No. 11–15129

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**UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT**

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INTEL CORPORATION, a Delaware corporation,

*Plaintiff-Counterclaim Defendant-Appellant,*

v.

AMERICAN GUARANTEE AND LIABILITY INSURANCE COMPANY, a New York corporation,

*Defendant-Appellee*,

and

MARKEL AMERICAN INSURANCE COMPANY, a Virginia corporation,

*Counterclaimant-Appellee.*

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On Appeal from the District Court for the Northern District of California, San Jose Division, Case No. 5:09–cv–00299–JF (Honorable Jeremy Fogel)

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# REPLY BRIEF OF APPELLANT INTEL CORPORATION

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## Introduction and Summary of Reply Argument

Intel's opening brief presented a reasonable interpretation of AGLI's excess insurance policy that gives meaning to all the policy language, respects AGLI's legitimate interests, and preserves Intel's entitlement to defense coverage from AGLI after exhaustion of the underlying insurance limits. In response, AGLI fails to show that its belatedly developed interpretation is either the best or the only reasonable reading of its policy.

I. AGLI tacitly concedes that its construction would render its duty to defend narrower than its duty to indemnify, contrary to a basic tenet of insurance law. AGLI also does not deny that Intel's reading fully protects AGLI by ensuring that AGLI's excess coverage would not be triggered until others contributed $50 million, the full amount of the underlying limits. AGLI is thus forced to argue that the policy language unambiguously gave it a windfall by letting it off the hook simply because XL and Intel *together* contributed $50 million in defense costs as a result of the settlement of their coverage dispute.

In defending this surprising result, AGLI makes three primary arguments. First, AGLI charges that Intel's interpretation would write Paragraph C of Endorsement 1 out of the AGLI policy. Second, although AGLI recognizes that Condition H provided that both Intel and XL could contribute to exhausting the $50 million limit where Intel sought indemnity, AGLI argues that Condition H was

limited to indemnity and did not apply to the duty to defend. Third, AGLI contends that the case law requires an underlying insurer alone to pay the full policy limits in order to exhaust those limits. AGLI is wrong at every turn.

A. Intel's interpretation fully respects the wording of Paragraph C. Paragraph C required the underlying $50 million limits to be "exhausted by payment of judgments or settlements." But there was a settlement between XL and Intel, and as a result of that settlement XL paid part of the $50 million and Intel paid the rest. AGLI could easily have written Paragraph C to specify that *XL alone* had to pay the underlying limits before Intel was entitled to a defense. But AGLI chose not to write Paragraph C that way. Paragraph C was written in the passive voice, focusing on payment of the full underlying limits without concern for *who* paid that amount. Intel's reading not only gives meaning to Paragraph C, but gives it precisely the limited meaning its words convey: the duty to defend is triggered by "judgments or settlements" that exhaust the limits of the lower layer of coverage, without regard to who pays the judgments or settlements.

B. Condition H *did* address *who* could contribute to the underlying limits, and it was *not* limited to indemnity payments. AGLI reaches the opposite conclusion only by reading the policy language in an artificial, segmented fashion. AGLI analyzes the policy as if the parties initially agreed to adopt AGLI's preprinted, indemnity-only form policy and then separately adopted Endorsement 1

to incorporate the duty to defend from the XL policy. But Intel never agreed to adopt AGLI's preprinted form policy as initially drafted; Intel insisted on a duty to defend from the outset. The more natural way to read the AGLI policy—and the approach mandated by California law—is to read all of the simultaneously adopted provisions in conjunction. Because Intel insisted that AGLI agree to defend as well as to indemnify, Intel had no reason to think that Condition H's flexible approach to exhaustion would apply only to AGLI's indemnity obligation. Indeed, Condition H expressly stated that AGLI's "[c]overage" would apply when Intel or XL paid the limits of XL's policy, and AGLI's coverage undeniably included a duty to defend.

C. AGLI misreads the case law. AGLI's response completely ignores the discussion in Intel's opening brief of the *Hurley* and *Qualcomm* cases. Those cases, properly read, do not help AGLI. *Hurley* dealt with a differently worded statute involving a different kind of insurance, and *Qualcomm* merely highlights what AGLI did not do: write a clear exhaustion provision expressly requiring the underlying insurers alone to pay the full underlying limits of liability. AGLI also relies on the Wisconsin Supreme Court's decision in *Danbeck*, but *Danbeck* discussed underinsured motorist coverage, not excess third-party liability insurance. Indeed, *Danbeck* distinguished an earlier Wisconsin decision that *had* found exhaustion on the ground that the earlier case involved excess insurance.

