No. 11–15129

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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.

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)

OPENING BRIEF OF APPELLANT INTEL CORPORATION

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Corporate Disclosure Statement

Intel Corporation has no parent companies, and no publicly held company owns 10% or more of its stock.

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Jurisdiction

The district court had jurisdiction under 28 U.S.C. § 1332(a)(1) because the parties are citizens of different states and the amount in controversy exceeded $75,000. This Court has appellate jurisdiction under 28 U.S.C. § 1291 because Intel appeals from a final judgment entered January 12, 2011, that disposed of all claims and counterclaims. [ER 1–2] This appeal is timely under Federal Rule of Appellate Procedure 4(a)(1)(A) because Intel filed a timely notice of appeal the day after the district court entered final judgment. [ER 66–70]

Questions Presented

AGLI's excess liability insurance policy provided that its "coverage" included both a duty to defend and a duty to indemnify Intel against certain claims after Intel and/or its underlying insurer, XL, exhausted XL's policy limit of $50 million. The AGLI policy also contained a provision requiring AGLI to defend Intel once the underlying limit was "exhausted by payment of judgments or settlements." Intel settled coverage disputes with XL for less than $50 million, but the combination of XL's settlement payments and Intel's own payments for defense costs exceeded $50 million. AGLI refused to defend. The district court originally ruled for Intel but later reconsidered and held that only a settlement whereby XL paid 100% of its policy limit toward Intel's defense costs could trigger AGLI's duty to defend. The court granted summary judgment to AGLI and

an intervening insurer, Markel, even though AGLI had not moved for summary judgment.

The questions presented are:

1. Did the district court err in holding that the only reasonable interpretation of AGLI's insurance policy required XL alone to pay its $50 million policy limit toward defense of lawsuits in order to trigger AGLI's duty to defend, even though the policy expressly permitted Intel to contribute to exhausting that $50 million policy limit?

2. Did the district court err in not only vacating its partial summary judgment for Intel, but also *sua sponte* granting summary judgment against Intel?

Statement of the Case

In 2005, Intel's competitor Advanced Micro Devices, Inc. ("AMD") sued Intel, claiming that Intel had engaged in unfair business practices and anticompetitive conduct in advertising, promoting, discounting, selling, and marketing its microprocessors. AMD sought both an injunction and billions of dollars in damages. Numerous similar consumer class actions followed suit.

Intel turned to its insurance companies for assistance with its defense costs. Intel resolved coverage disputes with its primary insurer, XL, in a settlement agreement under which XL paid Intel less than XL's full $50 million policy limit. [ER 233–48 (under seal)] Intel had already paid the remainder of the $50 million

policy limit, and more, toward its defense costs, so it turned to AGLI, which had issued an excess insurance policy that was triggered by exhaustion of the XL policy. After AGLI refused coverage, Intel sued AGLI in the Northern District of California, seeking a declaration of coverage. [ER 374–89]

In the district court, Intel moved for partial summary judgment that the XL policy was exhausted and that AGLI's policy covered the underlying claims, creating a duty to defend. [ER 71–100] Neither AGLI nor Markel, another excess insurer that had intervened in the district court action, cross-moved for summary judgment. In a decision signed July 26, 2010, and filed the next week, the district court granted partial summary judgment for Intel, holding that the XL policy limit was exhausted and that AGLI had a duty to defend because the underlying claims potentially fell within the policy's scope. [ER 32–65 (under seal)]

AGLI and Markel sought reconsideration of the district court's ruling based on a new argument that AGLI had made in parallel coverage litigation against Intel in Delaware state court. [ER 24–31] In an order dated December 7, 2010, the district court vacated its earlier grant of partial summary judgment to Intel and *sua sponte* granted summary judgment of no exhaustion to AGLI and Markel. [ER 3–23] The district court entered final judgment on January 12, 2011 [ER 1–2], and Intel filed its notice of appeal the next day [ER 66–70].

Statement of Facts

A. Fundamental Concepts of Insurance Law

Because insurance law uses somewhat arcane terminology, this brief will summarize some basic concepts of insurance law before describing the details of the insurance policies at issue here. Because the policies in this case are governed by California law, this discussion cites black-letter California law.

Liability insurance policies typically impose two duties upon the insurer: (1) the duty to *defend* suits against the policyholder, and (2) the duty to *indemnify* the policyholder for the damages that the policyholder must pay as a result of a settlement or judgment. The duty to defend is broader than the duty to indemnify. The duty to indemnify arises after the policyholder pays or is found liable to pay a third-party claim. The duty to defend, by contrast, arises at the onset of a claim. Because liability on the claim necessarily has not yet been determined, the duty to defend arises whenever there is a mere *potential* or *possibility* that the claim may fall within the scope of the policy. *See, e.g.*, *Montrose Chem. Corp. v. Superior Court*, 6 Cal. 4th 287, 299–300 (1993); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 275–77 (1966).

This case involves "excess" insurance coverage. Many policyholders have insurance programs that include both primary and excess coverage. "In the ordinary case, excess … coverages are designed to pick up where the primary

insurance coverage leaves off, providing an excess layer of coverage above the limit of the primary policy, and [to] protect against gaps in coverage." *Garamendi v. Mission Ins. Co.*, 131 Cal. App. 4th 30, 46 (2005) (citations omitted). Excess policies typically require the underlying policy limit to be "exhausted" before excess coverage kicks in. Exhaustion normally occurs when payments from certain sources reach a threshold amount, but exhaustion and the resulting trigger of excess coverage can occur in various ways depending on the policy language. Many excess policies "follow form" to the underlying policies—*i.e.*, they contain the same coverages, conditions, and exclusions as the underlying policies.

Insurance coverage is construed broadly. That is so regardless of the type of policy and regardless of whether the issue is exhaustion, the duty to defend, the duty to indemnify, or something else. A fundamental precept of insurance law is that coverage must comport with the objectively reasonable expectations of the insured. *See, e.g.*, *Safeco Ins. Co. of Am. v. Robert S.*, 26 Cal. 4th 758, 763 (2001). Thus, all doubts or uncertainty regarding coverage or the potential for coverage are resolved in favor of the policyholder and against the insurer. *See, e.g.*, *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1081 (1993); *Wausau Underwriters Ins. Co. v. Unigard Sec. Ins. Co.*, 68 Cal. App. 4th 1030, 1036 (1998). In particular, coverage grants are construed broadly and exclusions are construed narrowly. *See, e.g.*, *MacKinnon v. Truck Ins. Exch.*, 31 Cal. 4th 635, 648 (2003).

B. Intel's Insurance Program and the XL and AGLI Policies

During the policy period at issue, Intel had a unique "manuscript" (specially designed) insurance program that included multiple levels of insurance and allowed Intel to exhaust underlying policy limits and reach excess layers of insurance by relying on either payments by the underlying insurers or its own funds. The program was designed such that excess layers would follow form to an underlying policy provided by XL. Each layer of coverage in Intel's insurance program included both defense and indemnity coverage, and each layer could be exhausted by payment of defense costs and/or indemnity by Intel, its insurers, or a combination of the two.

