to an interested director.[40]

The Underlying Claimants further assert that the remainder of the Airport Tract was rendered unmarketable, and had its value instantly diminished by $640,000, when it was separated from taxiway access.[41] Martin allegedly later replatted the hanger lots again to create a third hangar lot, which was conveyed to Johann and Michael Mair.[42] The profit from the sale of this third hangar lot should have benefited WSC and the Owners as opposed to Martin individually.[43] The Underlying Claimants assert that WSC still had debt outstanding and incurred additional debt to

[36] Ex. B, WSC00175–176; Ex. C, WSC00235.

[37] Ex. B, WSC00178; Ex. C, WSC00238.

[38] Ex. B, WSC00177; Ex. C, WSC00237.

[39] Ex. B, WSC00179; Ex. C, WSC00239–240.

[40] Ex. B, WSC00179; Ex. C, WSC00240.

[41] Ex. B, WSC00179; Ex. C, WSC00240.

[42] Ex. B, WSC00180; Ex. C, WSC00241.

[43] Ex. B, WSC00180–81; Ex. C, WSC00241.

pay expenses that could and should have been covered by the proceeds from the sale of the Airport Tract. The Board allegedly has struggled with strategies to restructure the debt.[44]

The Board purportedly has postponed needed repairs and the acquisition of a generator and other equipment needed to provide the Cooperative services and to remain in compliance with applicable regulations.[45] At the same time, the Board has raised rates, service fees, and membership fees.[46] Moreover, the Board also allegedly has allowed the Cooperative to become financially dependent on "the extremely questionable practice of collecting standby fees from nonpatrons."[47]

A professional forensic appraiser analyzed the financial impact of the March 2016 conveyance and confirmed that the Owners sustained an immediate loss of more than $1,000,000.[48] The Underlying Claimants allege that the March 2016 "fire sale" was unauthorized, improper, and unfair to the Owners and involved breaches of fiduciary duty and other misconduct by Directors.[49] The "fire sale" has compromised the legitimate business of the Cooperative and resulted from "the acts and omissions of the agents responsible for managing the assets it uses to operate."[50] The Underlying Claimants assert that the Directors engaged in various *ultra vires* acts in violation of Section 20.002(c) of the Texas Business Organizations Code, including the unauthorized conveyance of property; improper use of Cooperative assets; improper disbursement of Cooperative assets to benefit the Directors; and failure to recover loss.[51]

[44] Ex. B, WSC00180–81; Ex. C, WSC00241.

[45] Ex. B, WSC00180–81; Ex. C, WSC00241.

[46] Ex. B, WSC00180–81; Ex. C, WSC00241.

[47] Ex. B, WSC00180–81; Ex. C, WSC00241.

[48] Ex. B, WSC00181–82; Ex. C, WSC00241–42.

[49] Ex. B, WSC00182–83; Ex. C, WSC00242.

[50] Ex. B, WSC00182; Ex. C, WSC00242.

[51] Ex. B, WSC00183–188; Ex. C, WSC00243–251.

Had the Airport Tract been properly marketed and sold for what it was worth, the Owners would have netted "well over $1,000,000," which could have been used to extinguish outstanding debt, acquire needed equipment, and provide reserve funds for the "legitimate business of a water supply and sewer" entity.[52] Rather, the Cooperative's "unfaithful fiduciaries gave away valuable property interests for next to nothing, devalued other property interests, and now propose not only to leave that transaction intact but to make it worse by giving away the Piper Lane taxiway."[53] The Owners have been burdened with unnecessary debt service and higher rates and fees, and the Cooperative still doesn't have needed equipment and facilities. The Underlying Claimants assert that the Directors breached their fiduciary duties to the WSC.[54] The Underlying Claimants seek to recover the damages that the Directors purportedly caused based on their alleged conduct.[55]

B. Request for Coverage and Allied World's Wrongful Denial of Coverage

The Policy has a Public Officials and Management Liability Coverage Form (the "POML Coverage"), which provides claims-made coverage for Wrongful Acts, subject to a limit of $1,000,000 for each claim, and a $3,000,000 aggregate limit for all Claims, all Wrongful Acts, and Offenses.[56]

On May 31, 2019, Plaintiffs timely submitted the Underlying Lawsuit to Allied World, requesting defense and indemnity under the Policy.[57] This request was denied. On November 8, 2019, Plaintiffs again submitted to Allied World a request for defense and indemnity under the

[52] Ex. B, WSC00187; Ex. C, WSC00246.

[53] Ex. B, WSC00187; Ex. C, WSC00246.

[54] Ex. B, WSC00192; Ex. C, WSC00250.

[55] Ex. B, WSC00188; Ex. C, WSC00248; 254–55.

[56] Ex. A, Document 1, WSC00117. Allied World conceded that the claims in the Underlying Lawsuit relate back to the claims first asserted in 2016, at which time policy number 5105-0560-03 was in effect. *See* Ex. D, WSC00275; Ex. F, WSC00287.

[57] Ex. A, Document 2.