II. AGLI further suggests that Intel was on notice that the district court might enter summary judgment against it. Not so. Neither AGLI nor Markel moved for summary judgment, and the district court never advised Intel that it was considering such a move *sua sponte*. Intel did argue that *Intel* was entitled to summary judgment and that AGLI needed no continuance because parol evidence could not help *AGLI's* cause. In an effort to streamline and avoid potential fact disputes, Intel also did not present parol evidence in support of its interpretation. But that hardly meant that Intel waived its right to introduce parol evidence in response to a possible entry of summary judgment *against* Intel. AGLI ignores that insurance law is not reciprocal: ambiguities are construed in favor of the policyholder. The parol evidence that AGLI sought to pursue could not have defeated summary judgment for Intel. By contrast, the parol evidence that Intel would have offered would have established a latent ambiguity preventing summary judgment *against* Intel. At a minimum, the district court was required to provide notice to Intel and allow it to introduce extrinsic evidence showing that AGLI's policy was reasonably susceptible to Intel's interpretation.

## Argument

### I. THE COMBINATION OF XL'S SETTLEMENT PAYMENT AND INTEL'S OWN DEFENSE PAYMENTS EXHAUSTED THE UNDERLYING LIMITS

AGLI makes three principal arguments on the merits, all of them flawed.

### A. Intel's Interpretation Gives Meaning to Paragraph C

AGLI repeatedly chants the mantra that Intel's reading would write Paragraph C out of AGLI's policy. But repeating something over and over does not make it true, and AGLI's assertion is not true. Under Paragraph C, AGLI had no duty to defend until "the Underlying Insurance Limits shown in Item 6. of the Declarations [we]re exhausted by payment of judgments or settlements." [ER 107] Intel's construction fully recognizes and gives meaning to that provision because it requires that the exhaustion result from a judgment or settlement.

Indeed, AGLI's complaint about Intel's supposed delay in making a claim against the AGLI excess policy proves the point. Intel refrained from making a claim until 2008 precisely because Paragraph C required a judgment or settlement resulting in exhaustion of the underlying limits shown in Item 6 (the $50 million limit of XL's coverage). In 2008, Intel and XL agreed to settle their dispute over XL's coverage, and, as a result of that settlement, XL paid a portion of the $50 million and Intel accepted responsibility for the remainder. That settlement exhausted the $50 million underlying limit and triggered AGLI's duty to defend.

AGLI's argument that Intel is nullifying Paragraph C rests on the incorrect assumption that Paragraph C required XL *alone* to pay $50 million in defense costs before AGLI owed a duty to defend. Paragraph C said no such thing. It stated:

> Nothing contained in this Endorsement shall obligate [AGLI] to provide a duty to defend any claim or suit

> before the *Underlying Insurance Limits* shown in Item 6. of the Declarations *are exhausted by payment of judgments or settlements*.

[ER 107 (emphasis added)] On its face, Paragraph C required exhaustion of the "Underlying Insurance Limits" rather than exhaustion of any duty by XL alone to pay policy limits. Moreover, the exhaustion provision was written in the passive voice, not the active voice. In adopting that language, AGLI chose to focus on the fact of the payment, not the actor. To be sure, Paragraph C indicated that exhaustion had to be "by payment of judgments or settlements," but it did not say *who* had to contribute the funds. If AGLI wanted to avoid a duty to defend until XL alone contributed the entire underlying $50 million limits, it could and should have written Paragraph C clearly, using the active voice, to say just that:

> Nothing contained in this Endorsement shall obligate AGLI to provide a duty to defend any claim or suit before *the insurers under each of the policies listed in Item 6. of the Declarations have paid the full amount of the Underlying Insurance Limits* in the form of judgments or settlements.[1]

Thus, Intel is not reading language *out* of Paragraph C; AGLI is reading *in* a sole-source exhaustion requirement that appears nowhere in the language that AGLI itself drafted. To make matters worse, AGLI's interpretation would turn