1. Intel's "fronting" (first-line) policy for the policy year at issue, April 1, 2001, to April 1, 2002, had a $5 million limit. The fronting policy was a comprehensive general liability policy including, among other things, coverage for "advertising injury." The policy contained both a duty to defend and a duty to indemnify up to the limit of the insurance. [ER 305–30][1]

[1] In practice, fronting policies are typically used to satisfy financial responsibility laws rather than to shift risk from the policyholder to the insurer. For example, they may include a deductible or "self-insured retention" equal to the policy limit. Intel's fronting policy for 2001–2002 was such a policy. Although this brief mentions the fronting policy for completeness, the issues in this appeal do not turn on the scope of the coverage of that policy. Retentions and fronting policies like this one are not considered insurance under California law. *Aerojet-General Corp. v. Transport Indem. Co.*, 17 Cal. 4th 38, 50 (1997).

2. The next layer up in this policy year was XL's "umbrella" insurance policy, which provided an additional $50 million in coverage. [ER 134–69] Understanding the XL policy is important because its terms were expressly incorporated into the AGLI excess policy at issue here.

Like the fronting policy, the XL policy provided broad commercial insurance, including coverage for claims involving "advertising injury." The XL policy also contained a special "Retained Limits" provision. Retained limits are normally self-insured amounts that the policyholder must pay before the insurer owes coverage. The XL policy, however, specifically permitted Intel to insure some or all of Intel's retained limit ($16 million) and to reach the retained-limit threshold through a combination of fronting insurance and Intel's own out-of-pocket payments:

> [Intel] may insure any or part of or all of the retained limit … or take advantage of any other insurance available to it without prejudice to or invalidation of coverage under this policy. If any such insurance is less than [Intel's] retained limit, then [Intel] will make up the difference.

[ER 144]

Coverage under the XL policy included both a duty to defend and a duty to indemnify. In particular, the XL policy provided that the insurer

> shall defend any suit against [Intel] alleging such injury or destruction and seeking damages on account thereof,

> even if such suit is groundless, false, or fraudulent, and to pay all allocated claims expenses.

[ER 136] The XL policy defined the "allocated claims expenses" owed by XL as a subset of Intel's "ultimate net loss," which in turn was defined as "all sums which [Intel] is legally obligated to pay as damages because of … advertising liability … and allocated claims expenses to which this policy applies." [ER 139] "Allocated claims expenses" included both defense costs (costs incurred in the "the defense of legal proceedings against [Intel]") and damages ("all costs taxed against [Intel] in any such suit and all interest on the entire amount of judgment therein which accrues after entry of the judgment"). [ER 139] The XL policy provided that its limit was $50 million for any kind of "ultimate net loss." [ER 144] The parties to this case thus agreed that the XL policy was a "burning limits" policy that could be exhausted by either defense or indemnity payments.[2]

3. Above the XL policy lay various excess insurance policies, starting with the AGLI policy at issue here. Each of Intel's excess insurance policies followed form to XL's primary policy. In particular, Endorsement 1 of the

[2] Under most liability insurance policies, payments of defense costs do not reduce the amount of indemnity owed and thus cannot exhaust the policy limit. By contrast, under "burning limits" policies, payments of defense costs and indemnity costs count equally toward exhausting the policy limit. *See Powerine Oil Co., Inc. v. Superior Court*, 37 Cal. 4th 377, 402 (2005).

AGLI policy, entitled "Following Form Endorsement," contained three paragraphs relevant here.

Paragraph A of Endorsement 1 stated that

> This policy follows the exact terms and conditions of the [XL policy]

except with respect to provisions not at issue here (the limit of AGLI's liability, the premium amount, and exclusions relating to asbestos and nuclear accidents). [ER 107] Paragraph B of Endorsement 1 likewise provided that

> All preprinted terms and conditions of [AGLI's policy] are deleted to the extent they are inconsistent with the terms and conditions of [XL's policy].

[ER 107] As a result of these provisions, the coverage terms of the XL policy substituted for all narrower preprinted coverage terms of the AGLI form policy. Among other things, the duty to defend in the XL policy superseded the disclaimer of a duty to defend in the preprinted AGLI form.

The final provision of the following-form Endorsement 1 was Paragraph C, which is one of the two provisions at the heart of this appeal. Paragraph C provided that nothing in the Endorsement required AGLI to defend until the underlying limits were "exhausted by payment of judgments or settlements":

> 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]

The other provision central to the current dispute is the exhaustion provision of the AGLI form policy, Condition H. The parties agree that Condition H was *not* inconsistent with the XL policy and thus went into effect despite Endorsement 1. Like the "Retained Limits" provision of the XL policy, Condition H allowed Intel to satisfy the limit of the policy underlying the AGLI policy through a combination of payments by Intel or its underlying insurer, XL:

> H. When Damages Payable
>
> 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.
>
> When the amount of damages is determined, [AGLI] will promptly pay on behalf of [Intel] the amount of damages covered under this policy.

[ER 120] AGLI's coverage, including its duty to defend, thus applied once Intel, XL, or a combination of the two paid the full limit of the XL policy ($50 million above the $16 million in retentions and fronting amounts).[3]

C. The Underlying AMD Actions

In June 2005, AMD sued Intel in the United States District Court for the District of Delaware, claiming that Intel had engaged in unfair business practices

[3] For the Court's convenience, Endorsement 1 (including Paragraph C) and Condition H are reprinted in the one-page Addendum at the end of this brief.

and anticompetitive conduct in advertising, promoting, discounting, selling, and marketing its microprocessors. [ER 456–504] Some of the alleged misconduct purportedly took place during the AGLI policy period of April 1, 2001–April 1, 2002.

In the ensuing months, more than 80 putative class actions were filed in federal court, similarly alleging anticompetitive practices in Intel's advertising, promotion, discounting, sale, and marketing of its microprocessors. [ER 505–33; ER 565–616] Those class actions were consolidated into *In re Intel Corporation Microprocessor Antitrust Litigation*, MDL No. 1717–JJF (D. Del.). In addition, six consumer class actions with similar allegations were filed and subsequently consolidated in the California Superior Court for Santa Clara County. [ER 534–64] For simplicity, this brief will refer to AMD's action and the federal and state consumer class actions as the "Underlying AMD Actions."