Policy based on the allegations in the Second Amended Original Petition.[58] By letter dated December 19, 2019, Allied World—through its authorized third-party claims administrator, Network Adjusters, Inc.—wrongfully denied coverage and refused to provide a defense.[59] Plaintiffs then submitted the Third Amended Original Petition to Allied World on August 25, 2020.[60] The Third Amended Original Petition is the "live" pleading filed in the Underlying Lawsuit. After much delay, Allied World finally responded via letter dated April 12, 2021, again reiterating its improper denial of coverage.[61]

V. ARGUMENTS AND AUTHORITIES

A. Standard of Review and Burden of Proof

"The Federal Rules of Civil Procedure . . . [authorize] motions for summary judgment upon proper showing of the lack of a genuine, triable issue of material fact."[62] Rule 56(c) "mandates the entry of summary judgment, after adequate time for discovery, and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial."[63] To avoid summary judgment, the burden placed on the respondent is to produce evidence of a genuine issue of material fact.[64] The substantive law determines which facts are "material," and a material fact is "genuine" if a reasonable jury could return a verdict in favor of the non-moving party.[65]

---

[58] Ex. A.

[59] Ex. F.

[60] Ex. H.

[61] Ex. I; *see* Ex. A.

[62] *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986).

[63] *Id.* at 322.

[64] *See Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 585–86 (1986).

[65] *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

In an insurance case, the burden is on the insured to show that a claim against it potentially is within the scope of coverage under the policy.[66] Thus, the insured must first meet its burden to establish that the facts alleged in the pleading by the underlying plaintiff states a claim against the insured that is *potentially* within the scope of coverage.[67] If, however, the insurer relies on policy exclusions or other limitations to defeat the duty to defend, the burden shifts to the insurer to disprove coverage.[68] All exceptions or limitations on liability are strictly construed against the insurer and in favor of the insured.[69] Once the insurer proves an exclusion applies, the burden then shifts back to the insured to show the claim falls within an exception to the exclusion.[70]

B. The Underlying Lawsuit Implicates the Duty to Defend

For the following reasons, Allied World owes a complete defense to Plaintiffs in the Underlying Lawsuit.

1. The Duty to Defend, Generally

Texas courts apply the "eight corners" rule to determine whether an insurer has a duty to defend.[71] The Supreme Court of Texas has explained the "eight corners" rule in the following way:

> Where the [complaint] does not state facts sufficient to clearly bring the case within or without the coverage, the general rule is that the insurer is obligated to defend if there is, potentially, a case under the complaint within the coverage of the policy. Stated differently, in case of doubt as to whether or not the allegations of a complaint against the insured state a cause of action within the coverage of a liability policy sufficient to compel the insurer to defend the action, such doubt will be resolved in the insured's favor.[72]

---

[66] *See Federated Mut. Ins. Co. v. Grapevine Excavation Inc.*, 197 F.3d 720, 723 (5th Cir. 1999).

[67] *Canutillo Indep. Sch. Dist. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 99 F.3d 695, 701 (5th Cir. 1996).

[68] *See Guaranty Nat'l Ins. Co. v. Vic Mfg. Co.*, 143 F.3d 192, 193 (5th Cir. 1998); *see also* TEX. INS. CODE ANN. § 554.002 (West 2017).

[69] *Lawyers Title Ins. Corp. v. Doubletree Partners, L.P.*, 739 F.3d 848, 859 (5th Cir. 2014).

[70] *See Guaranty Nat'l*, 143 F.3d at 193.

[71] *Mid-Continent Cas. Co. v. JHP Dev., Inc.*, 557 F.3d 207, 212 (5th Cir. 2009).

[72] *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997).

Citing the provision above, the Fifth Circuit has recognized that the "eight corners" rule is "very favorable to insureds because doubts are resolved in the insured's favor."[73] While courts cannot read facts into pleadings or imagine factual scenarios, they "may draw inferences from the petition that may lead to a finding of coverage."[74] "Even if the plaintiff's complaint alleges multiple claims or claims in the alternative, some of which are covered and some of which are not, the duty to defend arises if at least one of the claims is facially within the policy's coverage."[75] The Fifth Circuit has offered insurers the following advice: "When in doubt, defend."[76] In this regard, whether an insurer has a duty to defend is determined based on an evaluation of the live pleading filed in the underlying liability lawsuit.[77] The court can, however, also review whether prior pleadings also implicated the duty to defend.

2. The Requirements of the Coverage A. Insuring Agreement are Met

The Coverage A. Insuring Agreement of the POML Coverage states, in relevant part:

> **A. COVERAGE A. INSURING AGREEMENT – LIABILITY FOR MONETARY DAMAGES**
>
> **1.** We will pay those sums that the insured becomes legally obligated to pay as "damages" arising out of a "claim" for:
>
> **a.** a "wrongful act," . . . .
>
> * * *

[73] *Gore Design Completions, Ltd. v. Hartford Fire Ins. Co.*, 538 F.3d 365, 368 (5th Cir. 2008).

[74] *Id.* (citations omitted).

[75] *Colony Nat'l Ins. Co. v. United Fire & Cas. Co.*, 677 F. App'x 941, 944 (5th Cir. 2017) (emphasis added).

[76] *Gore Design Completions, Ltd.*, 538 F.3d at 369.

[77] *See Archon Investments, Inc. v. Great Am. Lloyds Ins. Co*., 174 S.W.3d 334, 339 (Tex. App.—Houston [1st Dist.] 2005, pet. denied); *see also Primrose Operating Co. v. Nat'l Am. Ins. Co*., 382 F.3d 546, 552 (5th Cir. 2004) ("an amended pleading completely supersedes prior pleadings, . . . the duty to defend rests on the most recent pleading.").