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[1] The clear, active-voice alternative that Intel is suggesting is hardly far-fetched. Indeed, it is similar to the clear, active-voice language of the excess policy in *Qualcomm*, one of the cases on which AGLI heavily relies. *See* pages 11–13, *post*.

insurance law on its head by rendering AGLI's duty to defend narrower than its duty to indemnify. Given Condition H, even AGLI concedes that $50 million in payments by Intel, XL, or some combination of the two could trigger AGLI's duty to *indemnify*. Yet AGLI insists that such a combination of payments could *not* trigger its duty to *defend*. At the time it purchased the coverage, Intel had no reason to expect that AGLI would later contort the policy language in a manner contrary to basic principles of insurance law.[2]

Ultimately, even if Paragraph C is ambiguous about who had to make the payments needed to trigger AGLI's duty to defend, that ambiguity must be construed in favor of Intel and against AGLI, which drafted the language at issue. "In the insurance context, we generally resolve ambiguities in favor of coverage." *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 822 (1990). "Similarly, we generally interpret the coverage clauses of insurance policies broadly, protecting the objectively reasonable expectations of the insured. … Because the insurer writes the policy, it is held 'responsible' for ambiguous policy language, which is therefore construed in favor of coverage." *Id.* (citations omitted). Construing

[2] Theoretically, perhaps, a policy could be drafted to make an insurer's duty to defend narrower than its duty to indemnify. To achieve such an odd result, however, the insurance company would need to write the policy language to put its policyholder on exceptionally clear notice of the unusual coverage provided. AGLI's policy was nowhere near that clear. Indeed, it is so difficult to parse that the district court construed it once in each party's favor.

Paragraph C consistent with Intel's reasonable expectations is especially appropriate because AGLI seeks to impose a limitation on its defense coverage. Under California law, coverage limitations (like policy exclusions) are "strictly construed against the insurer and liberally interpreted in favor of the insured." *Delgado v. Heritage Life Ins. Co.*, 157 Cal. App. 3d 262, 271 (1984).

### B. Condition H Must Be Read in Conjunction with the Rest of Intel's Actual Policy Providing a Duty to Defend, Not in Conjunction with AGLI's Superseded Form Policy

AGLI contends that Condition H should be ignored because Condition H supposedly applied only to the duty to indemnify, not to the duty to defend. To begin with, the outcome of this case would not change even if AGLI were right. Even on AGLI's reading, Condition H itself does not impose a single-payment-source requirement. To prevail, AGLI must show that *Paragraph C* did so—and as just explained, Paragraph C says no such thing. In any event, AGLI's indemnity-only reading of Condition H must be rejected.

Condition H provided that AGLI's "coverage" would be triggered when any combination of Intel and its insurance from XL contributed the $50 million underlying limits. [ER 133] As Intel explained in its opening brief (at 34) and AGLI does not refute, "coverage" is a broad term of art that can include the duty to defend as well as the duty to indemnify. Even AGLI acknowledges that its policy followed the form of XL's policy and thus included not just a duty to indemnify for

damages ("ultimate net loss") but also a duty to defend and pay "allocated claims expenses" including attorneys' fees and defense costs. [*See* ER 136, ER 139]

To avoid this result, AGLI reads its policy in an artificial, segmented fashion. AGLI analyzes the policy as if Intel and AGLI first agreed to AGLI's preprinted form policy, which contained Condition H but was limited to a duty to indemnify and disclaimed a duty to defend. Then, AGLI assumes, Intel and AGLI agreed to Endorsement 1, which added a duty to defend to follow the form of the primary XL policy but left Condition H limited to the duty to indemnify.

That approach is clever but untethered to reality. Intel and AGLI never agreed to use AGLI's preprinted form by itself. Intel insisted on a duty to defend at the outset, and the following-form provisions of Endorsement 1 were part and parcel of the parties' original agreement. The various provisions were adopted simultaneously, and the proper way to read them is in conjunction as a single contract, not as artificially separated agreements. Indeed, as Intel showed in its opening brief (at 25–26), California law *requires* related contractual documents to be construed *in pari materia*. At a minimum, Intel's approach is *a* reasonable way to interpret the policy as a whole, and that is all that Intel must show to prevail.

