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| DISTRICT COURT, CITY AND COUNTY OF DENVER COLORADO<br><br>Address: City and County Building<br>1437 Bannock Street<br>Denver, CO 80202 |  |
| **Plaintiffs:** COLORADO INTERSTATE GAS CO., *et al*<br><br>vs.<br><br>**Defendants**: NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA. | **COURT USE ONLY**<br><br>Case No. 08CV4157<br><br>Courtroom: 203 |

**FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT**

The case was tried to the Court between May 14 – May 24, 2012. The Court makes the following findings of fact, conclusions of law and enters judgment in accordance with this Order.

## I. Background and Nature of Claims

The case involves a gas pipeline explosion in southeastern Wyoming on November 11, 2006. The blade of a bulldozer operated by Bobby Ray Owens (Mr. Owens) struck and ruptured a large (roughly 36"), high pressure (roughly 880 p.s.i.) underground natural gas pipeline owned and operated by the El Paso Corporation (El Paso) and various subsidiaries. The pipeline will be referred to as the WIC pipeline.

The rupture of the WIC pipeline caused a huge fireball which resulted in Mr. Owens' death and property damage (to the pipeline, the bulldozer, and loss of natural gas from the WIC pipeline). Mr. Owens' body was found some distance from the bulldozer, whose door was open, suggesting that Mr. Owens may have attempted to escape from the conflagration but was incinerated alive while he ran.

At the time of the explosion, Mr. Owens was working on the construction of a new natural gas pipeline which was being constructed parallel to the WIC pipeline by another company and its contractors (collectively, the REX line or REX parties[1]). Because of the nearby REX pipeline construction, El Paso contracted with Plaintiff Pipeline Strategies & Integrity, LLC (PSI) to perform various tasks related to the WIC pipeline, including encroachment location. Encroachment location means placing aboveground flags to reflect the WIC pipeline's location under ground so that the REX parties and their contractors could avoid it. A PSI employee, Gary Brack (Mr. Brack), was used by El Paso to perform encroachment location of the WIC pipeline to prevent exactly the type of catastrophic accident that occurred.

At the time of the explosion, PSI had primary general liability insurance with Gemini Insurance Company (Gemini). Gemini used a third-party claims administrator, Kelly Krull (Mr. Krull), who in turn hired the Hustead Law Firm in Denver as defense counsel for PSI. PSI had excess coverage with National Union Fire Insurance Company of Pittsburgh, Pennsylvania (NU). NU is one of a group of insurance companies affiliated with AIG Insurance and a related entity, Chartis Insurance.[2]

Mr. Owens' daughter and family (the Owens family) hired lawyers to pursue wrongful death claims against multiple parties, including El Paso, PSI, and the REX parties. Before filing a lawsuit, the Owens family made an unapportioned demand against all potential defendants in the amount of $27.5 million to settle claims arising from Mr. Owens' death. A pre-litigation settlement conference was held involving the Owens family and their lawyers, PSI and its defense counsel, El Paso, and the Rex parties in April 2007. At the settlement conference, the Owens family agreed to settle all wrongful death claims they had against El Paso and PSI for $3.1 million.

In May 2007, PSI's primary insurer, Gemini, offered to pay its entire policy limits of $1 million in settlement of the Owens' family claims against PSI and attempted to tender those limits and ongoing defense responsibilities to the excess carrier, NU. NU refused this offer. The settlement eventually resulted when El Paso paid the $3.1 million itself, with the Owens' family

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[1] This encompasses a number of different entities between whom, for purposes of this trial, it is unimportant to differentiate.

[2] During the trial, the parties referred to NU and Chartis, and its parent AIG, interchangeably. For convenience, the Court will refer to all as NU in this Order.

assigning all claims it had against PSI to El Paso. In July 2007, NU denied coverage relating to Mr. Owens' death.

El Paso later filed this case, suing PSI, Gemini, and NU to recover the $3.1 million it paid to settle the Owens' family claims, along with seeking damages for damage to the WIC pipeline and for escape of natural gas from the WIC pipeline. Separately, PSI filed a bad faith claim against NU on July 30, 2009. Both cases were consolidated in September 2009. In 2010, Gemini settled the claims asserted against it by paying its $1 million in coverage to El Paso. El Paso and PSI entered into a settlement agreement regarding the assigned Owens' family claim, in which PSI agreed that the negligence of its employee, Mr. Brack, was a cause of the WIC pipeline explosion and El Paso's damages. The parties were "re-aligned," with both El Paso[3] and PSI pursuing claims against NU. As finally postured in the Third Amended Complaint (in the 08CV4157 case) and Complaint (in the 09CV7438 case) and tried before this Court, El Paso and PSI asserted claims against NU for:

1. Declaratory relief that:

a. NU's excess policy provided PSI with coverage for the WIC pipeline explosion and the resulting injuries and damages, including Mr. Owens' death and the damage to and escape of natural gas from the WIC pipeline, and;

b. NU was obligated to pay for all losses which PSI and El Paso sustained as a result of Mr. Owens' death and damages to and loss of natural gas from the WIC pipeline.

2. Breach of contract, claiming that NU breached its contract of insurance in not paying the $3.1 million to settle the Owens' family claims, along with legal expenses and costs, and damages to El Paso from damage to the WIC pipeline and loss of natural gas.

3. Insurance bad faith. El Paso assigned all claims for bad faith to PSI above and beyond the $3.1 million it paid to settle the Owens' family claims, its legal expenses and costs in connection with that claim, and damage to the WIC pipeline (less the $1 million paid by Gemini) and loss of natural gas.

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[3] Claims of related El Paso entities, including those of Mt. Franklin Insurance, have either been dismissed or resolved pending appeal, based on rulings made both by this Court and by Judge Whitney. Those claims were not in issue at trial.

NU counterclaimed for declaratory relief that there was no coverage for the WIC pipeline explosion based on exclusions that will be discussed below.

The Court received the testimony of the following witnesses:

a. Thomas Muscarella

b. David Koren

c. Marcus Jensvold

d. Tomasz Sikora

e. Mitch Harless

f. Richard Dauchy

g. Mike Humberd

h. Kathleen Ballard

i. Gerald Stuart

j. Hank Einspahr

k. Bill Sparger

l. Dan Williams

m. Tom Morgan

n. Matt Mask

o. James Anspach

p. Kevin Amatuzio

q. John Dole

r. Paul Cadorette

s. Leonard Romeo (by video deposition)

t. Warren McCann (by video deposition)

and considered the exhibits which were introduced. The Court makes the following finding of facts and conclusions of law.

**Findings of Fact**

## II. PSI and El Paso

### A. General Relationship, Insurance and Alliance Agreement

4. PSI contracted to do work for El Paso for a number of years before the pipeline explosion.

5. El Paso is a large gas pipeline corporation. PSI is a small, family-owned business operated out of Colorado Springs, Colorado.

6. Mr. Humberd purchased PSI from its previous owner, Mr. Williams, in 2006.

7. El Paso required PSI to enter into the Alliance Agreement (Ex. 3) as a condition of doing work on El Paso projects.

8. El Paso required PSI to enter into an indemnification provision in the Alliance Agreement, as follows:

> A. Contractor's Indemnity
>
> Contractor agrees to indemnify and hold harmless Company, its subsidiaries and affiliates and all their respective directors, officers, agents and employees (all hereinafter collectively referred to as the "Indemnitee"), from all and every kind and character of liability, damages, losses, costs, expenses, demands, claims, suits, actions and causes of action on account of illness, personal injury or death to employees or any other persons, damage to property of Company or others or other loss or liability arising from any cause whatsoever growing out of or in connection with Contractor's negligent performance of the Work or Contractor's strict liability. Further, Contractor, at its own expense, shall defend any demand, claim, suit, action or cause of action brought against the Indemnitee where such demand, claim, suit, action or cause of action arises from any cause for which the Indemnitee may be entitled to be indemnified and held harmless pursuant to this Article XII., and Contractor shall pay all damages, losses, costs, and expenses (including attorneys' fees), growing out of or in connection with such demand, claim, suit, action or cause of action; provided, however, that the Indemnitee shall be entitled to participate in such defense at the Indemnitee's own expense if it so desires.
>
> Notwithstanding the foregoing, in no event shall Contractor be liable to indemnify and hold harmless the Indemnitee from any liability, damages, losses, costs, expenses, demands, claims, suits, actions or causes of action arising out of the sole negligence of the Indemnitee.