> We will have the right and duty to defend any "claim" seeking those "damages." However, we will have no duty to defend the insured against any "claim" seeking "damages" for a "wrongful act" . . . .[78]

a. Insured

WSC is the Named Insured,[79] and its "Business Description" is "Special District."[80] Thus, pursuant to SECTION III. – WHO IS AN INSURED of the Policy, WSC's "executive officers" and directors are insureds with respect to their duties as WSC's officers or directors.[81] Also qualifying as insureds are WSC's "[e]lected or appointed officials" of WSC's operating boards, with respect to acts within the course and scope of their duties for WSC or its operating boards.[82] Because the Underlying Claimants allege that the Directors acted at all times relevant to the Underlying Lawsuit in their respective capacities as WSC's officers, directors, and/or elected or appointed, Plaintiffs qualify as insureds.[83]

b. "Damages"

The Underlying Claimants also seek "damages." The term "damages" is defined simply as "monetary damages."[84] Underlying Claimants rely upon section 20.002 of the Texas Business Organizations Code, which provides an avenue for the recovery of monetary relief and compensation from directors for *ultra vires* conduct.[85] Additionally, the Underlying Claimants

[78] Ex. A, Document 1, WSC00119.

[79] Ex. A, Document 1, WSC00002.

[80] Ex. A, Document 1, WSC00002.

[81] Ex. A, Document 1, WSC00126–127.

[82] Ex. A, Document 1, WSC00127.

[83] *See* Ex. B, WSC00157–00159; Ex. C, WSC00216–217

[84] Ex. A, Document 1, WSC00133.

[85] *See* Ex. B, WSC00160–161, 00191; Ex. C, WSC00218, 00251. *See also* TEX. BUS. ORGS CODE ANN. § 20.002 (West 2019); Elizabeth S. Miller & Robert A. Ragazzo, *The* Ultra Vires *Doctrine*, 20 TEX. PRAC., BUS. ORGS. § 27:9 (3d ed.) ("Section 20.002(c) . . . preserves the ability of a corporation's shareholders to seek equitable relief with respect to *ultra vires* transactions and monetary relief against the officers or directors who exceeded their authority.").

assert that the "Owners" of WSC incurred over $1,000,000 in damages as a result of the conduct of the Directors associated with the Airport Tract.[86] The Underlying Claimants also seek unspecified exemplary damages.[87] Thus, this requirement for coverage is satisfied.

c. "Wrongful Act"

The term "wrongful act" is defined as:

> any actual or alleged error, act, omission, neglect, misfeasance, nonfeasance, or breach of duty, including violation of any civil rights law, by any insured in the discharge of their duties for the Named Insured, individually or collectively, that results directly but unexpectedly and unintentionally in "damages" to others.[88]

Within *each* pleading, the Underlying Claimants allege that the Directors breached their fiduciary duties and engaged in "other misconduct" in various ways, including the failure to obtain the "highest price obtainable" for the Airport Tract;[89] failure to engage a real estate professional to market the Airport Tract;[90] failure to list, advertise, or market the Airport Tract;[91] failure to retire outstanding debt of WSC;[92] postponing needed repairs and acquisition of equipment needed to comply with regulations;[93] and failure to provide reserve funds for the "legitimate business of a water supply and sewer" entity.[94] There are no allegations that Plaintiffs expected or intended for any "damages" to result from this conduct. Thus, this requirement for coverage is also satisfied.

---

[86] *See* Ex. B, WSC00182; Ex. C, WSC00214.

[87] Ex. B, WSC00195–196; Ex. C, WSC00254–255.

[88] Ex. A, Document 1, WSC00135.

[89] *See* Ex. B, WSC00165; Ex. C, WSC00226.

[90] *See* Ex. B, WSC00170, 174, 187; WSC00229–30, 233, 246.

[91] *See* Ex. B, WSC00170, 174, 187; WSC00229–30, 233, 246.

[92] Ex. B, WSC00179; Ex. C, WSC00239.

[93] Ex. B, WSC00181; Ex. C, WSC00241.

[94] Ex. B, WSC00187; Ex. C, WSC00246

d. "Claim" and the Related Claims Provision

The Underlying Lawsuit constitutes a "claim," which is defined, in relevant part, as "a civil proceeding in which 'damages' arising out of a[] . . . 'wrongful act' to which this insurance applies are alleged."[95] Moreover, pursuant to the Related Claims provision in the Policy,

> All related "claims" based on or arising out of: the same, related or continuous "wrongful acts" or offenses; or "wrongful acts" or offenses which arise from a common nucleus of facts; or the same act or interrelated acts of one or more insureds, shall be considered a single claim, which is first made when the earliest of such "claims" was made.[96]

As Allied World has conceded, the allegations in the Underlying Lawsuit relate to "wrongful acts" involving the common nucleus of facts regarding a claim submitted in 2016, at which time the Policy was in effect:[97] the Director's acts and omissions surrounding the marketing and sale of the Airport Tract. Thus, the Underlying Lawsuit is a "claim" that was first made, pursuant to the Related Claims provision, under the Policy.