Tellingly, AGLI cites no case law supporting, much less requiring, its segmented approach. At page 32 of its brief, AGLI relies on *Union Oil Co. v. International Insurance Co.*, 37 Cal. App. 4th 930, 937 (1995), to argue that "[t]he

AGLI Policy must be read *in the order in which it was drafted*" (emphasis added). But *Union Oil* says no such thing. To the contrary, it says that "[w]e interpret contracts (including insurance contracts) as a whole, with each clause lending meaning to the others," and that "we should interpret contractual language in a manner which gives force and effect to every clause rather than to one which renders clauses nugatory." *Id.* (quoting *Titan Corp. v. Aetna Cas. & Sur. Co.*, 22 Cal. App. 4th 457, 473 (1994)). Here, Intel *is* appropriately interpreting the AGLI policy as a whole, with each clause lending meaning to the others, and Intel is *not* rendering Paragraph C nugatory. Paragraph C required exhaustion of the underlying limits of insurance to result from certain events (judgments or settlements), but Condition H explained whose payments could contribute to such exhaustion (both Intel's and XL's).

AGLI also relies on the title of Condition H ("When Damages Payable"), arguing that Condition H must be limited to indemnity because "damages" relate to indemnity. As explained in Intel's opening brief, however, the short, generalized title of Condition H plainly referred to the *second* sentence of Condition H, which governed the timing of AGLI's obligation to pay damages covered under the policy. At issue here is the *first* sentence of Condition H, which refers to triggering of "coverage," not "damages." Through Endorsement 1, AGLI's "coverage" also included a duty to defend and pay Intel's defense costs.

### C. AGLI Misreads the Case Law

AGLI argues that *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 161 Cal. App. 4th 184 (2008), and *Farmers Insurance Exchange v. Hurley*, 76 Cal. App. 4th 797 (1999), compelled the district court's interpretation of AGLI's policy, and that a Wisconsin decision, *Danbeck v. American Family Mutual Insurance Co.*, 629 N.W.2d 150 (Wis. 2001), supported it. But all three cases are readily distinguishable. Indeed, Intel explained in its opening brief (at 38–41) why *Qualcomm* and *Hurley* were inapposite, yet AGLI's response wholly ignores that discussion. AGLI also fails to explain why this Court should follow *Danbeck*, which did not involve an excess liability policy like the one here.

In *Qualcomm*, the Court of Appeal made clear that its decision depended on the particular "literal policy language" of the policy at issue. 161 Cal. App. 4th at 187. The decision expressly declined

> to formulate a definitive rule applicable in every case in light of varying equitable considerations which may arise, and which may affect the insured and the primary and excess carriers, and which depend upon the particular policies of insurance, the nature of the claim made, and the relation of the insured to the insurers.

*Id.* at 204 (quoting *Signal Cos., Inc. v. Harbor Ins. Co.*, 27 Cal. 3d 359, 369 (1980)).

Contrary to AGLI's suggestion (at 48), the policy language at issue in *Qualcomm* did not differ "slightly" from the language of Paragraph C here. The

policy language differed *markedly* and in the most important respects, as a side-by-side comparison confirms:

| **Paragraph C** | ***Qualcomm* Policy (161 Cal. App. 4th at 195)** |
|---|---|
| Nothing contained in this Endorsement shall obligate us to provide a duty to defend any claim or suit before the Underlying Insurance Limits in Item 6. of the Declarations <u>are exhausted</u> by payment of judgments or settlements.<br>(emphasis added) | Underwriters shall be liable only after the <u>insurers under each of the Underlying Policies</u> have paid or have been held liable to pay the full amount of the Underlying Limit of Liability.<br>(emphasis altered) |

In *Qualcomm*, the policy used the active voice and expressly provided that the excess insurer was liable only after the *underlying insurers* had paid or been held liable to pay the full amount of the underlying limit. *Id.* at 195. Here, in contrast, Paragraph C was written in the passive voice: it merely required the underlying limits to be exhausted and was silent about who had to pay any amount. The very language that the *Qualcomm* court found clear and compelling is absent here. In fact, the language in *Qualcomm* more closely tracks the language of Condition H of AGLI's policy, except that Condition H critically differed by making clear that Intel *or* its underlying insurer—not just the underlying insurer alone—could contribute to exhausting the underlying limits:

| **Condition H** | ***Qualcomm* Policy (161 Cal. App. 4th at 195)** |
|---|---|
| Coverage under this policy will not apply unless and until the insured or the insured's underlying insurance has paid or is obligated to pay the full amount of the Underlying Limits of Insurance stated in Item 6.B. of the Declarations.<br>(emphasis added) | Underwriters shall be liable only after the insurers under each of the Underlying Policies have paid or have been held liable to pay the full amount of the Underlying Limit of Liability.<br>(emphasis altered) |

If anything, *Qualcomm* supports *Intel's* reading of the AGLI policy.