(Ex. 3, Art. XIIA). The Alliance Agreement provides it is to be governed by Texas law.

9. Mr. Sikora, El Paso's in-house corporate counsel, explained that the objective of the indemnity agreement was to address the fact that El Paso was self insured for its first $10 million of liability exposure. If contractors were allowed to work on El Paso's pipelines, El Paso insisted that the contractor indemnify El Paso *except* if the loss was the result of El Paso's sole negligence. (Ex. 3, Art. XIIA, last paragraph). If there was an event caused by the concurrent negligence of both El Paso and PSI employees, PSI would indemnify El Paso for the first $5 million of exposure. If, however, the loss was the result of the sole negligence of El Paso's employees, then the contractual duty to indemnify did not arise.

10. El Paso was one of PSI's most consistent and best clients. Mr. Humberd was aware of the Alliance Agreement and the indemnity provision when he bought PSI and knew this provision would be in effect. Mr. Humberd considered the indemnity agreement to be a 'cost of doing business' with El Paso. It also was a standard provision in other contracts with pipeline companies.

11. Before and up to 2006, El Paso had been one of PSI's largest customers, generating $1 million - $2 million in revenue annually.

12. El Paso also required that it be listed as an 'additional insured' on the contractor's general liability policy for the first $5 million in coverage. (*E.g.*, Ex. 2, p 2-39; Ex. 3, p 3-25)

13. PSI provided the Alliance Agreement (containing the indemnity provision) to its retail insurance broker (Mr. Six), its wholesale insurance broker (Mr. Jensvold), and to its primary and excess insurer, including NU.

14. PSI had primary coverage through Gemini, with policy limits of $1 million. (Ex. 2)

15. PSI had excess coverage through NU, with policy limits of $5 million. (Ex 1). The NU policy was a form following policy, meaning that it essentially followed the policy provisions of the Gemini primary policy.

16. The NU policy contained the following exclusions and provisions:

C. **Contractual Liability**

This insurance does not apply to any liability for which the **Insured** is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:

1. that the **Insured** would have in the absence of a contract or agreement; or

2. assumed in an **Insured Contract**, provided the **Bodily Injury** or **Property Damage** occurs subsequent to the execution and prior to the termination of the **Insured Contract**. Solely for the purposes of liability assumed in an **Insured Contract**, reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an **Insured** are deemed to be damages because of **Bodily Injury** or **Property Damage** and included in the Limits of Insurance of this policy, provided:

   a. liability to such party for, or for the cost of, that party's defense has also been assumed in the same **Insured Contract**; and

N. **Insured Contract** means that part of any contract or agreement pertaining to your business under which any **Insured** assumes the tort liability of another party to pay for **Bodily Injury** or **Property Damage** to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

(Ex. 1, at 1-9 and 1-22).

17. Both Mr. Humberd (and PSI's previous owner, Dan Williams) and Mr. Sikora understood and believed that the Alliance Agreement was an 'Insured Contract' for which there was coverage under the NU policy, and for which PSI would be required to indemnify El Paso if El Paso was negligent and its negligence contributed to a loss or injury, *except* if El Paso's negligence was the sole negligence involved.

18. Before 2006, the Alliance Agreement and its indemnity provision had been submitted to PSI's wholesale insurance broker (Mr. Jensvold) and to the underwriters at NU. Up to 2006, NU had not taken the position that the Alliance Agreement or indemnity clause was unenforceable for any reason, including Texas' 'express negligence' doctrine.[4]

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[4] In *Ethyl Corp. v. Daniel Const. Co.*, 725 S.W.2d 705, 708 (Tex.1987), the Texas Supreme Court held that the enforceability of contractual provisions purporting to indemnify one party from the consequences of its own negligence was dependent on the parties' written agreement clearly expressing that intent.

## B. Exclusion for Professional Services

19. PSI's primary policy with Gemini contained an exclusion from coverage for additional insureds performing certain services, which provided

A. Section II – Who is An Insured is amended to include as an insured any person or organization for whom you are performing operations when you and such person or organization have agreed in writing in a contract or agreement that such person or organization be added as an additional insured on your policy. Such person or organization is an additional insured but only with respect to liability caused by your ongoing operations performed for that insured. A person's or organization's status as an insured under this endorsement ends when your operations for that insured are completed. This insurance does not apply to liability caused by the sole negligence of any additional insured.

B. With respect to the insurance afforded to these additional insureds, the following additional exclusions applies:

This insurance does not apply to:

1. The preparing, approving, or failing to prepare and approve, maps, shop drawings, opinions, reports, surveys, field orders, change orders or drawings and specifications; and

2. Supervisory, inspection, architectural or engineering activities.

(Ex. 2, at 2-39).

20. PSI's excess policy with NU contained two exclusions relating to professional services being performed by insureds.

21. Endorsement No. 10 to the NU policy provided:

This policy is amended as follows:

**Section V. EXCLUSIONS** is amended to include the following additional exclusion:

**Professional Liability**

This insurance does not apply to any liability arising out of any act, error, omission, malpractice or mistake of a professional nature committed by the **Insured** or any person for whom the **Insured** is legally responsible.

It is understood this exclusion applies even if the claims against any **Insured** allege negligence or other wrongdoing in the supervision, hiring, employment, training or monitoring of others by that **Insured**.

(Ex. 1, at 1-47) The term "of a professional nature" is not defined in Exclusion No. 10 or anywhere else in the remainder of the NU policy.

22. Endorsement No. 13 to the NU policy provided:

Section V. **EXCLUSIONS** is amended to include the following additional exclusions:

**Contractors**

This insurance does not apply to:

1. **Property Damage** to any property or equipment leased by the **Insured**;

2. **Property Damage** to property being installed, erected or worked upon by the **Insured** or by any agents or subcontractors of the **Insured**;

3. any liability arising out of any project insured under a "wrap-up" or any similar rating plan;

4. any liability arising out of the rendering of, or the failure to render, professional services or any error, omission or mistake of a professional nature performed by or on behalf of the **Insured**, including but not limited to:

   a. the preparation or approval of maps, plans, opinions, reports, surveys, designs or specifications; and

   b supervisory, inspection, architectural, engineering or surveying services.

   However, this exclusion shall not apply to services performed by or on behalf of the **Insured** within construction means, methods, techniques, sequences and procedures in connection with **Insured's** operations in the **Insured's** capacity as a construction contractor;

(Ex. 1, at 1-52). The terms "professional services" or "of a professional nature" are not defined in Exclusion No. 13 or anywhere else in the remainder of the NU policy.

## III. Mr. Brack's Activities and the Events Leading to November 11, 2006 WIC pipeline Explosion

23. There was considerable disputed testimony about Mr. Brack's activities related to the WIC pipeline and whether those activities were 'professional services' or 'of a professional nature.'

24. Hank Einspahr is an operations technician and line locator for Colorado Interstate Gas Company, and was working with Mr. Brack on the WIC pipeline. The Court found Mr. Einspahr's testimony to be credible. The line locator's job is to communicate with the contractor (REX, in this case) and meet with the contractor when the new line gets close to or crosses over the existing (WIC pipeline, in this case) pipeline. The line locator will mark the location of the existing pipeline to keep construction within 10 – 25 feet of the existing line. Mr. Brack used a 'Metrotech' 850 line locator which, according to Mr. Einspahr, is somewhat like a metal detector. The Metrotech emits a beeping sound which stops when it is positioned over an underground gas pipeline. Additionally, a needle on the Metrotech moves to a higher number when it is positioned over the pipeline.

25. Mr. Einspahr acknowledged that Mr. Brack's job included more than simply using the Metrotech line locator. Mr. Brack functioned as the 'eyes' of El Paso and PSI at the job site relative to the location of the existing pipeline.