3. No Exclusions Preclude the Duty to Defend

Because the insuring agreement of the Policy is implicated as a matter of law,[98] for Allied World to avoid providing a defense, it has the burden to show that an exclusion applies.[99]

a. The Contractual Liability Exclusion is Inapplicable

The Contractual Liability Exclusion (Exclusion 11.) bars coverage for:

> "Damages," "defense expenses," costs or loss based upon, attributed to, arising out of, in consequence of, or in any way related to any contract or agreement to which the insured is a party or a third-party beneficiary, including, but not

[95] Ex. A, Document 1, WSC00133.

[96] Ex. A, Document 1, WSC00120.

[97] Ex. D, WSC00275.

[98] In its April 12, 2021 denial letter, Allied World specifically admits that "Coverage[] A . . . of the POML Coverage Section are implicated by the allegations in the Third Amended Petition." Ex. F, WSC00294.

[99] *See Guaranty Nat'l Ins. Co. v. Vic Mfg. Co.*, 143 F.3d 192, 193 (5th Cir. 1998); TEX. INS. CODE ANN. § 554.002 (West 2017).

> limited to, any representations made in anticipation of a contract or any interference with the performance of a contract.[100]

Within the pleadings, there are multiple allegations that the Directors engaged in "wrongful acts" associated with the failure to market, advertise, and sell the Airport Tract for the best price available.[101] Obtaining the best price for the Airport Tract was a key component for the "Cooperative" being able to upgrade the wastewater treatment plant.[102] The Directors were, according to the Underlying Claimants, required but failed to take steps to obtain the most value out of selling the Airport Tract, and the failure to do so directly resulted in the inability to retire debt, an increase in rates and assessments, and a loss to the Underlying Claimants and other Members of the "Cooperative" of at least $1 million.[103]

The focus of the Underlying Lawsuit is not on any contract or even any representations made in anticipation of any contract, but rather on the *pre*-contract misdeeds and conduct by the Directors, which fall outside the scope of the Contractual Liability Exclusion. In *Admiral Insurance Company, Inc. v. Briggs*, the U.S. District Court for the Northern District of Texas evaluated a similar provision that barred coverage for "claims 'based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving any oral or written contract or agreement' unless 'such liability would have attached to the Insured in the absence of the oral or written contract or agreement.'"[104] In that case, the insured's former landlord sued it for stock fraud, alleging that the insured—through its current and former officers—made material misrepresentations concerning the insured's future success to convince the landlord to accept the

[100] Ex. A, Document 1, WSC00122.

[101] Ex. B, WSC00170, 174; Ex. C, WSC00229, 233.

[102] Ex. B, WSC00169; Ex. C, WSC00228.

[103] Ex. B, WSC00181–82; Ex. C, WSC00241–42.

[104] 264 F. Supp. 2d 460, 462 (N.D. Tex. 2003).

insured's stock instead of cash for payment on a lease.[105] The insurer argued that the stock fraud claim fell within the contract exclusion because it "involved" the lease contract.[106] The insurer's argument was rejected for two reasons.

First, the court held that the insurer's proffered interpretation was "overly broad" because, if adopted, the exclusion would bar coverage "for all stock fraud claims because they all involve a contract for the sale of stock."[107] The court also held that the *pre*-contract misdeeds—the misrepresentations regarding the insured's success that induced the landlord to accept the stock—meant that the subsequent breach of contract was immaterial to the security fraud claims, "because the alleged harm in the . . . [underlying] case occurred at the time the agreement to accept stock instead of cash was made. The lease contract did not cause the stock fraud claim, it simply provided the context in which the stock fraud took place."[108] Relying on the interpretive doctrine of *ejusdem generis*,[109] the court stated: "the phrase 'in any way involving' must be read in a manner consistent with the terms 'based upon, arising out of, directly or indirectly resulting from or in consequence of' a contract—all terms indicating a causal relationship between the contract and the claim."[110]

Likewise, in *McPeek v. Travelers Casualty & Surety Company of America*, the Western District of Court of Pennsylvania ruled that the insureds' pre-contract actions were not subject to almost an identical exclusion.[111] In that case, the insureds allegedly made "a variety of fraudulent

[105] *Id*. at 462–63.

[106] *Id*. at 463.

[107] *Id*. at 462.

[108] *See id*. at 463.

[109] The doctrine of *ejusdem generis* is "a rule of contract construction that provides that, if words of a specific meaning are followed by general words, the general words are interpreted to mean only the class or category framed by the specific words." *Id*. at 463 n.4 (citing *Hussong v. Schwan's Sales Enters., Inc.*, 896 S.W.2d 320, 325 (Tex. App.—Houston [1st Dist.] 1995, no writ)).

[110] *Id*.

[111] No. 2:06-CV-114, 2006 WL 1308087, at *4 (W.D. Pa. May 10, 2006).

and/or negligent misrepresentations and/or omissions in connection with the purchase of two notes."[112] An exclusion in the policy at issue barred coverage for a claim "for or arising out of any actual or alleged liability of any Insured under any express contract or agreement; provided, however, that this exclusion shall not apply to liability which would have attached in the absence of such express contract or agreement."[113] The underlying action contained counts of securities fraud, fraudulent misrepresentations, a negligent misrepresentations against the officers, and a breach of contract claim against the corporate entities.[114] The Court ruled that the tortious conduct for which the insured was being sued preceded and induced the purchase of the notes which were breached and are "based upon (pre-contract) fraud, rather than contractual liability."[115] Thus, the Court determined that the securities fraud, negligent misrepresentation, and fraudulent misrepresentation claims "d[id] not 'aris[e] out of any alleged liability of any Insured under any express contract or agreement' and are not covered by the contract exclusion."[116]

Here, allegations exist in each pleading that the Directors had fiduciary duties to preserve the assets of the "Cooperative" and that they failed to do so based on their acts (or omissions) in the way that the sale of the Airport Tract was marketed, advertised, and negotiated. In that regard, the Underlying Claimants specifically assert in each pleading that the decision to sell the Airport Tract was made years before the purported sale occurred.[117] These pre-contractual misdeeds relate to the Directors failure to market and advertise the sale of the Airport Tract. In other words, had

[112] *Id*. at *3–4.