AMD and Intel ultimately settled their dispute in November 2009, but the consumer class actions remain pending. For present purposes, the merits of the Underlying AMD actions and the size of Intel's settlement payment to AMD are irrelevant. What matters is that those lawsuits have been extremely expensive to defend. The precise amount Intel has paid for attorneys' fees and other defense costs is confidential, but it indisputably exceeds the sum of Intel's retention and

fronting insurance amounts ($16 million), the XL policy limit ($50 million), and the AGLI policy limit ($50 million). [ER 331–33 (under seal)]

D. Intel's Settlement with XL

In 2006, Intel filed a declaratory judgment action against XL after XL refused to defend Intel in two class actions unrelated to the Underlying AMD Actions. *Intel Corp. v. XL Ins. Am., Inc.*, No. 1–06–CV–061620 (Cal. Super. Ct., Santa Clara Cty.). After the trial court ruled in 2008 that XL had a duty to defend Intel in those class actions, Intel and XL entered into a Settlement Agreement and Release in which Intel released any claims against XL for policies that XL issued to Intel for the policy periods of 1998–2001 and 2001–2002. [ER 228–63 (under seal)] The claims released in the settlement included Intel's claims for coverage of Underlying AMD Actions that had been previously tendered to XL as well as the two class actions that originally spawned the coverage suit. [ER 234–35]

Although Intel's settlement with XL was for less than the 2001–2002 XL policy limit of $50 million, the combination of XL's settlement payment and Intel's own contribution toward its costs of defending the Underlying AMD Actions exceeded the $50 million policy limit. [ER 331–33 (under seal)]

E. Intel's Coverage Dispute with AGLI and the Parties' Parallel Lawsuits in California and Delaware

Intel notified AGLI of the Underlying AMD Actions in October 2005, shortly after AMD filed suit. After Intel settled its coverage dispute with XL in

2008, Intel advised AGLI that the XL policy limit had been exhausted and that AGLI's duty to defend had been triggered. [ER 382][4]

Intel and AGLI initially entered into a standstill agreement, but AGLI ultimately denied coverage on January 9, 2009. On the first day allowed under the standstill agreement, Intel and AGLI filed lawsuits against one another: Intel sued AGLI in the United States District Court for the Northern District of California seeking, among other things, a declaration of coverage [ER 374–89], while AGLI sued Intel in the Delaware Superior Court for New Castle County seeking, among other things, a declaration of noncoverage and assistance from other insurers if it were found liable to Intel [Request for Judicial Notice ("RJN") 1–13]. Although the cases were largely mirror images, both trial court judges proceeded to consider the merits in parallel. [ER 360–73; RJN 14–66].[5]

The proceedings in the Delaware action should not affect the result here, but they do provide helpful background. Intel accordingly asks the Court to take judicial notice of the Delaware docket items included in Intel's excerpts of record.

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[4] Although all of Intel's policies also include a duty to indemnify, Intel has not sought indemnification for liability in the Underlying AMD Actions and it does not intend to do so in the future.

[5] Intel's excess policy with Markel is not at issue in this lawsuit because Intel did not tender its defense to Markel. Indeed, Markel did not even provide coverage to Intel coverage for the 2001–2002 policy year. Nevertheless, AGLI's Delaware lawsuit sought contribution from Markel (and other insurers), and

F. The District Court's Initial Ruling that the XL Policy Limit Was Exhausted and that AGLI Owed a Duty to Defend

Intel filed a motion for partial summary judgment in the district court, asking that court to determine that (1) the combination of XL's settlement payment and Intel's own payments toward its defense costs exhausted the XL policy limit and triggered AGLI's policy, and (2) AGLI owed Intel a duty to defend because the Underlying AMD actions potentially fell within the substantive scope of Intel's "advertising injury" coverage. In a decision signed on July 26, 2010, the district court granted the motion. [ER 32–65 (under seal)]

As to exhaustion of the XL policy limit, the only issue on this appeal, the district court reasoned that two provisions of the AGLI policy appeared contradictory. [ER 41] Paragraph C of Endorsement 1 provided that "[n]othing contained in this Endorsement shall obligate [AGLI] to provide a duty to defend … before the Underlying Insurance Limits … are exhausted by payment of judgments or settlements." [ER 42] AGLI contended that this provision implicitly required XL alone—not a combination of XL and Intel—to pay the entire $50 million XL policy limit. The district court recognized, however, that Condition H of the preprinted AGLI policy survived and provided that "[c]overage under this policy will not apply unless and until *the insured or the insured's underlying insurance*

Markel was granted leave to intervene in this lawsuit as well. For simplicity, Intel will describe arguments made by both AGLI and Markel as AGLI's arguments.

ha[s] paid the full amount of the Underlying Limits ….” [ER 41 (emphasis added)] The latter term, the district court noted, plainly “allows for damages to be payable under the AGLI Policy so long as the full amount of the underlying limits of the XL Policy have been reached by a *combination of payments by* the insured and the insured’s underlying insurance.” [ER 41 (emphasis in original)]

The district court concluded that “[i]f AGLI intended to amend the plain language … with respect to when damages are payable, it needed to do so more explicitly.” [ER 42] At best the policy was ambiguous as to whether Endorsement 1 (which generally *expanded* AGLI’s obligations to match those of XL) superseded Condition H by *narrowing* its applicability, and any ambiguity had to be construed against the insurer. [ER 42] The combination of XL’s payments and Intel’s own payments thus exhausted the XL policy and triggered AGLI’s coverage. [ER 42]

G. The District Court’s Later Summary Judgment of No Exhaustion

After briefing in the district court was complete, AGLI moved in Delaware for partial summary judgment of no exhaustion and hence no liability to Intel. In a decision signed July 29, 2010, the Delaware court ruled for AGLI, holding that the XL policy had *not* been exhausted. [RJN 115] The Delaware court was unaware of the district court’s ruling three days earlier and based its holding on a policy construction argument that AGLI first made in reply in that case and had not raised

in the district court. That ruling prompted AGLI to ask the district court to reconsider its grant of partial summary judgment to Intel.

The district court granted reconsideration [ER 24–31] and ultimately reversed itself, holding that the AGLI policy unambiguously required XL to pay its entire $50 million policy limit before AGLI's duty to defend could be triggered [ER 3–23]. The district court agreed with Intel that Condition H was unchanged by Paragraphs A and B of Endorsement 1, which provided that AGLI's excess policy would follow the terms and conditions of the underlying XL policy. In the district court's new view, however, the "coverage" to which AGLI committed under Condition H of its preprinted form policy included only "damages," and damages concerned only the duty to indemnify, not the duty to defend. [ER 15] In an effort to reconcile that conclusion with the following-form endorsement, the district court further held that the reference in Paragraph C of Endorsement 1 to "exhaust[ion] by payment of judgments or settlements" unambiguously required that the full underlying limit be paid by XL alone, even in the context of a settlement of a coverage dispute regarding the duty to defend. [ER 18] The district court thus repudiated its earlier conclusion that the combination of Condition H and Paragraph C of Endorsement 1 created an ambiguity that had to be resolved in Intel's favor. [ER 19–20]

Concluding that the combination of XL's settlement payments and Intel's own defense payments could not exhaust the XL policy, the district court rescinded its earlier grant of partial summary judgment to Intel and denied Intel's motion. [ER 20] Although the district court recognized that AGLI and Market had not cross-moved for summary judgment, it also decided, *sua sponte*, to grant them summary judgment dismissing Intel's declaratory judgment and breach-of-contract causes of action. [ER 20–21] The district court did so without warning to Intel and without allowing Intel to proffer extrinsic evidence supporting its policy interpretation.

Intel appeals from the ensuing final judgment disposing of all claims. [ER 1–2] After Intel filed its notice of appeal in this case, the Delaware trial court denied Intel's motion for rehearing. [RJN 116–21] A number of issues remain pending before the Delaware trial court, but when those issues are resolved, Intel intends to seek a stay of that action. If the Delaware action is not stayed by the Delaware trial court, Intel intends to request a stay from the Delaware Supreme Court after the Delaware trial court enters final judgment. In any event, whatever the Delaware courts may do, the first final judgment was in this case, and Intel asks this Court to reverse or vacate that judgment.