26. An internal investigation by El Paso showed that Mr. Brack was an experienced line locator:

> These alignment sheets would have been made available to Mr. Brack upon his request. Mr. Brack has stated, however, that he did not need the WIC and CIG alignment sheets to carry out his assigned tasks under the applicable Work Request issued to PSI. He stated he was involved in the construction of the WIC line in 1982 and had worked on the relevant portion of the pipeline during his over-thirty-year career with CIG. As such, he stated he had a very good understanding of the location of the pipelines. Moreover, he indicated that, since he understood his job was to physically locate the pipelines using pipeline locator equipment and mark the location where necessary, he would only use the alignment sheets as a tool to assist him in locating the *general* area of the pipelines.

(Ex. 69, at 69-11) The internal El Paso investigation also showed:

> **2. Interviews with Mr. Brack**
>
> Mr. Katchmar of PHMSA interviewed Mr. Brack the night of the incident. The internal investigation team interviewed Mr. Brack in the early afternoon of Sunday, November 12. We understand the content of the Saturday and Sunday interviews of Mr. Brack to be generally consistent. A subsequent interview of Mr. Brack was conducted by Mr. Katchmar on January 3, 2007. CIG's attorneys were present for the second interview.
>
> In describing his work before the rupture, Mr. Brack stated that he had first physically located the WIC pipeline, using the Metrotech 850, at the permanent WIC pipeline marker to the west of the rupture site. There is a cathodic protection (CP) node at this location, and Mr. Brack indicated he connected the Metrotech 850 to the CP node and used the direct induction method for determining the location of the pipeline. He confirmed the permanent marker was located on the top of the pipeline. Based on that line of sight, he believed the white-flagged stakes marking REX's temporary construction right of way were sufficiently far enough away from the WIC pipeline as not to require any flagging.[19] Looking straight ahead, using his line of sight, he also stated that from the western permanent pipeline marker, he could see the eastern pipeline marker.[20]
>
> Mr. Brack stated that after locating the WIC line at the permanent pipeline markers, he used a 10-foot rule in making the judgment that no marking was required. If the edge of the REX temporary construction right-of-way was at least 10 feet away, then it was sufficiently far away that the location of the WIC pipeline did not need to be pin-flagged. As a general rule of thumb, if he could drive his pick-up truck between the location of the WIC pipeline and the location of the REX white stakes, then there was sufficient distance between the two. If there was not sufficient distance, then Mr. Brack would pin-flag the location of the WIC pipeline every 50 feet or so (as necessary to maintain the line of sight).
>
> Mr. Brack stated he walked about 100 feet from the western permanent pipeline marker and physically located the WIC pipeline using the Metrotech 850. Using line of sight, he again judged that the location of the white stakes indicating the edge of the REX temporary construction right-of-way was at least 10 feet away.
>
> He stated after he confirmed the location of the WIC pipeline marker on the western side, he went to the permanent WIC pipeline marker on the eastern side of the rupture and repeated the same process. He stated he used the Metrotech 850 to locate the WIC line. He confirmed the pipeline marker was on top of the pipeline. He observed the REX stakes and judged them to be far enough away. He walked about 100 feet to the west and repeated the process.[21] In each instance, Mr. Brack judged the edge of the REX temporary construction right-

(Ex. 69, at 69-20)

27. Tom Morgan is the Vice President of Operations for Western Pipeline/El Paso. The WIC pipeline in question was within his jurisdiction. Mr. Morgan did not consider Mr. Brack's activities with respect to the WIC pipeline to be 'professional services.' The Court found Mr. Morgan's testimony to be extremely credible.

28. Matt Mask is the Director of Operations for El Paso's Rocky Mountain Division. The Court found Mr. Mask's testimony to be extremely credible.

29. Mr. Mask described the activities of a line locator like Mr. Brack to be a 'B-level' as opposed to 'A-level' activity. There are hundreds of technicians who perform the same task; many of them are entry-level technicians. Mr. Mask described Mr. Brack as being the 'boots on the ground, eyes on the line' encroachment inspector for PSI and El Paso. Mr. Brack, it turns out, correctly located the WIC pipeline to the west and east of the rupture area; however, he failed locate the line in an area of approximately 1,100 feet where the line deviated in direction. It is believed that Mr. Brack did not mark that particular 1,100 feet section of the WIC because he could visually see from one above-ground, permanent line marker to another and believed the underground line went straight, without any deviation, between those above-ground markers. In fact, this would have been a physical impossibility from the approximate position where Mr. Brack would have been standing.

30. Mr. Humberd had personal knowledge of Mr. Brack's activity. Mr. Humberd has, himself, performed the same sort of line-locating activities. Mr. Brack monitored the construction of the REX pipeline to observe for encroachments onto the WIC pipeline. Mr. Brack was provided with a set of 'maps' (the alignment sheets referred to, above, in ¶ 26) and told the area where the REX contractors would be working. He would then go to that area to observe and to mark areas when the REX construction could encroach too closely on the WIC pipeline. Mr. Humberd described the Metrotech as a simple instrument which a ten-year-old could be taught to use. Mr. Humberd did not consider Mr. Brack's activities to be 'professional.'

31. Accounts of Mr. Brack's activities are also contained in contemporaneous documents[5] prepared by individuals who had reason to

[5] These documents, quoted below, were provided to NU and are contained in NU's claims file, Ex. 1066.

record information received from Mr. Brack accurately, and whose information is consistent with the testimony of Messrs. Einspahr, Morgan, Mask and Humberd.

32. In a status report of April 17, 2007, PSI's attorney described the activities of Mr. Brack as follows:

> Mr. Brack happened to be working on a shorter assignment for PSI at the time the work request came in for this job, so Dan Williams, manager of PSI, offered him the job. Mr. Williams has stated that once he sent Gary Brack to Wyoming to be El Paso's encroachment inspector, he had no supervisory or other substantive contact with Mr. Brack. Gary Brack took all of his directions from El Paso and reported directly to El Paso. It appears that all PSI did was put Mr. Brack in contact with El Paso and brokered a deal for this job pursuant to the Alliance Agreement.
>
> Gary Brack stated that it was his understanding that he was hired to do the same thing he has done for El Paso and other gas companies who hire encroachment inspectors. He watches pipeline crossings and road crossings and watches pipeline digs that are close to the incumbent pipeline. Whenever the constructing company is going to drive heavy equipment over the pipeline, he goes out first and tells them what precautions they need to follow to prevent damage to the pipeline. He physically watches the excavations when the new pipeline is crossing over the incumbent pipeline. If the new construction right of way appears close to the incumbent pipeline, he will pin flag the area.
>
> Based on the information we have at this time, it appears that Gary Brack was qualified for what he was hired to do, which was to be an encroachment inspector (which is someone who primarily watches the contractor's movement of heavy equipment and digging at pipeline crossings, not someone who goes out in front of the clearing crew to mark the pipeline). It does not appear that he was hired, nor could he have completed, the task of marking the entire pipeline.

(Ex. 1066, at 1066-714, 715)

33. In an April 18, 2007 settlement memo prepared by PSI's attorney to the mediator for the settlement conference, the following information was provided (Ex. 38-3):

Mr. Brack began his encroachment inspections for this portion of the project on August 5, 2006 (he had worked on the other spreads in a different capacity for some time before this). Based on his daily reports, it appears he checked the section of pipeline where the accident occurred on November 7, 2006. His hand written notes on the alignment sheets indicated he "flagged/checked" pertinent portions shown on drawing no. 190020-5135.

Mr. Brack has stated that he took his metal detector to the western permanent pipeline marker and located the pipeline below the marker. In prior interviews, he has apparently stated that the REX right of way stakes were at least 10 feet away from the pipeline. El Paso's measurements dispute this, showing that at the western permanent pipeline marker the REX right of way was only 4.9 feet away from the pipeline.

In addition, Mr. Brack has apparently said in prior interviews that he walked with his metal detector 100 feet to the east, noting that the pipeline was at least 10 feet away from the REX right of way. Again, El Paso's post-explosion measurements dispute this, stating that 100 feet away from the western marker the REX right of way was only 1.6 feet away from the WIC pipeline.