[113] *Id*. at *3.

[114] *Id.* at *2–3.

[115] *Id*. at *4.

[116] *Id*. at *4–5 (quoting the exclusion being evaluated by the court).

[117] *See, e.g.*, Ex. B, WSC00169; Ex. C, WSC00228 (allegations that the Board of WSC voted in 2013 to upgrade the wastewater treatment facilities and sell the Airport Tract).

the Directors and WSC properly marketed the Airport Tract and not breached their fiduciary duties to obtain the highest and best use and most profit, then there would be no loss. Thus, any contract or agreement conveying the Airport Tract and other real estate to FHH, LLC or Martin "simply provided the context in which the [breach of fiduciary duties and other misdeeds] took place."[118] Courts around the country have reached similar conclusions as it relates to the relationship between pre-contact misdeeds and forms of a "contract" exclusion.[119]

The exclusion also does not apply because the breach of fiduciary claims alleged in each pleading in the Underlying Lawsuit could stand on their own and are independent of any contract or agreement.[120] This is exemplified by the numerous allegations regarding the Directors' *ultra vires* acts. Additionally, there are no allegations that the Directors (except Martin) are even parties to any contract or agreement used to convey the Airport Tract.[121] This exclusion utilizes "the insured" as opposed to "any insured" or "an insured."[122] Pursuant to the "Separation of Insureds" provision, the Policy applies "[s]eparately to each insured against whom 'claim' is made."[123] Thus,

---

[118] *See Admiral Ins. Co., Inc. v. Briggs*, 264 F. Supp. 2d 460, 463 (N.D. Tex. 2003).

[119] *See, e.g.*, *Clark Sch. For Creative Learning, Inc. v. Philadelphia Indem. Ins. Co.*, No. 12-10475-DJC, 2012 WL 6771835, at *5 (D. Mass. Dec. 26, 2012), *aff'd*, 734 F.3d 51 (1st Cir. 2013) (holding that breach of contract exclusion was inapplicable to "pre-contract misdeeds" because they were based on conduct independent of the contracts); *Church Mut. Ins. Co. v. U.S. Liab. Ins. Co.*, 347 F. Supp. 2d 880, 888–89 (S.D. Cal. 2004) (finding that a contractual liability exclusion did not apply to claims that an insured was involved in a pattern and practice of defrauding contractors by entering into contracts without intending to pay).

[120] *See Am. Chem. Soc. v. Leadscope, Inc.*, No. 04AP–305, 2005 WL 1220746, at *10 (Ohio Ct. App. May 24, 2005) (finding that claims of conversion of trade secrets was not excluded by a contractual liability exclusion because the claims could be maintained "without regard" to any contract and the "claim for conversion neither necessarily arises from nor is based upon contractual liability").

[121] *See McPeek*, 2006 WL 1308087, at *4 (noting that an additional reason a similar exclusion was not applicable is because the individual officer insureds were not parties to the contracts at issue).

[122] *Ooida Risk Retention Group, Inc. v. Williams*, 579 F.3d 469, 472–73 (5th Cir. 2009) (separation of insureds provision operates to give "effect to the separate coverage promised each insured by using the term 'the insured' to refer to the particular insured seeking coverage").

[123] Ex. A, Document 1, WSC00131; *see also King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 189 (Tex. 2002) (finding that when a policy contains a similar "separation of insureds" clause, the intentional conduct of one insured could not be imputed to another insured for purposes of determining an occurrence).

as it relates to the Directors, the Contractual Liability Exclusion is inapplicable on its face, as there is no indication that any Directors (except Martin) were parties to any contract at issue.

In the alternative, the Contractual Liability Exclusion is ambiguous as used in the Policy. The Supreme Court of Texas has found that, "[i]f . . . language of a policy or contract is subject to two or more reasonable interpretations, it is ambiguous."[124] If the court finds an ambiguity in the contract provisions, particularly in an exclusion clause, the court should construe the policy strictly against the insurer.[125] Accordingly, if an ambiguity exists, a court must adopt the insured's interpretation as long as it is reasonable, even where the insurer's interpretation is a more reasonable interpretation.[126] In *Church Mutual Insurance Co. v. U.S. Liability Insurance Co.*, the insurer refused to defend its insured with regard to allegations pertaining to two causes of action for fraud for intentional misrepresentation and concealment and for negligent misrepresentation.[127] The insurer argued that these allegations triggered an exclusion for "any Claim made against any insured arising out of, directly or indirectly resulting from or in consequence of, or in any way involving: . . . . any actual or alleged breach of contract."[128] Relying on the prefatory language, the insurer argued that all that was necessary to trigger the exclusion was an incidental connection between breach of contract and fraud.[129] The court disagreed, finding that the exclusionary language was "susceptible to two interpretations: the expansive interpretation urged by [the insurer]," which would eliminate coverage for all claims that have any relation to a breach of

[124] *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex. 1995); *see Valmont Energy Steel, Inc. v. Commercial Union Ins. Co.*, 359 F.3d 770, 774 (5th Cir. 2004).