Summary of Argument

The district court erred as a matter of law in concluding that Intel could not combine XL's settlement payments with its own payments for defense costs to exhaust the XL policy limit and trigger AGLI's duty to defend. At a minimum, the district court erred in granting summary judgment of no exhaustion *sua sponte*, without letting Intel present additional evidence supporting its policy interpretation that at least would have created a genuine issue of material fact.

1. Endorsement 1 of AGLI's policy provided that AGLI's policy would follow the form of Intel's underlying XL policy, other than exceptions irrelevant here. Although the preprinted form AGLI policy disclaimed any duty to defend Intel, Endorsement 1 overrode that disclaimer and incorporated the duty to defend and pay defense expenses from the XL policy. Under Condition H of the AGLI policy, AGLI's "coverage" was triggered once any combination of Intel and Intel's underlying insurance paid XL's underlying limit of $50 million. Endorsement 1 and the terms of the underlying XL policy expanded AGLI's "coverage" to include a duty to indemnify as well as a duty to defend. Read together, Condition H and Endorsement 1 provided that AGLI's duty to defend triggered when Intel and/or XL paid the $50 million limit of the XL policy.

Paragraph C of Endorsement 1 does not change the analysis. Paragraph C provided that nothing in Endorsement 1 required AGLI to defend a case until the

underlying policy limit was exhausted by payment of "judgments or settlements." On its face, having AGLI's duty to defend turn on payment of "judgments or settlements" seems strange because the duty to defend is triggered at the *outset* of a case and judgments and settlements ordinarily *resolve* cases. But the "judgments or settlements" language makes more sense when one realizes that underlying insurance is often disputed: the parties ensured that settlement of such a dispute could exhaust the XL policy limit. More generally, Paragraph C must be interpreted in light of its purpose: to confirm that AGLI had no duty to step up until Intel's "Underlying Insurance Limits shown in Item 6. of the Declarations" were exhausted. Item 6 of the Declarations provided that the "Underlying Insurance Limits" were $50 million. Read in that light, Paragraph C as a whole meant that AGLI's duty to defend was not triggered until after others had paid $50 million in one way or another.

Reading Paragraph C to require XL to pay $50 million to *indemnify* Intel before AGLI had any duty to *defend* Intel would render AGLI's duty to defend largely illusory because an insured has little need for a defense after it has already settled or paid a judgment in the underlying action. Furthermore, AGLI's reading would result in the anomaly of a duty to defend narrower than the duty to indemnify: AGLI concedes that any combination of $50 million in claim payments by Intel and/or XL could trigger AGLI's duty to *indemnify*, yet it

contends that XL alone had to pay $50 million in defense costs before AGLI could have a duty to *defend*.

In any event, Paragraph C was silent about *who* had to pay the $50 million. It did not specifically address Condition H, and it did not prohibit Intel from using its own payments of defense costs to exhaust the XL policy limit and trigger the AGLI policy. As Condition H and the "Retained Limits" provision of the XL policy confirm, Intel structured its insurance program so that it could exhaust underlying policy limits and trigger further coverage through a combination of its own payments and insurance payments. Nowhere did AGLI clearly indicate that only payments by XL could exhaust the underlying limit and trigger AGLI's duty to defend, or that AGLI's duty to defend was narrower than its duty to indemnify and essentially illusory. At a minimum, Intel's reading of the entire AGLI policy, including the incorporated XL policy and the additional consistent provisions of the AGLI policy, is reasonable, and any ambiguity must be resolved in Intel's favor as a matter of law.

Intel's interpretation is not only consistent with what a reasonable policyholder would expect, but also fair to AGLI even though the law does not require that result. AGLI's legitimate interest was in ensuring that its excess coverage would not be triggered until after others had contributed the $50 million

underlying limit. Intel's interpretation maintains that protection. AGLI's interpretation, by contrast, results in an unwarranted windfall to AGLI.

The district court's contrary analysis on reconsideration was flawed. The district court believed that Condition H was limited to indemnification of "damages." But the relevant language of Condition H referred to triggering of "coverage." After application of Endorsement 1, AGLI's "coverage" included duties to defend and pay for defense costs, not just a duty to reimburse "damages." The district court recognized that AGLI's policy ultimately included a duty to defend, but thought Condition H could not refer to a duty to defend because such a reading would contradict Paragraph C of Endorsement 1. That analysis was wrong for the reasons discussed above. At a minimum, the combination of exhaustion provisions was ambiguous and thus had to be construed broadly, in Intel's favor. The case law on which the district court relied is readily distinguishable, and the better-reasoned authority only confirms Intel's reasonable expectation of coverage.

2. Even if the district court correctly denied Intel summary judgment of exhaustion, it erred in *sua sponte* granting AGLI and Markel summary judgment of no exhaustion. Because AGLI and Markel did not cross-move for summary judgment, Intel had no reason to put forth evidence that supported its policy interpretation but risked complicating the argument and inviting fact disputes. In particular, Intel had no reason to present and did not present parol evidence

showing a latent ambiguity in the AGLI policy. Such evidence could have included testimony about Intel's intent in structuring its excess liability policies; the excess policies above the AGLI policy, whose coverage triggered even if underlying insurers did not pay the policy limits by themselves; and AGLI's policy for the next year, which had a provision nearly identical to Condition H that applied to both the duty to indemnify and the duty to defend. Thus, even if the Court affirms the district court's denial of Intel's summary judgment motion, it should reverse the district court's grant of summary judgment of no exhaustion.

Standard of Review

This Court reviews grants and denials of motions for summary judgment *de novo*. *See, e.g.*, *Humane Soc'y of U.S. v. Locke*, 626 F.3d 1040, 1047 (9th Cir. 2010); *Nolan v. Heald College*, 551 F.3d 1148, 1153 (9th Cir. 2009). All inferences must favor the non-moving party, and a summary judgment against that party must be reversed if it would be entitled to prevail under any reasonable construction of the evidence and any applicable theory of law. *See, e.g.*, *Posey v. Lake Pend Oreille School Dist. No. 84*, 546 F.3d 1121, 1126 (9th Cir. 2008).

In reviewing a district court's *sua sponte* grant of summary judgment, this Court also considers whether the party against which judgment was entered had a full and fair opportunity to develop and present facts and arguments supporting its position. *Norse v. City of Santa Cruz*, 629 F.3d 966, 972–73 (9th Cir. 2010) (en

banc) (district court lacked power to enter summary judgment *sua sponte* where the plaintiff was not given "a 'full and fair opportunity to ventilate the issues' prior to the district court's summary judgment on [his] claims"; error was not harmless where Court did not know what other evidence the plaintiff would have presented) (quoting *Greene v. Solano Cnty. Jail*, 513 F.3d 982, 990 (9th Cir. 2008)).