Mr. Brack has stated that he drove approximately 1,000 feet to the eastern permanent pipeline marker, again using his metal detector to locate the WIC pipeline, which he felt was 10 feet away from the REX right of way. El Paso's measurements indicate the REX right of way was only 5.9 feet away at that marker. Mr. Brack also stated that he again walked about 100 feet, this time to the west, locating the pipeline and determining it was 10 feet away from the right of way. El Paso asserts that at the 100-foot mark the REX right of way was actually 2.1 feet on the wrong side of the WIC pipeline.

When we met with Mr. Brack on March 12, 2007, he could not remember where the REX right of way flags were, but assumed they must have been at least 10 feet away from the pipeline, as it was his practice to pin flag if he felt the right of way was closer than 10 feet. Mr. Brack states that he clearly remembers looking from one pipeline marker and seeing the other, and felt there was a straight line in between. Apparently El Paso's investigators will state that it would have been impossible for Mr. Brack to see the from one pipeline marker to the next.

34. Mr. Brack was interviewed by representatives of the Department of Transportation (DOT) and Pipelines and Hazardous Materials Safety Administration (PHMSA) shortly after the explosion. In an interview on December 19, 2006, Mr. Brack's comments were summarized as:

**22. I need you to explain your normal day on the REX construction project?**
Gary worked on the Pience Project until the end of JAN 2006. Started on Spread 4 on August 1st, 2006. Start @ 7:00 am. Left camper to fill up PU Truck & head to job site...where he knew they were working. Gary would see where they were & check the ROW in front of the work crew. Generally, Gary would "eyeball" the lay of the land & the WIC line markers & the white topped ROW stakes to understand if he needed to locate & flag the nearest "hot" line. Gary said he was

* * *

During this question, we discussed line crossings and Gary said he watched every line crossing. I told Gary that in my opinion, those were the big items that no-one could miss. At line crossings,

everyone slows down & is more careful about the proximity of foreign lines. I also told Gary that I was more concerned about the cross country ROW where the contractor was moving along next to "hot" lines for miles & miles. I asked Gary if he had seen the WIC as-builts for the area where the incident happened. He said no so I pulled up the powerpoint slide show on my computer and showed him the last picture and we discussed the PIs and where the incident occurred and where he might have taken his locate readings that showed the WIC line was not in the REX staked ROW. During this discussion, one of the attorneys said something about the WIC as-builts and if Gary would have used them if he had had a copy of them. Gary said he would not have used the as-builts even if he had a copy because you can't rely on them so many years later. Gary said that there was nothing in the area of the incident that caused him to think the REX ROW was encroaching on the WIC pipeline. We also discussed what I had written down during my first interview with Gary on the afternoon of the incident. I asked Gary if he still stood behind that statement which he had initially on the Thursday after the incident and he said yes.

(Ex. 1053, at 1053-3 and 4)

## IV. Liability Exposure of PSI, El Paso, and Other Parties

35. The causes of the pipeline explosion were multi-factorial.

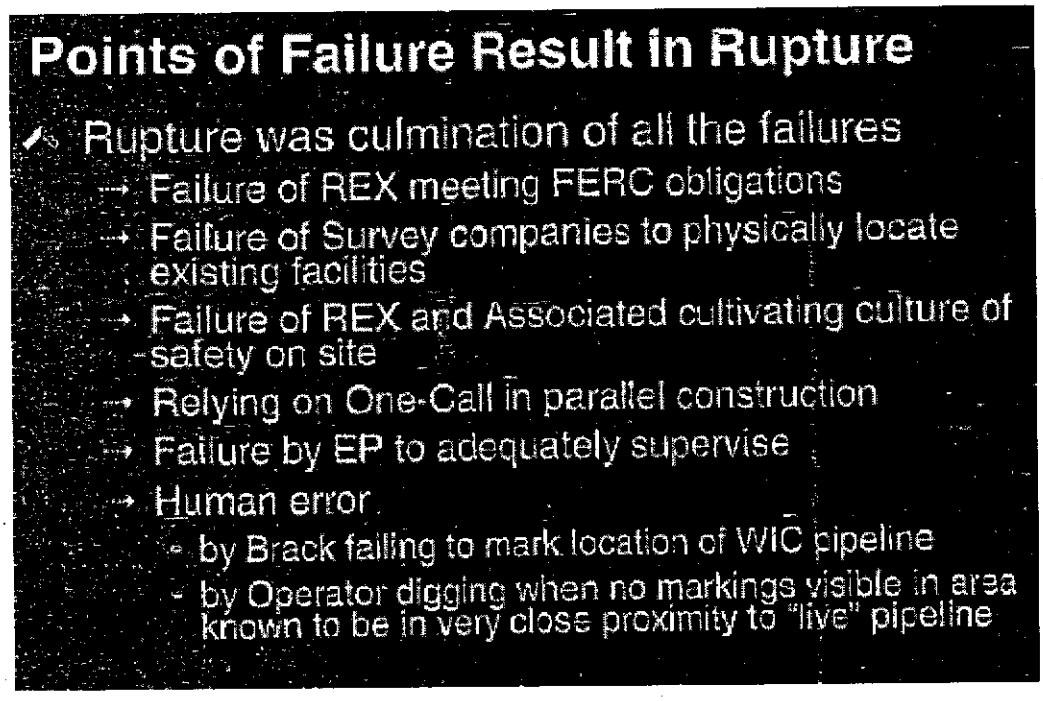
36. PSI had considerable liability exposure for Mr. Brack's mistakes. Mr. Brack failed to check what turned out to be the critical 1,110 feet of the WIC pipeline because he mistakenly believed that he could 'eyeball' that distance between (what he thought were) two permanent above-ground pipeline markers and concluded – incorrectly – that the pipeline's underground position went straight between those above-ground markers. In fact, the underground position of the pipeline veered sharply during that 1,110 feet distance, precisely where Mr. Owens was operating the bulldozer. Mr. Brack had an opportunity to use the as-built (underground) maps for the WIC pipeline but chose not do so.

37. An investigation conducted by the Wyoming Department of Labor/Occupational Safety and Health Administration reached the same conclusion in its report of May 21, 2008:

> The individual responsible for locating and marking the existing pipeline made an error. By not consulting the engineered, as-built drawings, and not using the line locating instrumentation he'd been provided to check the line at a frequency that ensured the known location of the pipeline, he authorized the ROW crew to work over a hot line, which resulted in the death of one of the dozer operators.

(Ex. 69, at 69-11)

38. As correctly asserted by El Paso in a meeting with PHMSA in October 2008, there were multiple areas of failure:




(Ex. 1009, at 1009-11)

39. On November 23, 2009, PHMSA ultimately found El Paso (the entity over which it had regulatory responsibility) had violated multiple federal regulations, leading to the pipeline rupture:

> **widely known to be among the greatest pipeline safety threats. Respondent knew of the presence of extensive construction and excavation activities in the vicinity of its pipelines, yet the company failed to have and follow procedures meant to address the risks of excavation adjacent to its pipelines. Next, even if other parties contributed to the incident, Respondent was primarily responsible for the proper locating, marking, and surveillance of its facilities. The regulations and Respondent's own procedures make this clear. Yet Respondent failed on several accounts to prepare and/or follow the many procedures that are specifically intended to address threats to its pipelines and prevent incidents. In addition, Respondent placed the crucial responsibility for locating and marking its pipelines in the hands of just one person, the line locator. Yet it failed to provide him with accurate information, management, and supervision. Finally, the liability of the other two entities was not at issue in this matter.**

(Ex. 1007, at 1007-12) Included within its findings, PHMSA found that El Paso improperly failed to provide Mr. Brack with accurate maps of the WIC pipeline. (*Id.*, 1007-2, 3) PHMSA levied a civil fine of $2.3 million against El Paso.

## V. PSI Notice to Carriers

40. NU received notice about the WIC pipeline explosion and potential claims of the Owens family from PSI on February 22, 2007.