[125] *Valmont*, 359 F.3d at 774.

[126] *Balandran v. Safeco Ins. Co. of Am.*, 972 S.W.2d 738, 741 (Tex. 1998).

[127] 347 F. Supp. 2d 880, 884 (S.D. Cal. 2004).

[128] *Id.*

[129] *Id.*

contract and essentially constitute an "evisceration of coverage," and "a narrower interpretation, which, without eviscerating coverage, accounts for the clearly stated exclusion for breach of contract and claims arising from it which are more than just incidentally related thereto."[130] Just as in that case, the Contractual Liability Exclusion is ambiguous and should be interpreted narrowly as to not apply to the pre-contractual misdeeds. Any broader interpretation would eviscerate coverage for the risks that WSC intended to cover through the purchase of this Policy.[131]

b. The Criminal Acts and Violation of Laws Exclusions are Inapplicable

Allied World has also asserted that the Criminal Acts (Exclusion 12.) and Violation of Laws (Exclusion 19.) exclusions bar coverage. The Criminal Acts Exclusion applies to:

> "Damages," "defense expenses," costs or loss arising out of or contributed to by any fraudulent, dishonest, criminal or malicious act of the insured . . . , or the willful violation of any statute, ordinance or regulation committed by or with the knowledge of the insured. However, we will defend the insured for covered civil action subject to the other terms of this Coverage Form until either a judgment or final adjudication establishes such an act, or the insured confirms such act.[132]

Exclusion 19. precludes coverage for "'Damages,' 'defense expenses,' costs, or loss arising from an insured's willful violation of any federal, state, or local law, rule, or regulation."[133] Allied World's analysis misses the mark. The primary basis for reliance on these exclusions are the purported violations of the Texas Open Meetings Act (the "TOMA") as it relates to the negotiation and sale of the Airport Tract.

---

[130] *Id.* at 886.

[131] *See*, *e.g., id*. at 885 (noting that the insurer's "expansive interpretation" of the breach of contract exclusion "is at odds with the coverage provision of the . . . Policy, which provides coverage for 'Wrongful Acts'" that include "any actual or alleged act, error, omission, misstatement, misleading statement, neglect or breach of duties.").

[132] Ex. A, Document 1, WSC00122.

[133] Ex. A, Document 1, WSC00123.

As an initial matter, the prior pleading contained and the live pleadings contains multiple allegations against the WSC and the Directors involving "claims" for "wrongful acts" that do not relate, in any form or fashion to a "fraudulent, dishonest, criminal or malicious act of the insured," "the willful violation of any statute, ordinance or regulation committed by or with the knowledge of the insured," or "an insured's willful violation of any federal, state, or local law, rule, or regulation." These alleged "wrongful acts" include, but are not limited to, the failure to obtain the "highest price obtainable" for the Airport Tract;[134] failure to engage a real estate professional to market the Airport Tract;[135] failure to list, advertise, or market the Airport Tract;[136] failure to retire outstanding debt of WSC;[137] postponing needed repairs and acquisition of equipment needed to comply with regulations;[138] and failure to provide reserve funds for the "legitimate business of a water supply and sewer" entity.[139] As a result, neither the Criminal Acts nor the Violation of Laws Exclusions provides a basis for Allied World to deny defense coverage.

Even if these "wrongful acts" implicate the TOMA, no allegation exists that any of the alleged violations were *willful*. Because the term "willful" is not defined in the Policy, under Texas law it must be given its plain and ordinary meaning and is evaluated in the context of how that term is used in the exclusions.[140] Texas courts have recognized that the word "willful" means "intentional; deliberate" or "having or showing a stubborn and determined intention to do as one

[134] *See* Ex. B, WSC00165; Ex. C, WSC00226.

[135] *See* Ex. B, WSC00170, 174, 187; WSC00229–30, 233, 246.

[136] *See* Ex. B, WSC00170, 174, 187; WSC00229–30, 233, 246.

[137] Ex. B, WSC00179; Ex. C, WSC00239.

[138] Ex. B, WSC00181; Ex. C, WSC00241.

[139] Ex. B, WSC00187; Ex. C, WSC00246

[140] *Anadarko Petroleum Corp. v. Houston Cas. Co.*, 573 S.W.3d 187, 193 (Tex. 2019).

wants, regardless of the consequences or effects."[141] The pleading is simply devoid of factual allegations that there was any intentional, deliberate, or stubborn conduct by the Directors. And, in fact, the TOMA, which is a statute appearing at Section 551.001 *et seq*. of the Texas Government Code, does not contain any intent element; rather, it is strict liability statute where unintentional violations can occur.[142] In fact, when evaluating whether there is an intent element to establish liability under the TOMA for improperly calling a closed meeting, the Texas Court of Criminal Appeals has specifically held that, "based upon the plain language of the section 551.144 [of the TOMA] and the rules of grammar and common usage, a member of a governmental body can be held criminally responsible for his involvement in the holding of a closed meeting which is not permitted under the Act *regardless of his mental state with respect to whether the closed meeting is permitted under the Act*."[143]