Argument

I. THE COMBINATION OF XL'S SETTLEMENT PAYMENTS AND INTEL'S PAYMENTS FOR DEFENSE COSTS EXHAUSTED THE XL POLICY LIMIT AND TRIGGERED COVERAGE UNDER AGLI'S POLICY

Intel organized its commercial liability coverage in the 2001–2002 policy year so that (a) each policy included a duty to defend as well as a duty to indemnify and (b) each policy's limit could be exhausted, triggering further coverage, by a combination of the insurer's payments and Intel's own payments. As shown below, a reasonable reading of the AGLI policy comports with that approach. By contrast, the district court's contrary interpretation strains the policy language, contradicts the careful structure of Intel's insurance program, and defies fundamental principles of insurance law. At a minimum, the AGLI policy's treatment of exhaustion is ambiguous and Intel's reasonable construction must prevail. *See, e.g.*, *Kazi v. State Farm Fire & Cas. Co.*, 24 Cal. 4th 871, 879 (2001) ("Any ambiguous terms are resolved in the insured's favor, consistent with the insured's reasonable expectations.").

A. Read Together, Endorsement 1 and Condition H Allowed Intel to Exhaust the XL Policy Limit by a Combination of XL's Payments and Its Own Payments for Defense Costs

The declarations page of AGLI's excess policy confirms that AGLI's policy was a "Following Form Excess Liability Policy" and that the XL policy was the "Controlling Underlying Policy." [ER 105] Although the preprinted form AGLI policy recited various insuring agreements and exclusions from coverage, the parties specifically superseded those provisions though Endorsement 1, the "Following Form Endorsement." [ER 107] After warning that the endorsement "CHANGES THE POLICY," Paragraph A of Endorsement 1 provided that "[t]his policy follows the exact terms and conditions of the [XL policy,]" except for the liability limit, the premium amount, and certain exclusions that no one contends are relevant here. [ER 107] Paragraph B of Endorsement 1 provided that "[a]ll preprinted terms and conditions of the [AGLI excess policy, other than the identified exceptions] are deleted to the extent they are inconsistent with the terms and conditions of the [XL policy]." [ER 107]

Thus, although the preprinted form AGLI policy disclaimed any duty to defend and stated that AGLI would indemnify only for damages [ER 116], Endorsement 1 had the effect of deleting that disclaimer and replacing it with the controlling wording of the underlying XL policy, which expressly imposed a duty to defend [ER 136]. In particular, the XL policy required both a defense of "any

suit against [Intel] alleging such injury or destruction and seeking damages on account thereof, even if such suit is groundless, false, or fraudulent" and payment of "all allocated claims expenses" up to the policy limit. [ER 136] "Allocated claims expenses" expressly included payments to outside attorneys, experts, and others "for services in connection with the investigation and settlement of claims and the defense of legal proceedings against [Intel]." [ER 139] Through Paragraphs A and B of Endorsement 1, AGLI assumed the same duty to defend Intel, up to AGLI's own policy limit.

Condition H of the preprinted AGLI policy must be read in conjunction with the duty to defend incorporated from the XL policy. Condition H read, in full:

> H. When Damages Payable
>
> 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.
>
> When the amount of damages is determined, [AGLI] will promptly pay on behalf of [Intel] the amount of damages covered under this policy.

[ER 120] Both the parties and the district court agreed that Condition H was not inconsistent with the underlying XL policy. Condition H thus must be read *in pari materia* with the incorporated duty to defend. *See* Cal. Civ. Code § 1641 ("The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other."); *Palacin v.*

Allstate Ins. Co., 119 Cal. App. 4th 855, 864 (2004) (if an insurance policy incorporates or refers to other documents, the court must engage in a "double-layered analysis" of disputed terms); *Heston v. Farmers Ins. Group*, 160 Cal. App. 3d 402, 417 (1984) (interrelated employment agreement and credit plan had to be read together).

In particular, as a result of Paragraphs A and B or Endorsement 1, the "[c]overage under this [AGLI] policy" to which Condition H referred included a duty to defend as well as a duty to indemnify. And under Condition H, that "coverage," including AGLI's duty to defend, began to apply when either "the insured [Intel] or the insured's underlying insurance [XL] has paid or is obligated to pay" the $50 million underlying XL policy limit stated in Item 6.B of the Declarations.

To avoid this result, AGLI contends that "coverage" under Condition H was limited to indemnification for damages. That would have been true under AGLI's preprinted form policy, which provided no duty to defend at all, but Endorsement 1 changed that result. The combination of Endorsement 1 and Condition H plainly expanded AGLI's "coverage" to include a duty to defend. And that "coverage" applied once "the insured or the insured's underlying insurance" paid or was obligated to pay the underlying $50 million limit of insurance.

AGLI has pointed to the heading of Condition H ("When Damages Are Payable"), but that reliance is misplaced for three reasons. First, Condition K of the controlling XL policy expressly stated that "section, paragraph and subparagraph headings are for reference only and shall not in any way affect the meaning or interpretation of this policy." [ER 151] Second, the summary heading of Condition H corresponded to a different part of Condition H. The second sentence of Condition H specifically addressed when damages to third parties were payable: promptly after the amount of damages was determined. The relevant provision here is the previous sentence, which specified when "*coverage*" began to apply: when any combination of Intel's or XL's payments exceeded the underlying limit. Last but not least, Endorsement 1's expansion of AGLI's duties to include a duty to defend as well as a duty to indemnify makes it inappropriate to limit the scope of "coverage" by referring to a term such as "damages" that may describe payments made under a duty to indemnify only, but inherently cannot fully describe the scope of a duty to defend.

Paragraph C of Endorsement 1 does not change the analysis. Paragraph C provided:

> 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)] At first blush, the language of Paragraph C seems odd because it purports to limit the duty to *defend* a case, which arises at the *outset* of the case, until after exhaustion by payment of "judgments or settlements," which typically *resolve* cases. The language makes sense, however, when one recognizes that underlying insurance is often disputed. The parties appropriately recognized that the settlement of such a dispute could exhaust the XL policy limit. More generally, Paragraph C must be interpreted in light of its apparent purpose: to confirm that AGLI had no duty to defend or to indemnify until the limit of Intel's underlying insurance with XL was exhausted. Read in that light, Paragraph C merely ensured that AGLI's duty to defend would not trigger until after others paid $50 million in one way or another.[6]

In any event, Paragraph C was completely silent about *who* must make payment to exhaust the XL policy. It said nothing about Condition H. And it did not prohibit Intel from using its contribution to its defense costs to exhaust the XL policy limit and trigger the AGLI policy. The proper approach, then, is to read all of Endorsement 1 and Condition H together, and that approach leads to the

[6] Indeed, Paragraph C need not even be read to have that effect. Paragraph C by its terms was limited to the effect of Endorsement 1 alone: "[n]othing contained *in this Endorsement*" obligated AGLI to provide a duty to defend any claim or suit before the XL policy limit was exhausted. Technically speaking, Endorsement 1 did not directly impose a duty to defend; it was the XL policy adopted through Paragraphs A and B of Endorsement 1 that did so.

conclusion that Intel's contribution to its own defense costs pursuant to its settlement with XL counted toward exhaustion of the XL policy limit.