41. El Paso claimed that it was an additional insured under the NU policy and also gave its own notice to NU. (Ex. 1066)

42. Mr. Sikora, in-house counsel for El Paso and in charge of the Western Pipelines unit, became involved in this matter in early 2007.

43. By early 2007, Mr. Owens' surviving family (an adult daughter, his parents, and brothers) were represented by attorneys in contemplation of asserting a wrongful death claim against PSI, El Paso and the REX parties, among others.

## VI. Claims Activities at NU in Early 2007

44. In 2007, NU had no written claims handling guidelines or policies. New excess claims managers at NU were simply taught what they needed to know on the job. The result of this practice was lack of a consistent, predictable company-wide policy to assure that proper claims-handling standards were used.

45. The PSI/El Paso claim was assigned to NU's Segmentation Department on February 22, 2007. The Segmentation Department investigates notice of excess claims to determine whether the claim should be referred to the claims group for active claims handling, or should be filed as 'notice only.'[6]

46. The claim remained in the Segmentation Department for more than two (2) months. During this time, no decision was made whether the claim would be referred for active claims handling, or simply closed as a 'notice only' claim.

47. During this time, there was no communication between NU and PSI about the status of the claim, what NU was going to do, or whether the claim had been closed or sent to the claims group.

48. Per NU's practice, coverage counsel cannot be hired while a claim remains in NU's Segmentation Unit. Thus, coverage counsel was not retained by NU to investigate coverage in February, March, or April 2007.

---

[6] For example, a claim of a sprained ankle involving an underlying primary policy with $1 million in coverage might simply be filed as notice only.

49. On March 16, 2007, the initial NU adjuster, Mr. Gandelsman, spoke with the third-party claims administrator (Mr. Krull) who was adjusting the claim on behalf of Gemini. From this conversation, Mr. Gandelsman learned that there a possible defense to coverage based on the Professional Services exclusion relating to the nature of Mr. Brack's activities, as he noted in the claims file:

End of note

*Final*

| | |
|---|---|
| Branch | : 169 |
| Case | : 207156 |
| Written By | : Gandelsman, Gennady |
| Claimant Name | : Owens Bobby |
| Insured Name | : PIPELINE STRATEGIES AND INTEGR |
| Note Title | : NEW ASSIGNMENT |
| Created | : 03/16/2007 4:07PM |
| Printed | : 04/08/2009 2:13PM |

Spoke with Kelly Kruel. He has retained counsel to discover insured's involvement. They believe that there might be an exclusion in the policy for professional liability. Insured believes that the employee of the insured may have provided payroll contracting work for the utility company.

(Ex. 1066)

50. In March and April 2007, NU did not independently investigate whether or not Mr. Brack's activities on the WIC pipeline, leading up to the pipeline explosion, did or did not fall within the Professional Services exclusions (Endorsements 10 and 13) of the NU policy. However, NU had all of the information referred to above, prepared by the PSI defense attorney retained by Gemini (Ms. Piccone) and El Paso.

## VII. Settlement Conference in April 2007

51. Recognizing that litigation about Mr. Owens' death was a foregone conclusion and the desirability of achieving an early resolution – and to further the promise El Paso's president made to the Owens family to 'make things right' – El Paso and Mr. Sikora solicited a settlement demand from the Owens family attorneys and arranged to schedule a pre-litigation settlement conference with the former Governor of the State of Wyoming, the Hon. Michael Sullivan, acting as the third-party neutral.

52. On March 29, 2007, the Owens' family attorneys made an unapportioned settlement demand of $27.5 million to all potential defendants, including PSI and El Paso. (Ex. 33) The Owens' attorneys were aware of a similar sort of pipeline explosion and injury in Carlsbad, New Mexico involving

El Paso which, Mr. Sikora confirmed at trial, settled in the 'same ballpark' as the $27.5 million settlement demand.

53. Ms. Piccone provided a preliminary opinion regarding PSI's liability exposure to NU on April 17, 2007. (Ex. 35) She opined that "many more questions must be answered before we can make a definitive determination regarding PSI's potential liability." (*Id.*)

54. The settlement demand was sent to Gemini and NU on April 18, 2007. (Ex. 1066, at 1066-33)

55. The settlement conference occurred on April 19, 2007. Mr. Sikora attended on behalf of El Paso. Ms. Piccone, the defense counsel retained by Gemini to represent PSI, was present, along with Mr. Jackson, the coverage counsel for Gemini.

56. NU did not send a representative to the settlement conference.

57. The parties and claims representatives in attendance at the settlement conference did not have sufficient monetary authority from the involved insurers to accomplish an overall settlement of the Owens' family claims.

58. As of the time of the settlement conference, NU believed that settlement would be 'premature' because all the information about the explosion was not known, a belief expressed by the initial adjuster on the case on April 18, 2007 (Ex. 1066, at 1066-34), and also at trial by NU's claims manager, Mr. Muscarella.

59. Mr. Sikora, however, already recognized there was considerable liability exposure on behalf of both PSI and El Paso. PSI's employee, Mr. Brack, had not marked the WIC pipeline correctly. From the investigation which had been completed by the date of the settlement conference, Mr. Sikora understood that Mr. Brack admitted that the WIC pipeline was not marked with a yellow flag (as it should have been) at the location of the explosion, that Mr. Brack had 'eyeballed' the location, thought it looked fine and did not mark it. Mr. Sikora believed that this was not a 'close miss' by Mr. Brack but, instead, that his negligence was 'devastatingly obvious.'

60. Mr. Sikora recognized that there was the risk of liability exposure on behalf of El Paso and other parties, but accurately described Mr. Brack's involvement as having been the 'last clear chance' to have avoided the explosion.

61. Mr. Sikora correctly appreciated that the photographs of Mr. Owens' remains and the aftermath of the pipeline explosion were so gruesome (Ex. 41) that the case should never proceed into litigation or ever get to a jury. He correctly realized that everyone's exposure and costs would increase significantly if the wrongful death claim went into suit.

62. After joint negotiations stalled, Mr. Sikora persisted and tried to use the momentum of the settlement conference to attempt a separate settlement. While still at the April 19, 2007 settlement conference, Mr. Sikora encouraged Ms. Piccone to work with him to get the case settled at that time. However, Ms. Piccone had no authority from Gemini or NU at the time to settle the case.

63. At the April 19, 2007 settlement conference, Mr. Sikora explored the possibility of a separate settlement between the Owens family and El Paso. The attorneys representing the Owens family were unwilling to negotiate separately unless a separate settlement also included PSI, so that all Gemini and NU insureds were included in any separate settlement.

64. In response to this demand, Mr. Sikora creatively suggested to the Owens family and their attorneys that the Owens family make a very reasonable, take-it-or-leave-it, non-negotiable, time-limited demand to El Paso and PSI. Mr. Sikora emphasized that if the offer was within the realm of a reasonable verdict for a Harris County, Texas jury, he would take the offer to the insurance carriers (Gemini and NU) and push for acceptance of the offer. He proposed that the offer be left open for thirty days after the April 19, 2007 settlement conference, be non-revocable during those thirty days, and be non-negotiable: either the carriers would accept and the Owens' family claims against El Paso and PSI would be settled, or all discussions would end. He wanted to take an offer to the carriers (Gemini and NU) which would be so reasonable that it would be a 'no-brainer' for the carriers to accept.

65. Mr. Sikora proposed successive offers of $1.0, $2.0 and then $3.0 million to separately settle the claims against PSI and El Paso, all of which were rejected by the Owens family and their attorneys. Mr. Sikora told the Owens family and their attorneys that they were making a grave mistake and was preparing to leave the settlement conference. Shortly afterwards, still at the April 19, 2007 settlement conference, the Owens family and their attorneys agreed to Mr. Sikora's concept and made a take-it-or-leave-it, non-negotiable, time-limited demand of $3.1 million to separately settle all claims for wrongful death against PSI and El Paso.

## VII. NU's Follow-Up After Settlement Conference – Events up to May 25, 2007

66. The separate settlement offer to PSI and El Paso was communicated to NU on April 20, 2007. (Ex. 19; Ex. 1066, at 1066-30, 31). Mr. Sikora sent letters to Gemini and to NU (Ex. 46) about the proposal as well.