Allied World's position on the Criminal Acts Exclusion is even more tenuous. That exclusion—by its express terms—*does not* apply to the duty to defend *until* "either a judgment or final adjudication establishes such an act, or the insured confirms such act."[144] Under Texas law, the "final adjudication" phrase means that the exclusion applies ***only*** if there is a finding of a *willful* violation (which, as noted above, Plaintiffs dispute is even met) through final judgement or settlement in the Underlying Lawsuit, ***not*** in a parallel coverage action *or* parallel lawsuit.[145] In its

---

[141] *Apache Corp. v. Castex Offshore, Inc.*, No. 14-19-00605-CV, --- S.W.3d ---, 2021 WL 1881213, at *5 (Tex. App.—Houston [14th Dist.] May 11, 2021, no pet.) (quoting NEW OXFORD AMERICAN DICTIONARY 1978 (Angus Stevenson & Christine Lindberg eds., 3d ed. 2010)).

[142] *See, e.g.*, *Tovar v. State*, 978 S.W.2d 584, 587 (Tex. Crim. App. 1998) (explaining that "public welfare offenses typically involve relatively minor punishment, as does section 551.144 [of the TOMA], and tend to hold persons strictly liable for their conduct.").

[143] *Id*. at 587 (emphasis added).

[144] Ex. A, Document 1, WSC00122.

[145] *See e.g.*, *Pendergest-Holt v. Certain Underwriters at Lloyd's of London*, 600 F.3d 562, 573 (5th Cir. 2010) (citing *Westport Ins. Corp. v. Hanft & Knight, P.C.*, 523 F. Supp. 2d 444, 454–55 (M.D. Pa. 2007); *Virginia Mason Med. Ctr. v. Executive Risk Indem. Inc*., No. C07-0636MJP, 2007 WL 3473683, at *5 (W.D. Wash. Nov. 14, 2007)).

Answer, Allied World expressly states that its reliance on the Criminal Acts Exclusion is based on "a finding in a lawsuit related to the Underlying Lawsuit."[146] Reliance upon an adjudication from a "lawsuit related to the Underlying Lawsuit" is simply improper under applicable Texas law. Allied World's reliance on that "related" lawsuit also contravenes the well-established "eight corners" rule, as reliance on the "related" lawsuit constitutes evidence that is extrinsic to the factual allegations in the live pleading.[147] At the very least, the language of these exclusions creates an ambiguity as to the scope of their application because, while they both purport to bar coverage for the same or similar conduct (willful violation of statute/state law), one of them entitles the insureds to a defense until it is established that an excluded violation occurs while the other does not.

C. Allied World Violated the Prompt Payment of Claims Act by Failing to Defend

The Prompt Payment of Claims Act in the Texas Insurance Code provides for additional damages when an insurer improperly refuses or delays payment of a claim.[148] An insurer's breach of the duty to defend constitutes a *per se* violation of the Prompt Payment of Claims Act.[149] It is not necessary, for purposes of the Prompt Payment of Claims Act, to demonstrate that the denial was made in bad faith.[150] Rather, as the Fifth Circuit recently reaffirmed, the Prompt Payment of

---

[146] Allied World Specialty Insurance Company's Answer and Affirmative Defenses to Plaintiffs' Original Complaint [Doc. 6], pp. 15–16, ¶ 7; *see* p. 16, ¶ 8.

[147] *Richards v. State Farm Lloyds*, 597 S.W.3d 492, 500 (Tex. 2020) ("The eight-corners rule merely acknowledges that, under many common duty-to-defend clauses, only the *petition* and the *policy* are relevant to the initial inquiry into whether the petition's claim fits within the *policy's* coverage.") (emphasis in original); *Pine Oak Bldrs., Inc. v. Great Am. Lloyds Ins. Co.*, 279 S.W.3d 650, 655 (Tex. 2009) (holding that in deciding the duty to defend, the court should not consider extrinsic evidence from either the insurer or the insured but rather must rely on the language of the policy and allegations in the underlying pleading).

[148] *See* TEX. INS. CODE ANN. § 542.060 (West 2021).

[149] *See Pine Oak Builders, Inc.*, 279 S.W.3d at 652 (applying the Prompt Payment of Claims statute to an insurer's breach of its defense obligation); *Lamar Homes, Inc. v. Mid-Continent Cas. Co*, 242 S.W.3d 1, 20 (Tex. 2007) (holding that the right to a defense benefit under a liability insurance policy is a "first-party" claim within the meaning of the Prompt Payment of Claims statute); *see also Trammell Crow Residential Co. v. Virginia Sur. Co., Inc.*, 643 F. Supp. 2d 844 (N.D. Tex. 2008).