By contrast, AGLI's narrow reading of Condition H and its broad reading of Paragraph C contradict basic principles of insurance law, starting with protecting the reasonable expectations of policyholders. As discussed above, Intel structured its insurance program to ensure that its contributions toward defense costs would count toward exhausting underlying policy limits and triggering further coverage. The "Retained Limits" provision of the XL policy so provided [ER 144], and Intel reasonably read the combination of Condition H and Endorsement 1 to accomplish the same result.

Moreover, policy coverage must be meaningful. If Paragraph C were read to require XL to pay $50 million to indemnify Intel before AGLI's duty to defend could be triggered, AGLI's duty to defend would have been illusory. Policyholders no longer need a defense after they have settled an underlying case or paid a judgment. They sometimes do, however, need a defense in the exact circumstances of this case: when the underlying litigation is ongoing, but a dispute with an insurer that afforded a prior layer of insurance has been resolved or settled.

What is more, AGLI's interpretation flips the traditional relationship between the duty to defend and the duty to indemnify. The duty to defend is ordinarily broader than the duty to indemnify. Indeed, that virtually has to be the

case because the duty to defend is determined before liability is established. Yet under AGLI's reading, the duty to indemnify would be easier to trigger than the duty to defend. Even AGLI concedes that its duty to *indemnify* arose after Intel, XL, or any combination of the two paid out $50 million to defend, settle, or pay judgments on covered claims. Yet, under AGLI's interpretation, AGLI's duty to *defend* required XL and XL alone to pay $50 million in settlements or judgments. Intel reasonably expected that AGLI's duty to defend would be at least as broad as AGLI's duty to indemnify.

Because insurance law protects the reasonable expectations of policyholders and resolves all ambiguities in their favor, AGLI needed to give Intel clear notice of all limitations on exhaustion and any modifications of the defense obligation prescribed by the XL policy. *See, e.g.*, *MacKinnon v. Truck Insurance Exchange*, 31 Cal. 4th at 648 ("the burden rests upon the insurer to phrase exclusions and exceptions in clear and unmistakable language," which must be "*conspicuous, plain and clear*") (emphasis original); *Fireman's Fund Ins. Cos. v. Atl. Richfield Co.*, 94 Cal. App. 4th 842 (2001) (lack of explicit exclusion of coverage otherwise granted by broad policy language gives rise to inference that the parties intended not to limit coverage); *Delgado v. Heritage Life Ins. Co.*, 157 Cal. App. 3d 262, 271 (1984) (exclusions and limitations are "strictly construed against the insurer and liberally interpreted in favor of the accused"). Nothing in Paragraph C of

Endorsement 1, Condition H, or elsewhere in the AGLI policy clearly indicated that only XL's payments and not Intel's payments could contribute to exhausting the XL policy and triggering AGLI's duty to defend. Tellingly, the theory on which AGLI prevailed was developed by its lawyers years later and was not even presented to the district court until AGLI's motion for reconsideration. Clever *post hoc* lawyering by insurance companies cannot defeat reasonable expectations of insurance policyholders.

Notably, although California law does not require that an interpretation of an insurance policy be fair to the insurance company that drafted it, Intel's interpretation is in fact quite fair to AGLI. AGLI's legitimate interest was to ensure that its excess coverage would not trigger until after others had contributed $50 million. AGLI had no reason to care where that $50 million came from. Indeed, AGLI concedes that its duty to *indemnify* could be triggered by $50 million in payments by Intel alone. In the end, Intel's interpretation is not only *a* reasonable reading of AGLI's policy, but the only one that fairly reflects the reasonable expectations of both contracting parties.

Finally, and relatedly, Intel's interpretation is consistent with common sense, basic principles of economics, and sensible public policy. By definition, excess coverage applies when a policyholder's losses exceed a specified amount. The insured is supposed to look elsewhere for losses up to that amount, and the excess

carrier is off the hook if the losses are below that threshold. Here, Intel's losses undisputedly exceeded the limit of the XL policy, and even AGLI admits that it would be liable if XL had paid that amount in full. From an economic perspective, it should not matter to AGLI how XL and Intel allocated Intel's losses up to that specified amount, and Condition H makes clear that the parties appreciated as much. No policy language provided that AGLI would be off the hook if XL paid less than the specified amount and Intel paid the rest. The issue, therefore, is whether AGLI must honor its commitment to insure Intel against losses exceeding the specified amount or whether, as the district court held, AGLI may avoid its obligation based on creative after-the-fact lawyer arguments. Apart from the settled law that ambiguities are construed against the insurance company, no legitimate or intended purpose would be served by allowing AGLI to avoid covering Intel's losses above the specified amount. The result would be a pure and unwarranted windfall for AGLI.

B. The District Court's Analysis on Reconsideration Was Flawed

The district court originally recognized that the "plain language of the Following Form Excess Liability Policy allows for damages to be payable under the AGLI Policy so long as the full amount of the underlying limits of the XL Policy have been reached by a *combination of payments* by the insured and the insured's underlying insurance." [ER 41 (emphasis original)] It further reasoned

that Paragraph C did not purport to change the XL policy, but "only clarifies the effect of the terms *contained within the endorsement itself*." [ER 42 (emphasis original)] The court stated that, "at best, the reference to exhaustion in [Paragraph C] creates an ambiguity," which under California law had to be construed against the insurer. [ER 42] That analysis was correct.

On reconsideration, however, the district court changed its entire approach. Because Condition H contained the word "damages," the district court read it as relevant only to AGLI's duty to indemnify. [ER 14–15] The district court acknowledged that the relevant provision of Condition H refers to "coverage," but held that "coverage" was limited to a duty to indemnify for "damages." [ER 15] In so doing, the district court relied primarily on provisions of the AGLI form policy that had been abrogated by adoption of following-form Endorsement 1. [ER 14–15] The district court also concluded that the XL policy and common law associated the term "damages" with the duty to indemnify and not the duty to defend. [ER 14] The district court's revised analysis was flawed at each turn.

The relevant portion of Condition H refers to "*coverage*," not "damages":

> *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

[ER 120] As discussed above, the second paragraph of Condition H addressed AGLI's duty to pay covered "damages" promptly, but the first paragraph uses the term "coverage." Insurance "coverage" refers to all risks covered and protections owed by an insurer, including its duty to defend as well as its duty to indemnify. *See, e.g.*, *Best's Glossary of Insurance Terms*, *available at* http://www.ambest.com/resource/glossary.html#C (defining "coverage" as "[t]he scope of protection provided under an insurance policy"); *Black's Law Dictionary* 372 (7th ed. 1999) (defining "coverage" as "[i]nclusion of a risk under an insurance policy; the risks within the scope of an insurance policy").

In this case, the preprinted form AGLI policy originally limited "coverage" to payment for covered "damages" [ER 116], which was quite logical for a policy that contained a duty to indemnify but not duty to defend. The parties superseded those limitations, however, through Endorsement 1. In particular, Paragraph A of Endorsement 1 required AGLI to follow the form of the XL policy, and Paragraph B of Endorsement 1 deleted all inconsistent provisions of the preprinted form AGLI policy. The ultimate "coverage" of the AGLI policy thus turned on the coverage provisions of the XL policy whose form was followed. Section I of the XL policy required XL "to pay on behalf of the Insured the ultimate net loss …." [ER 136] "Ultimate net loss" was defined to include both "damages" *and* "allocated claims expenses," and "allocated claims expenses" was defined to

include attorneys' fees and other defense costs as well as investigation costs, settlement costs, and post-judgment interest. [ER 139] Furthermore, Section II of the XL policy expressly required the insurer to "defend any suit" against Intel alleging injuries within the policy scope, regardless of the validity of the claims. [ER 136] "Coverage" under the XL and AGLI policies thus included both the duty to indemnify *and* the duty to defend. Contrary to the district court's conclusion, AGLI's "coverage" of Intel was *not* limited to a duty to reimburse for "damages."