AGLI next argues (at 48) that *Hurley* considered "the operative language in the AGLI policy." Not so. In *Hurley*, the Court of Appeal considered what "exhausted by payment of judgments or settlements" meant in the context of an underinsured motorist (UIM) insurance statute that read:

> This [underinsured motorist] coverage does not apply to any bodily injury until the limits of bodily injury liability policies applicable to all insured motor vehicles causing the injury have been exhausted by payment of judgments or settlements, *and proof of the payment is submitted to the insurer providing the underinsured motorist coverage*.

Cal. Ins. Code § 11580.2(p)(3) (emphasis added). Statutes implicate particular public policy concerns that contracts do not. Indeed, *Hurley* emphasized that the case there involved a statute rather than an insurance contract. 76 Cal. App. 4th at 802–03 (distinguishing cases cited by the insured because they involved contracts, not statutes). Moreover, the additional statutory language italicized above proved vital to the holding that Farmers owed no coverage until the UIM carrier paid its

entire limits. Two of the three judges concurred, "reluctantly," precisely because the statute expressly required "proof of the payment" to the UIM carrier. *Id.* at 808. Here we also have additional language, but it cuts the other way: Condition H stated that "coverage" was triggered when "the insured *or* the insured's underlying insurance" paid or was obligated to pay the full underlying limits. No similar language appeared in the UIM statute in *Hurley*.

Finally, *Danbeck* is also not on point. Like *Hurley*, *Danbeck* considered a first-party UIM claim. In *Teigen v. Jelco of Wisconsin, Inc.*, 367 N.W.2d 806 (Wis. 1985), an earlier case involving excess insurance for third-party claims, the Wisconsin Supreme Court held that an underlying policy *had* "been exhausted by payment of judgments or *settlements*" even though the insured and its primary insurer had settled for below policy limits. 367 N.W.2d at 810 (emphasis in original). *Danbeck* reached the opposite result, pointedly distinguishing *Teigen* on the ground that *Teigen* "did not concern the interpretation of an exhaustion clause in a UIM policy." 629 N.W.2d at 155. *Danbeck* thus makes clear that cases involving UIM policies are distinguishable from cases, like this one, that concern an exhaustion clause in an excess liability policy. In any event, *Danbeck* is also readily distinguished because it, unlike this case, did not involve an insurance contract that (in Condition H) expressly permitted the policyholder to help exhaust the underlying limits and trigger the coverage in dispute.

## II. THE DISTRICT COURT ERRED IN GRANTING SUMMARY JUDGMENT *SUA SPONTE* WITHOUT PROVIDING NOTICE TO INTEL AND WITHOUT ALLOWING INTEL TO OFFER PAROL EVIDENCE SUPPORTING ITS INTERPRETATION

AGLI does not suggest that it moved for summary judgment, that the district court told Intel that it might enter summary judgment of no exhaustion *sua sponte*, or that the district court actually considered parol evidence supporting Intel's interpretation of the policy. Instead, AGLI argues that (1) Intel had notice that the district court might rule *sua sponte* because Intel filed its own summary judgment motion, (2) Intel waived any opportunity to present parol evidence, and (3) Intel's parol evidence was irrelevant because the policy was not reasonably susceptible to Intel's reading. Once again, all three arguments are mistaken.