[150] *St. Paul Reinsurance Co., Ltd. v. Greenberg*, 134 F.3d 1250, 1255 n.21 (5th Cir. 1998) ("As long as the insurer is found to be liable under the policy, this fee attaches, even if the insurer had a reasonable basis for denying coverage.");

Claims Act is a "strict liability" statute.[151] By breaching the duty to defend, as set forth above, Allied World has thus violated the Prompt Payment of Claims Act.[152] As the Supreme Court of Texas recognized: "To prevail under a claim for [Prompt Pay] damages under section 542.060 [of the Texas Insurance Code], the insured must establish: (1) the insurer's liability under the insurance policy, and (2) that the insurer has failed to comply with one or more sections of the [Prompt Payment of Claims Act] in processing or paying the claim."[153] According to the Fifth Circuit:

> Put another way, it is not necessary for a plaintiff to prove that the insurer acted wrongfully or in bad faith. *See Biasatti v. GuideOne Nat'l Ins. Co.*, 601 S.W.3d 792, 794–95 (Tex. 2020) . . . The statute requires only liability under the policy and a failure to comply with the timing requirements of the [Prompt Payment of Claims Act].[154]

Plaintiffs have met their evidentiary burden to show that Allied World is liable under the Prompt Payment of Claims Act, as they have shown—as a matter of law—that Allied World had and continues to have a duty to defend under the Policy but refuses to provide a defense. Plaintiffs are entitled to a ruling that Allied World has violated the Prompt Payment of Claims Act based on its wrongful denial of coverage. Thus, Plaintiffs are entitled to an 18% penalty on defense fees and expenses, as well as attorneys' fees incurred in prosecuting this claim. The total amount of fees and the calculation of the penalty amount are not at issue in this Motion; however, Plaintiffs request a finding that due to the breach of the duty to defend, Allied World violated the Prompt Payment

---

see also Higginbotham v. State Farm Mut. Auto. Ins. Co., 103 F.3d 456, 461 (5th Cir. 1997) (construing the statute as a "strict liability" statute for failing to pay a valid claim).

[151] *Agredano v. State Farm Lloyds*, 975 F.3d 504, 507 (5th Cir. 2020) (citing *Barbara Techs. Corp. v. State Farm Lloyds*, 589 S.W.3d 806, 819 (Tex. 2019); *Ortiz v. State Farm Lloyds*, 589 S.W.3d 127, 135 (Tex. 2019) ("[A]n insurer's payment of an . . . award does not as a matter of law bar an insured's claims under" the TPPCA.)).

[152] The Prompt Payment of Claims Act provides for an 18% penalty per annum plus attorneys' fees. *See* TEX. INS. CODE ANN. § 542.060 (West 2021). At this point, Plaintiffs seeks only a ruling that Allied World breached the duty to defend and, in doing so, violated the Prompt Payment of Claims Act.

[153] *Barbara Techs. Corp.*, 589 S.W.3d at 813.

[154] *Agredano*, 975 F.3d at 507.

of Claims Act and is obligated to pay Plaintiffs' damages (*i.e.*, the fees and expenses incurred in the defense of the claims alleged in the Underlying Lawsuit), penalty interest on that amount at the rate of 18% per annum, and the attorneys' fees incurred in pursuing Allied World for coverage—the amount of which will be determined following this Court's determination of the duty to defend.

III. CONCLUSION

In sum, because there is at least a *potential* for coverage based on the factual allegations in both the Second Amended Original Petition and the Third Amended Original Petition (which is the live pleading in the Underlying Lawsuit) and terms of the Policy, Allied World—as a matter of law—had and continues to have a duty to defend Plaintiffs in the Underlying Lawsuit. Allied World cannot meet its burden to show that any exclusions bar coverage as a matter of law; therefore, it owed and continues to owe Plaintiffs a *complete* defense in the Underlying Lawsuit. For these reasons, Plaintiffs' Motion should be granted. Allied World has also violated the Texas Prompt Payment of Claims Act based on its improper denial of defense coverage.

WHEREFORE, PREMISES CONSIDERED, Plaintiffs pray that the Court grant their Motion for Partial Summary Judgment on the Duty to Defend, decree and order that because Allied World had and continues to have a duty to defend Plaintiffs in the Underlying Lawsuit, Allied World has breached the contract by refusing to defend, and, by not providing a defense, violated the Prompt Payment of Claims Act in the Texas Insurance Code. Plaintiffs further pray for all such further relief to which they may show themselves justly entitled.

Respectfully submitted,

SHIDLOFSKY LAW FIRM PLLC

/s/ Blake H. Crawford

Blake H. Crawford
Lead Attorney to be Noticed
State Bar No. 24065096
blake@shidlofskylaw.com
Douglas P. Skelley
State Bar No. 24056335
doug@shidlofskylaw.com
SHIDLOFSKY LAW FIRM PLLC
7200 N. Mopac Expy., Ste. 430
Austin, Texas 78731
512-685-1400
866-232-8412 (Fax)

ATTORNEYS FOR PLAINTIFFS WINDERMERE OAKS WATER SUPPLY CORPORATION, DANA MARTIN, WILLIAM EARNEST, THOMAS MICHAEL MADDEN, ROBERT MEBANE, PATRICK MULLIGAN, JOE GIMENEZ, DAVID BERTINO, MIKE NELSON, DOROTHY TAYLOR, and NORMAN MORSE

CERTIFICATE OF SERVICE

I hereby certify that, on August 13, 2021, I electronically filed under seal the foregoing document with the clerk of court for the U.S. District Court, Western District of Texas, Austin Division, using the electronic case filing system of the court. The electronic case filing system sent a "Notice of Electronic Filing" to attorneys of record for all parties who have consented in writing to accept service by electronic means.

/s/ Blake H. Crawford
Blake H. Crawford