Ultimately, the district court recognized that the AGLI policy included a duty to defend, but held that "coverage" under Condition H could not encompass a duty to defend because such a reading would contradict Paragraph C of Endorsement 1. [ER 15] Not so. Read in light of its purpose, Paragraph C ensured that the underlying insurance limit had to be exhausted before AGLI's duty to defend was triggered. Although Paragraph C stated that the underlying limit must be "exhausted by payment of judgments or settlements," that language merely clarified that settlements of coverage disputes could exhaust the underlying XL policy limit. Paragraph C did not purport to undermine the general following-form nature of AGLI's coverage, did not specify who could make the exhaustive payments, did not prohibit Intel from using its own defense payments to exhaust the XL policy limit, and did not contradict Condition H's provision that coverage could be triggered by a combination of payments by Intel and XL. At a minimum,

Paragraph C's reference to "exhaust[ion] by payment of judgments or settlements" was ambiguous and should be construed broadly, consistent with Intel's reasonable expectations.

The district court acknowledged that no California authority has interpreted this phrase in a similar context. [ER 17] And, contrary to the district court's suggestion, the most closely analogous case law supports Intel's interpretation and confirms that its expectation of coverage was reasonable.

Most notably, *Teigen v. Jelco of Wisconsin, Inc.*, 367 N.W.2d 806 (Wis. 1985), involved a commercial liability policy stating that the primary insurer was not "obligated 'to defend any suit after the applicable limits of the company's policy ha[d] been exhausted by payment of judgments or settlements." *Id.* at 810. The Wisconsin Supreme Court held that a below-policy-limit settlement and release between the insured and the primary insurer constituted exhaustion "by payment of judgments or settlements." *Id.* Holding otherwise would have conflicted with public policy favoring partial settlement, and the excess insurer was not prejudiced because its obligation to pay did not kick in until the policy limits were reached. *Id.* The excess insurer would "only incur those costs for which it is contractually responsible and for which it has already collected a premium." *Id.* at 811–12. The same is true here.

The case law also confirms that nothing in the term "exhausted by payment of judgments or settlements" requires that the payment involve settlement of underlying litigation. *See Pac. Employers Ins. Co. v. Servco Pac., Inc.*, 273 F. Supp. 2d 1149, 1154–56 (D. Haw. 2003) (following federal cases interpreting California law, holding that such language did not require judgment or settlement of the underlying claim, and concluding that a settlement between the policy holder and its primary insurer exhausted policy limits and triggered the excess carrier's duty to defend); *Tripplett v. Rosen*, Nos. 92AP–816 & –817, 1992 WL 394867, at *7–8 (Ohio Ct. App. Dec. 29, 1992) (exhaustion by "payment of judgments or settlements" included a settlement between the insured and its primary carrier, and the excess carrier was not disadvantaged because it was "liable only for amounts in excess of the underlying company's policy limits"). Indeed, the district court itself seemed to accept that "payment of judgments or settlements" could include payments to resolve coverage disputes, not just payments to resolve the underlying action. [ER 14] A contrary reading requiring resolution of the duty to defend to await determination of the insured's ultimate liability would violate the fundamental principle that the duty to defend is triggered before ultimate liability is determined. *See, e.g.*, *Montrose*, 6 Cal. 4th at 295 ("Imposition of an immediate duty to defend is necessary to afford the insured what it is entitled to: the full protection of a defense on its behalf."); *Buss v. Superior Court*, 16 Cal. 4th 35, 49

(1997) ("[T]o defend meaningfully, the insurer must defend immediately."). In this case, Intel topped off the amount XL paid in settlement, and treating the combination of Intel and XL payments as exhaustive is entirely fair to AGLI given that the combination of XL's settlement payments and Intel's own payments exceeded XL's policy limit.

In rejecting this logic, the district court purported to follow *Farmers Insurance Exchange v. Hurley*, 76 Cal. App. 4th 797 (1999) ("*Hurley*"). *Hurley* involved a statute stating that first-party underinsured motorist coverage does not apply until the limits of policies covering the underinsured vehicle "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). The Court of Appeal held that under the statute, Hurley's underinsured motorist policy from Farmers did not apply until the underinsured motorist's carrier paid the full limit of its policy. 76 Cal. App. 4th at 803. Although Hurley nominally had a judgment for the full $15,000 limit of the other driver's policy, the other insurer had actually paid only $5,000, and the court held that she therefore could not recover anything from Farmers. Notably, however, two of the three judges concurred only "reluctantly." *Id.* at 808. They acknowledged that the "correct result" would be to allow Hurley to recover but to permit Farmers to offset the full $15,000 of the other driver's insurance against the

amount it owed, and they conceded that the court's holding had no basis in the purpose of the statute, which was to prevent a windfall for the injured party in the form of a double payment. *Id.* They ultimately concurred, however, because the statute expressly required not just "exhaust[ion] by payment of judgments or settlements," but also "*proof of the payment*" to Farmers. *Id.* (emphasis in original) (going on to urge the Legislature to modify the statute to achieve its apparent purpose).

Hurley does not control this case for multiple reasons. First, *Hurley* involved a statute, not the wording of an insurance contract. Indeed, the court distinguished other cases reaching the opposite result on grounds that those cases involved a contract language, not statutory language. *Id.* at 802. This case, of course, involves a contract, not a statute. Second, the statute had additional wording not present here. Two of the three judges in *Hurley* concurred specifically because the statute contained further language not present in Paragraph C. Third, underinsured motorist statutes provide indemnity for first-party bodily injury coverage. They do not address coverage for third-party claims, much less the duty to defend such claims, and are therefore inapposite. Last but not least, the statute in *Hurley* did not contain any language remotely similar to Condition H, which expressly provided that AGLI's coverage was triggered when "*the insured or the*

insured's underlying insurance has paid or is obligated to pay the full amount of the Underlying Limits of Insurance …." [ER 120 (emphasis added)][7]

Nothing in *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 161 Cal. App. 4th 184 (2008), undercuts Intel's interpretation, either. The policy there provided that the excess insurer "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." *Id.* at 189. The Court of Appeal held that exhaustion required payment of the full underlying limit of liability, believing that the policy language was unambiguous and could not be altered by policy considerations. *Id.* at 198. But the policy there had no provision like Condition H. Here, Condition H expressly provided that either Intel or XL could exhaust the underlying limit of XL's policy. Moreover, unlike in *Qualcomm*, Intel is not seeking credit for a gap between the XL policy limit and what XL paid in