### A. Intel Had No Notice that the District Court Would Enter Summary Judgment Against It *Sua Sponte*

AGLI acknowledges (at 54) that summary judgment may be entered *sua sponte* only when the losing party was put on notice that the district court was considering the sufficiency of its claim. At no time before entering its order granting summary judgment to AGLI and Markel did the district court in this case advise Intel that it was considering entering judgment against Intel. AGLI cites the district court's Order Granting Leave to File Motion for Reconsideration, but as the title of that order indicates, the district court merely allowed AGLI and Markel to seek reconsideration of its earlier grant of summary judgment to Intel. [ER 24–31]

The order limited AGLI and Markel to arguing "exhaustion of Intel's underlying insurance as it relates to Condition H of the AGLI Policy." [ER 31] But the district court never suggested that it might find no exhaustion as a matter of law on its own motion. The district court's orders requesting supplemental briefing did no such thing, either. [SER 157–58, SER 170–71]

The cases AGLI cites are factually inapposite. In *Destination Ventures, Ltd. v. FCC*, 46 F.3d 54 (9th Cir. 1995), the district court followed the routine practice of converting the defendant's motion to dismiss into a motion for summary judgment because the motion relied on material outside the pleadings. In that case, the plaintiff obviously knew that the defendant was seeking judgment because the defendant had moved for judgment. Moreover, the plaintiff not only had the opportunity to counter the defendant's evidence; it did so by submitting its own extrinsic evidence. *Id.* at 56. That did not happen here. In *Portsmouth Square, Inc. v. Shareholders Protective Committee*, 770 F.2d 866 (9th Cir. 1985), the district court told the plaintiff at the pretrial conference that it planned to enter judgment for the defendant on grounds that the plaintiff did not state a valid legal claim. The defendant then had the opportunity to present both its legal theory and any supporting facts. *Id.* at 869. Nothing of that sort happened here, either.

### B. Intel Did Not Waive Its Right to Present Parol Evidence

AGLI alternatively contends that Intel forfeited any right to present parol evidence and oppose summary judgment against it. According to AGLI, Intel is barred because Intel did not present parol evidence in support of Intel's own motion for partial summary judgment of no exhaustion, because Intel opposed a continuance for AGLI to develop parol evidence, and because Intel did not offer any parol evidence in the Delaware action even though AGLI moved for partial summary judgment of no exhaustion there. AGLI errs both legally and factually.

Intel did not present parol evidence in support of its own motion for summary judgment of no exhaustion because (1) it thought it could prevail under the language of the agreement by itself and (2) proffering parol evidence would only have invited AGLI to raise factual disputes in response. Intel's argument that the policy language unambiguously favored it was neither a waiver of its backup argument that the policy was at least ambiguous nor a stipulation that Intel would forgo any reliance on extrinsic evidence. A motion for summary judgment contends that there are no genuine issues of material fact and that the *moving party* is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a). Such a motion does not concede that no genuine issues of material fact prevent summary judgment for the *opposing party*. Tellingly, AGLI offers no support for its contention that a motion for summary judgment automatically opens up the

moving party to summary judgment against it—without any cross-motion and without any notice that the district court might enter judgment *sua sponte*.

Intel did oppose AGLI's request for a continuance, but that is irrelevant because insurance law is not reciprocal. Intel contended that it was entitled to summary judgment based on the policy language alone. The parol evidence that AGLI proposed to pursue could not have defeated summary judgment for Intel because it at most could have shown that the policy language contained a latent ambiguity resulting in two reasonable interpretations. As discussed above, policyholders prevail as a matter of law in such situations.[3] By contrast, Intel *can* defeat summary judgment with parol evidence suggesting that the policy language is ambiguous and that both parties' interpretations are reasonable.[4]

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[3] Contrary to AGLI's suggestion (at 44), Intel has never contended that "courts automatically resolve all issues of coverage in favor of the insured instead of analyzing the actual policy language." Instead, consistent with California law, including the case AGLI cites, *Palacin v. Allstate Insurance Co.*, 119 Cal. App. 4th 855 (2004), Intel has directly addressed the policy language and argued that any ambiguities in that language must be construed against AGLI, which drafted it, and in favor of the reasonable expectations of the policyholder, Intel.

[4] AGLI errs in suggesting (at 44) that courts may find that an insurance contract unambiguously favors the insurer, thereby mooting the pro-policyholder construction rules, without considering parol evidence favoring the policyholder. As shown in Intel's opening brief (at 42–43), California courts consider extrinsic evidence in deciding whether a contract is ambiguous. *Palacin* is not contrary: it confirmed that "[w]hen the relevant provisions of an insurance contract are ambiguous, extrinsic evidence may be admitted to determine the proper interpretation," 119 Cal. App. 4th at 862, but it did not address, much less preclude, use of extrinsic evidence to reveal a latent ambiguity in the first place.