67. Under the NU policy (Ex. 1), one of the factors which triggered NU's duty of defense was a "suit" against the insured:

> C. This policy applies to **Bodily Injury**, **Property Damage**, and **Personal Injury and Advertising Injury** only if prior to the **Policy Period**, no **Insured** shown in Paragraph M2 of Section VII, no officer, no manager in your risk management, insurance or legal department and no employee who was authorized by you to give or receive notice of an **Occurrence**, claim or **Suit**, knew that the **Bodily Injury** or **Property Damage** had occurred, in whole or in part, or that an **Occurrence** had been committed that caused **Personal Injury and Advertising Injury**. If such an **Insured**, manager or authorized employee knew, prior to the **Policy Period**,

The policy defined a "suit" as:

> CC. **Suit** means a civil proceeding in which damages because of **Bodily Injury**, **Property Damage**, or **Personal Injury and Advertising Injury** to which this policy applies are alleged. **Suit** includes:
>
> 1. an arbitration proceeding in which such damages are claimed and to which the **Insured** must submit or does submit with our consent; or
>
> 2. any other alternative dispute resolution proceeding in which such damages are claimed and to which the **Insured** submits with our consent.

(Ex. 1, at 1-26) The parties stipulated that the Owens arbitration was a "suit" within the meaning of the NU policy.

68. NU was aware that the settlement offer expired by its own terms on May 25, 2007.

69. Mr. Sikora adopted an 'open kimono,' open-discovery approach and shared all information with Gemini and NU regarding the settlement conference and demands, as well as his assessment of PSI's and El Paso's exposure for the pipeline explosion.

70. On April 20, 2007, the case was assigned from the NU Segmentation Department to NU claims adjuster Norma Ovalle in the Mainstream Claims Unit, which handles smaller claims.

71. On April 25, 2007, Ms. Ovalle spoke with Gemini's coverage attorney, Mr. Jackson, and received a summary of potential coverage defenses prepared by Gemini. (Ex. 1066, at 50). This summary included the coverage defenses that (a) the Alliance Agreement was unenforceable under Texas law because it did not expressly set forth the indemnification agreement; and, (b)

the Professional Services exclusion. (*Id.*) At this time, NU had not retained its own coverage counsel.

72. On April 26, 2007, Ms. Piccone, the defense attorney retained by Gemini to represent PSI, sent the mediation statements of all parties (including Ex. 41 which contained the very gruesome photos of Mr. Owens' body) to Ms. Ovalle at NU. (Ex. 1066).

73. On April 30, 2007, Ms. Ovalle recommended that the case be transferred out of the Mainstream Claims Unit and to the Complex Claims Unit. She summarized the case as follows:

> -----Original Message-----
> From: Ovalle, Norma
> Sent: Monday, April 30, 2007 12:28 PM
> To: Muir, Robert
> Subject: Complex File - Recommend Transfer (Pipeline Strategies 169-207156)
>
> This claim was assigned on 4/20/07, I am recommending the claim referenced above be transferred to the Complex Unit as soon as possible.
>
> The incident occurred on 11/11/06 on the border of Wyoming and Colorado. Claimant lived in Texas. Per counsel hired by primary to do a coverage analysis and who attended mediation, suit would be filed in Texas, but Wyoming law would be applied.
>
> Our insured, Pipeline Strategies, was hired by El Paso Corp. to provide encroachment inspectors to survey existing El Paso pipeline in connection with laying of a new Rockies Express pipeline running from Colorado to Ohio. Associated Pipe Line Contractors of Houston, TX was hired by Rockies Express to do the work. Bobby Ray Owens, an Associated employee, was digging up a trench with a bulldozer for placement of new pipeline when the blades hit existing pipeline causing it to rupture. A fire ball ensued and engulfed Owens as he tried to run from the bulldozer. Owens died as a result of injuries sustained in the fire.

A Pipeline employee, Gary Brack, would survey the site and mark where existing El Paso lines lay and notify the construction crew of the area of encroachment and they would have to remove their right of way away from the existing pipeline. Brack was at the particular site 4 days prior to the incident and failed to determine there was El Paso existing pipe. It appears that Pipeline and Brack just missed the existing pipeline and failed to mark it.

The claim is not in suit, but there was a recent pre-suit mediation in which EL Paso brokered a deal to cap its damages at $3.1M in exchange for a release of EL Paso, Colorado Interstate Gas and Wyoming Interstate Company (both El Paso affiliates and owned the existing pipeline), and Pipeline Strategies contingent on the carriers consenting to the settlement and not taking the position that this deal is a voluntary payment. El Paso claims it is an additional insured under Pipeline's coverage pursuant to an indemnity clause in the contract. The timeline for accepting this deal expires on 5/25/07. Plaintiff's demand at mediation was $27M.

El Paso is looking for consent for them to fund the settlement pursuant to a reservation of rights from the carriers on potential coverage issues and then El Paso will pursue the carriers to get their money back. El Paso also now claims they have a property damage claim worth $1.6M for damages to the pipeline.

According to primary's counsel, Gemini will potentially tender their $1M policy limits to AIG, though they have extensive and complex coverage issues which counsel will email an outline to me on.

Given the issues presented above, multiple venues, choice of law, indemnification, and value of the damages, I recommend this file be transferred to Complex for further handling.

(Ex. 1066, at 1066-43). Ms. Ovalle and NU were aware that the primary carrier, Gemini, was considering tendering its $1,000,000 policy limits to NU as the excess carrier. (*Id.*) Other NU claims personnel recommended transfer to the Complex Claims Unit because "primary is bailing." (*Id.* at 1066-41)

74. Ms. Ovalle's recommendation was accepted and the claim was assigned to Michael Muscarella, the Director of the Complex Claims Unit, and to a claims adjuster in that unit, Leonard Romeo, between April 30 and May 4, 2007.

75. Mr. Muscarella was aware that time constraints and potential coverage issues existed. On May 4, 2007, he wrote to a superior at NU:

----- Original Message -----
From: Muscarella, Michael
To: Pedro, Bryan
Sent: Fri May 04 15:29:47 2007
Subject: FW: Pipeline Strategies (169-207156)

Bryan,

This is a new case which just came over from Mainstream with multiple coverage issues and time restraints. I believe we need to hire coverage counsel to address the multiple coverage issues which present themselves in this case. An outline of the case is below. Who is it that I seek permission from over in Coverage? Do I go to a Nadolna for permission to hire coverage counsel or someone else (AVP or Director)? Could you please advise? Thanks, Mike

(Ex. 1066).

76. Mr. Muscarella was aware that the time-limited settlement demand expired on May 25, 2007.

77. All parties acknowledged at trial that the settlement offer of $3.1 million extended by the Owens' family to settle their claims against PSI and El Paso was extremely reasonable. This is particularly true for a claim which would have been filed in Harris County (Houston), Texas, a venue with a known reputation for producing large jury verdicts. Mr. Muscarella conceded this point as well.

78. Mr. Muscarella was aware of the nature of the incident, including that it involved a fatality, significant property damage, that the primary coverage was $1 million through Gemini, that NU had a $5 million excess policy on top of Gemini's primary coverage, and that an offer had been made by the Owens' family to settle the wrongful death claim in the amount of $3.1 million – excluding any property damage claims.

79. Mr. Muscarella testified at trial that he believed that the claims against PSI arising from the WIC pipeline explosion (including the death of Mr. Owens and property damage) might not represent an excess claim which would exceed the limits of the primary Gemini commercial general liability policy and thus fall within NU's excess coverage. This testimony was not credible because of the nature of the Owens wrongful death claim and because Mr. Muscarella knew that the property damage claims, themselves, exceeded $1 million.

80. On May 7, 2007, Mr. Romeo, the claims adjuster, noted:

End of note

*Final*

Branch : 169
Case : 207156
Written By : Romeo, Leonard
Claimant Name : Owens Bobby
Insured Name : PIPELINE STRATEGIES AND INTEGR
Note Title : EXCESS INVESTIGATION
Created : 05/07/2007 6:27PM
Printed : 04/08/2009 2:13PM

File rec'd. Have noted mgr's assignment comments. Have contacted primary insurers counsel and provided my contact info, who advised Tender has not been sent yet. I inquired if they have any info as to what El Paso's insurance coverge and whether there has been "an other insurance" clause analysis. He advised that he doesnt know nor have any of their policies. Apparently they havent considered this.