[7] The district court also thought that cases cited in *dicta* in *Hurley* were persuasive [ER 17–18], but those cases also involved very different circumstances. *Community Redevelopment Agency v. Aetna Casualty & Surety Co.*, 50 Cal. App. 4th 329, 340 (1996), held that under the "horizontal exhaustion rule," an excess insurer in a case involving continuing loss had no duty to drop down and provide a defense before the limits of all primary insurers were exhausted. And *Olympic Insurance Co. v. Employers Surplus Lines Insurance Co.*, 126 Cal. App. 3d 593, 600 (1981), merely held that under the "pro-rata other insurance" provisions of excess policies, a policyholder could not use a $500,000 settlement to exhaust two primary policies with $20,000 and $1 million limits. Here, the AGLI policy is excess only to the XL policy, and once the XL policy limit was paid, the AGLI policy was triggered.

settlement. Intel paid the difference, and that payment protected AGLI's legitimate interest.[8]

In the end, Intel must prevail if its interpretation of Endorsement 1 and Condition H is a reasonable reading of the AGLI policy. Even if the contrary reading urged by AGLI and adopted by the district court is also reasonable, the policy was at least ambiguous and this Court must resolve that ambiguity in Intel's favor as a matter of law. The Court should therefore reverse the district court's grant of summary judgment to AGLI and Markel and direct the district court to reenter partial summary judgment that the underlying policies were exhausted. In light of the district court's correct earlier ruling that the duty to defend arose because substantive claims in the Underlying AMD Cases raised the potential for "advertising injury," the only remaining question will be the amount of money to which Intel is entitled. Intel will have no difficulty showing that it is entitled to AGLI's full policy limit.

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[8] Notably, *Qualcomm* was not decided until 2008, long after the AGLI policy issued in 2001. When the AGLI policy issued, the seminal decision on excess insurers' duty to pay following a below-policy-limits settlement with the primary insurer was *Zeig v. Massachusetts Bonding & Insurance Company*, 23 F.2d 665 (2d Cir. 1928). *Zeig* held that a provision that an excess insurance policy "shall apply and cover only after all other insurance herein referred to shall have been exhausted in the payment of claims to the full amount of the expressed limits of such other insurance" should not be read to require collection of the full amount of the primary insurance. *Id.* at 666. Intel's expectations as of 2001 were especially reasonable given *Zeig* and Intel's intent to be able to reach excess layers of insurance by relying on either underlying insurance payments or its own money.

II. EVEN IF THE DISTRICT COURT PROPERLY DENIED SUMMARY JUDGMENT FOR INTEL, IT ERRED IN *SUA SPONTE* GRANTING SUMMARY JUDGMENT AGAINST INTEL

As discussed above, a district court may enter summary judgment *sua sponte* only if it gives the losing party a full and fair opportunity to develop and present the facts and arguments that could defeat summary judgment. *Norse*, 629 F.3d at 972–73. The district court did not afford Intel that opportunity.

Only Intel moved for summary judgment (partial summary judgment, to be precise). AGLI and Markel chose not to cross-move for summary judgment or even partial summary judgment in their favor. Accordingly, Intel did not put forth evidence that supported its policy interpretation but may have risked creating a genuine dispute of material fact defeating summary judgment in its favor.

In particular, Intel had no reason to proffer and therefore did not proffer all the evidence that could have helped establish a latent ambiguity in the AGLI policy. California applies the flexible "Corbin" approach to the parol evidence rule under which courts consider extrinsic evidence in determining whether a contract is ambiguous, rather than the stricter "Williston" approach under which ambiguity turns solely on what is within the four corners of a contract. *See, e.g., A. Kemp Fisheries, Inc. v. Castle & Cooke, Inc.*, 852 F.2d 493, 498 (9th Cir. 1998); *see also Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33, 39–40 (1968) (error for court not to consider proffered extrinsic evidence that is

relevant to show a latent ambiguity in the contract); *Wolf v. Superior Court*, 114 Cal. App. 4th 1343, 1351 (2004) (error for trial court to refuse to consider extrinsic evidence on the meaning of a contract term on the basis of the trial court's own conclusion that the language of the contract appears to be clear and unambiguous on its face). If AGLI and Markel had moved for summary judgment, Intel would have presented such extrinsic evidence so that it could at least provoke a trial over the policy's meaning.

The evidence Intel could have presented included:

- testimony from employees of Intel or its insurance representative about Intel's intent in structuring its excess liability policies;
- the excess policies above the AGLI policy for 2001–2002, which, consistent with that intent, allowed coverage to trigger even though an underlying insurer did not pay the full policy limit by itself; and
- AGLI's insurance policy for the following policy year, which included a defense obligation and a provision nearly identical to Condition H and thus confirmed that Condition H was not necessarily limited to indemnity for damages.[9]

[9] AGLI's 2002–2003 insurance policy is part of the record [ER 264–304], but was cited for a different proposition.

It made no sense for Intel to present that evidence in connection with its own summary judgment motion because the evidence would have complicated Intel's argument and invited fact disputes. Moreover, AGLI's argument regarding Condition H and Endorsement 1 was raised for the first time in the district court on reconsideration.

Once the district court entertained the possibility of *sua sponte* entering summary judgment against Intel, it was required to warn Intel and allow Intel to submit additional evidence. It did not. Thus, even if this Court concludes that Intel was not entitled to summary judgment of exhaustion, it should reverse the district court's grant of summary judgment of no exhaustion.

Conclusion

The judgment of the district court should be reversed, and the case should be remanded for further proceedings.

Respectfully submitted,

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Addendum: Endorsement 1 and Condition H of the AGLI Policy

Endorsement 1:

> Following Form Endorsement
>
> …
>
> A. This policy follows the exact terms and conditions of the [XL policy] except with respect to:
>
> [limits of liability, premium, asbestos and nuclear exclusions, other coverage modification endorsements].
>
> B. Except as noted above, All preprinted terms and conditions of [AGLI's policy] are deleted to the extent they are inconsistent with the terms and conditions of [XL's policy].
>
> C. Nothing contained in this Endorsement shall obligate us 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.

Condition H:

> H. When Damages Payable
>
> 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.
>
> When the amount of damages is determined, [AGLI] will promptly pay on behalf of [Intel] the amount of damages covered under this policy.

Statement of Related Cases

Intel Corporation is not aware of any related cases pending in this Court. The following case involving related issues is pending in the Delaware Superior Court, New Castle County:

Am. Guar. & Liab. Ins. Co. v. Intel Corp., C.A. No. 09C–01–170 (JOH).

/s/ Lester O. Brown

Lester O. Brown

Certificate of Compliance

I certify that pursuant to Fed. R. App. P. 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached opening brief is proportionately spaced, has a typeface of 14 points or more, and contains 10,714 words.

/s/ Dan L. Bagatell

Dan L. Bagatell

Certificate of Service

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on April 25, 2011.

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/s/ Fiona A. Chaney

Fiona A. Chaney

20336-1286/LEGAL20399777.9

Certificate of Service

U.S. Court of Appeals Docket Number(s): 11-15129

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on April 25, 2011.

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I have mailed the foregoing document by First-Class Mail, postage prepaid, or have dispatched it to a third party commercial carrier for delivery within 3 calendar days to the following:

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