As to the Delaware action, AGLI misrepresents Intel's conduct. In Delaware, one ground on which AGLI moved for partial summary judgment was that its policy had not been triggered because Intel's *fronting* policy from Old Republic Insurance Company did not allow defense costs to erode its policy limit. [RJN 95] In opposition, Intel submitted parol evidence in the form of declarations from both Old Republic and Marsh, the insurance broker that arranged all of Intel's insurance policies during the 2001–2002 policy period. [RJN 95–96] AGLI did not raise its argument that Condition H applied exclusively to indemnity until its *reply* brief, leaving Intel no opportunity to respond or submit extrinsic evidence to contradict that new argument.

In any event, whatever happened in Delaware is beside the point here. In this case, neither AGLI nor Markel had moved for summary judgment and the district court never indicated that it was contemplating entering summary judgment that the XL policy limits were not exhausted. Intel had no reason to proffer parol evidence, and it was not required to do so.

Finally, AGLI argues that Intel is improperly raising a new argument on appeal. That argument is a Catch-22. Intel did not present parol evidence below because it was not on notice that such evidence might be needed. If AGLI's waiver theory were correct, the well-settled law requiring district courts to give notice before entering summary judgment *sua sponte* would be a dead letter.

### C. Intel's Parol Evidence Is Relevant Because the Policy Is Reasonably Susceptible to Intel's Interpretation

AGLI's third argument is essentially harmless error: according to AGLI, parol evidence was irrelevant and could not help Intel because the policy was not reasonably susceptible to Intel's interpretation. This argument, however, depends on AGLI's assertion that Intel is trying to read Paragraph C out of the policy. As discussed above, Intel is doing no such thing. Paragraph C may require exhaustion of the underlying limits "by judgments or settlements," but it does not address who can contribute to exhaustion. Intel was thus entitled to present parol evidence that (1) it intended to structure its excess policies to allow contribution by both Intel and underlying insurers, and (2) the policies both below and above the AGLI excess policy consistently allowed both Intel and the underlying insurers to contribute to exhausting the underlying limits.

AGLI's policy is even more reasonably susceptible to Intel's interpretation once Condition H is taken into account. At a minimum, the combination of Paragraph C and Condition H left doubt about whose payments pursuant to a judgment or settlement could count toward exhaustion. AGLI argues that Condition H had to be limited to indemnity, but AGLI's policy for 2002–2003 would have undermined that argument and established at least an ambiguity: the 2002–2003 policy contained a provision nearly identical to Condition H, yet it

included both defense and indemnity obligations. [*See* ER 283, 290 (in the district court record for a different purpose)]

Finally, this Court should keep in mind that the district court itself initially found the AGLI policy ambiguous even without considering Intel's parol evidence. [ER 41–42] Surely the policy would have been "reasonably susceptible" to Intel's interpretation when Intel's parol evidence is added to the mix. At the very least, this Court should remand so that the district court can consider the parol evidence in the first instance. Intel cannot fully present its argument in this Court precisely because the district court did not give notice and allow Intel to make its record. Thus, even if Intel was not entitled to summary judgment of exhaustion, the district court's hasty *sua sponte* summary judgment of no exhaustion must be set aside.

## Conclusion

California courts vigorously enforce insurers' duty to defend and vigorously protect policyholders' right to a defense. In the California Supreme Court's words, "California courts have been consistently solicitous of insureds' expectations on this score." *Montrose Chem. Corp. v. Superior Court*, 6 Cal. 4th 287, 296 (1993). Unfortunately, the district court was not solicitous. In finding no exhaustion as a matter of law, it misread Paragraph C and Condition H and nullified Intel's reasonable expectation that both XL's and Intel's contributions could exhaust the XL policy limits and trigger AGLI's duty to defend.

The summary judgment of no exhaustion and no duty to defend should be reversed, and the case should be remanded for further proceedings.

Respectfully submitted,

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**Certificate of Compliance**

I certify that pursuant to Fed. R. App. P. 32(a)(7)(C) and Ninth Circuit Rule 32–1, the attached reply brief is proportionately spaced, has a typeface of 14 points or more, and contains 5,364 words.

/s/ Dan L. Bagatell

Dan L. Bagatell

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