Contact El Paso counsel and left message.

Will review policies (primary policy is in file) and file. i await coverage unit recommendations on counsel.

Matter placed on diary for meeting with unit mgr.

(Ex. 1066).

81. On May 8, 2007, Gemini tendered its policy limits of $1 million to NU. (Ex. 48) In the tender, Gemini neither acknowledged nor repudiated its responsibility to pay attorneys' fees on behalf of El Paso. (*Id.*) NU understood that Gemini had elected not to pursue its coverage defenses, including defenses that Mr. Brack's activities were 'professional' and that the Alliance Agreement was allegedly unenforceable under Texas law.

82. Mr. Muscarella asserted at trial that the Gemini tender was 'improper' (because NU was still evaluating the facts and coverage) and 'premature' (because NU was still evaluating its position). These assertions of impropriety and prematurity are incorrect and not credible.

83. Mr. Muscarella conceded that NU was obligated to promptly investigate the claim in adherence with applicable industry standards and in accordance with NU's obligation of good faith and fair dealing to its insured.

84. On May 11, 2007, Mr. Romeo learned from PSI's defense counsel that Occupational Safety and Health Administration (OSHA) officials in Wyoming concluded that there had been a probable OSHA violation by PSI,

> On May 2, 2007 PSI received notice from the Wyoming OSHA office that it believes PSI's activities in marking the pipeline violated OSHA regulations. PSI will presumably have to answer to OSHA for these alleged violations. We do not know if the Wyoming OSHA office served a similar notice on El Paso Corporation.

(Ex. 1066), leading to and being a cause of the pipeline explosion. (This ultimately proved to be OSHA's final conclusions, *see* Ex.'s 66, 67[7] and 68 in May 2008.)

85. Sometime in early May (the date is unclear from the claims file), NU retained the Houston law firm of Sedgwick, Detert, Moran & Arnold, LLP (Sedgwick firm) as its coverage counsel on the case.

86. On May 14, 2007, Mr. Sikora had a lengthy conversation with the NU claims adjuster, Mr. Romeo, during which Mr. Sikora fully shared his information about and thoughts regarding the case

87. Although it had received all the investigatory materials of Ms. Piccone and PSI, and the materials provided by all parties to the settlement conference, *see* Ex's 53 and 135, NU was not prepared by May 25, 2007 to respond to the Owens' family demand.

88. By May 21, 2007 – 4 days before the expiration of the Owens' family offer – Mr. Sikora was frustrated and did not think that Mr. Romeo and NU were moving with appropriate speed. He received a letter from NU's coverage counsel at the Sedgwick firm (Ex. 54) seeking basic information about the case, suggesting that NU did not appreciate the significance of the looming deadline.

89. On May 23, 2007, Mr. Sikora had a phone conference with the NU claims adjuster, Mr. Romeo. Mr. Romeo stated that NU was going to deny coverage to PSI based on the policy's Pollution Exclusion (*see* ¶ 91, below) and that he also needed to look further at the Professional Services exclusions. Mr. Sikora became so frustrated that he 'yelled' at Mr. Romeo and told him to stop

---

[7] Ex. 67, the OSHA report, concludes:

> Gary Brack used to work for Colorado Interstate Gas (CIG). He took an early retirement when El Paso bought CIG. According to Gary, he has over thirty years experience with the pipelines in this area. Due to Gary's connections with CIG, they usually request his services when they have work or projects to contract out.
>
> Although Gary felt he could detect where a pipeline was located from the vegetation or a berm, he does use an instrument to assist with locating the lines. He uses a Metrotec 850. But Gary also admits he didn't always use the instrument to check the lines, only when he has a concern, such as when the ROW stakes appear to be too close to the line.
>
> The only reliable tool he used was an electronic device used to locate the line. He also used the generic alignment sheets that had been issued for construction. He did not have the engineered "as built" drawings at his disposal and claims he would not have used them. He was authorized to use his personal knowledge, experience, and visual indications on the

'stalling.' Mr. Sikora told Mr. Romeo that assertion of the Professional Services exclusions was 'crazy,' that Mr. Brack was an 'entry level' guy who 'was not a rocket scientist, was not an architect or an engineer,' that Mr. Brack 'was a guy with a metal detector like a 5-year-old on a beach,' that E & O policies[8] were not written for line-locators like Mr. Brack, that it was 'patently obvious' that a line-locator like Mr. Brack was not a professional and that NU should stop throwing up more meritless defenses. Mr. Sikora believed that the Professional Services exclusion invoked by NU as a basis for denying coverage to PSI was not applicable. In Mr. Sikora's view, the Professional Services exclusion would apply to highly specialized and educated individuals who would be covered by an E & O policy, not to a cross-functional technician on a pipeline. Mr. Brack's role was to mark areas of encroachment between the existing WIC pipeline and REX parties' construction, not to demarcate the entire line. Mr. Sikora analogized Mr. Brack's function to that of a technician from a utility who marks the location of an underground line, electricity or utility before construction or digging in the backyard.

90. Mr. Sikora also responded that the Pollution Exclusion had no applicability and that this was not a leaky tank or pipe case.

91. As of May 23, 2007, Mr. Romeo had not consulted with NU's in-house pollution claims department or Richard Koren, NU's Assistant VP of Environment Claims. *See* Ex. 1066, at 1066-22.

92. Mr. Romeo told Mr. Sikora that NU would be unable to decide on participation in the settlement by the deadline of May 25, 2007.

93. As a result, Mr. Sikora proceeded to what he described as a 'Plan B.' He believed the $3.1 million offer from the Owens family was extremely reasonable and would not be extended again after the May 25th deadline passed. He thought he would give NU additional time to complete its investigation while simultaneously not allowing the Owens' family offer to expire. Mr. Sikora proposed that El Paso pay the additional $2.1 million (on top of Gemini's limits of $1 million), provided that NU agree to waive the Voluntary Payments provision[9] of the policy on behalf of PSI. He believed this

---

[8] Errors and Omissions. This refers to the type of policy which a professional (architect, engineer, etc.) will have.

[9] The NU policy, like many insurance policies, gives the carrier the right to refuse to indemnify payments voluntarily made to a claimant by the insured and without permission or authorization of the insurer.

would avoid allowing the extremely advantageous $3.1 million offer to expire while, at the same time, affording NU more time to investigate.

94. Mr. Sikora tried to get a response to the 'Plan B' proposal from Mr. Romeo on May 24, 2007. Mr. Romeo did not initially respond. Mr. Sikora emailed Mr. Romeo on the evening of May 24, 2007 and had a conference call with Mr. Romeo and NU's coverage attorneys at the Sedgwick firm. Mr. Romeo stated that if Mr. Sikora wanted a waiver of the Voluntary Payments provision, 'he was going to have to do something for me': a waiver of any possible bad faith claim which El Paso might have had against NU. Mr. Sikora believed such a proposed waiver *per se* represented bad faith but told his superiors at El Paso that they had no choice but to accept. Mr. Sikora advised Mr. Romeo that El Paso would agree to the proposal. (Ex. 55)

95. Mr. Humberd at PSI was never contacted by Mr. Romeo, Mr. Muscarella, or anyone else at NU while these discussions occurred. Mr. Humberd continued to fear the bankruptcy of his company because of the pipeline explosion and its aftermath.

## VII. Events Between May 26 – July 31, 2007

96. On May 24, 2007, NU agreed to make a decision on its position about participation in the settlement within seventy-five (75) days.

97. Mr. Sikora proceeded to finalize the settlement with the Owens family, which was signed on May 30, 2007 (Ex. 65). The day before the settlement was finalized, PSI's defense counsel provided by Gemini declined to sign the release because of a concern that there would be insufficient coverage. PSI was removed from the release. Thus, the release only released the claims of the Owens family against El Paso (and related entities). The Owens family assigned its claims against PSI to El Paso. (Ex. 71)

98. Between May 25-July 31, 2007, no one at NU sought or requested any more information from Mr. Sikora or El Paso.

99. The NU claims file does show that the matter of issuing a Reservation of Rights to PSI under the Pollution Exclusion was discussed with and approved by NU's VP of Environmental Claims, Mr. Koren, in early June 2007. *But see* ¶ 89, above. This consultation was required if a Reservation of Rights letter was issued based on the Pollution Exclusion.

100. Apart from this limited activity, there is no evidence that any further investigation of any type was conducted by Mr. Romeo, Mr. Muscarella, NU, or by the Sedgwick firm between June 2007 and July 10, 2007.

101. On July 10, 2007, NU issued a Reservation of Rights (ROR) letter to PSI (Ex. 11) The letter was written by the Sedgwick firm although signed by Mr. Romeo and on AIG (NU's parent) letterhead.

102. As applicable to the claims which were tried in this case[10], the ROR reserved NU's rights to assert the following defenses:

> *the Bodily Injury or Property Damage claims arose out of the actual discharge, dispersal, release or escape of Pollutants;*
>
> *the Bodily Injury or Property Damage claims arise out liability of a professional nature performed and/or committed by or for the Insured;*
>
> *whether PSI and El Paso's Contract is an Insured Contract as defined by the policy;*

(Ex. 11, at 11-14)

103. Twenty-one days later, on July 31, 2007, NU (this time in a letter written by Ms. Adams at the Sedgwick firm) sent a letter to PSI and their Gemini defense counsel denying coverage altogether (DOC letter)(Ex. 13). In the DOC letter:

a. NU denied coverage for claims under the Professional Services Exclusion (under both Endorsements 10 and 13)[10];

b. NU denied coverage because it asserted that the Alliance Agreement was not an "insured contract" as defined by the NU policy; and

c. NU reserved its rights under the Pollution Exclusion.

(*Id.*) NU also asserted that there had not been exhaustion of the underlying Gemini limits and that Gemini was continuing to defend PSI and that, therefore, no duty to defend PSI arose.

104. NU concluded its DOC position by stating:

---

[10] Before trial, NU dismissed all other defenses it had apart from the Professional Services Exclusion and claim that the Alliance Agreement violated the 'express negligence' requirement of Texas law.

> On the basis of these considerations, National Union hereby disclaims coverage and denies payment under the excess policy for the bodily injury and property damage claims for which National Union was notified. In addition to those policy provisions outlined above,

(*Id.*)

105. The decision to deny coverage could not be made by a claims adjuster. Instead, it had to be (and was) approved by Mr. Muscarella.

106. Mr. Muscarella was unaware of any new data, facts, or information which NU acquired, or any additional investigation conducted by or on behalf of NU, in the twenty-one days between July 10 (the date the ROR letter was issued) and July 31, 2007 (the date the DOC letter was sent). Moreover, no additional information is apparent from NU claim file. (Ex. 1066)

107. Mr. Muscarella was unaware of any investigation which was undertaken with regard to the Alliance Agreement. He was unaware whether anyone at NU ever spoke to Mr. Williams, Mr. Humberd, or anyone at PSI or El Paso about their understanding of the Alliance Agreement or what their expectations had been regarding the Alliance Agreement.

108. At trial, and apart from merely re-reading the verbiage of the DOC letter about the Alliance Agreement, Mr. Muscarella could not advance any explanation, cogent or otherwise, as to what about the Alliance Agreement formed a legitimate basis for the DOC.

109. Between February 16, 2007 and issuance of the DOC letter, no one at NU ever spoke to PSI, anyone at PSI, or Mr. Brack. Beyond the materials provided by PSI's defense counsel and El Paso, no statement was obtained by NU from PSI or Mr. Brack; no information was garnered about Mr. Brack's background or training.

110. At trial, Mr. Muscarella asserted that NU met its duty of investigation by inviting PSI, both in the ROR and DOC letters, to submit additional information. This stock language in both letters,

> As noted above, AIG is continuing to investigate this claim. We would be pleased to review any additional documentation or information which you may have regarding this matter.

(Ex. 11, at 11-15) and

However, National Union will continue to review this matter. Accordingly, please forward any information or documentation received in connection with the pipeline explosion and/or the referenced Owens Family or property damage claims to our attention as soon as possible.

(Ex. 13, at 13-22), did not, contrary to Mr. Muscarella's claim, represent any type of investigation whatsoever.

111. In addition to the absence of any evidence showing -- or even suggesting -- that NU did anything to further investigate the claim, Mr. Brack's activities, or the Alliance Agreement between July 10, 2007 (ROR letter) and July 31, 2007 (DOC letter), it is noteworthy that the ROR and DOC letters are, for all intents, identical in language, structure and substance.

112. The Court concludes that the denial of coverage was a foregone conclusion by NU as of July 10, 2007 and that the decision to send a ROR letter, followed by the DOC letter twenty-one days later, was simply a ruse to create the appearance that NU had deliberated about the DOC. The Court finds that NU had already decided to deny coverage as of July 10, 2007.

113. NU never contacted Mr. Humberd between May 25, 2007 and issuing the DOC letter on July 31, 2007.

**VIII. Involvement of Mr. Jensvold --- July – December 2007**

114. Marcus Jensvold is a wholesale and surplus insurance lines broker in Houston. He works with retail agents to place policies.

115. Mr. Jensvold had been PSI's wholesale broker for a number of years before the 2006 WIC pipeline explosion. He placed the excess policy with NU and worked with NU senior underwriter, Richard Dauchy. NU was informed of non-professional aspects of PSI's business. The procuration of the excess policy was intended to cover those risks, including the risk of a pipeline exploration.

116. Mr. Jensvold was familiar with the Alliance Agreement and had provided it, year after year, to NU's underwriter. His understanding from PSI was that PSI intended to indemnify El Paso for all occurrences except those caused by the *sole* negligence of El Paso. According to Mr. Jensvold, the 'express negligence' requirement of Texas law was made clear to him and was made clear in the Alliance Agreement.

117. In the years preceding the WIC pipeline explosion, NU's senior underwriter, Mr. Dauchy, never raised any concern about or question with Mr.

Jensvold regarding the Alliance Agreement. Mr. Dauchy never suggested that the Alliance Agreement had not accomplished the requirement for a declaration of express intent to indemnify by PSI as required by Texas law.

118. In the spring of 2007, PSI's owner, Mr. Humberd, reached out to his insurance brokers for help, including Mr. Jensvold.

119. Mr. Jensvold corresponded with PSI's commercial broker in Colorado Springs about procuring post-explosion insurance for PSI. Mr. Jensvold commented (prophetically, as it turned out) about the Owens claim:

**From:** Marcus Jensvold
**Sent:** Wednesday, May 30, 2007 10:30 AM
**To:** 'Darrell Six'
**Subject:** RE: Pipeline Strategies - Aggregate Issue

Darrell - I could ask Gemini if they would consider a cancel / re-write. They know what their position on the claims is. But, I'm not optimistic they would, as I'm sure the claim is too fresh for them. I wouldn't think AIG would even consider now, as they are apparently mulling the claim over. I certainly hope they don't try to call this a Professional type claim. Bear in mind that Professional is excluded in the umbrella. What exactly happened? Did they tell the decedent where to dig or work? And he struck the active line doing it? I don't think AIG could call this Professional in nature or would even try. They would risk a serious bad-faith claim. It might be difficult to re-market this right now - to new markets - since the claim isn't settled yet. But if you want, we'll try our best. Marcus Jensvold

(Ex. 91)

120. When Mr. Jensvold received a copy of the July 31, 2007 DOC letter, he was 'dismayed' by NU's position. As the commercial broker on the case, Mr. Jensvold believed that the Alliance Agreement was "clearly an insured contract" covered under the NU excess policy.

121. Mr. Jensvold contacted Mitch Harless, a VP with AIG (NU's parent) in Houston about the DOC. Mr. Harless was a Claims Regional Vice President in services and marketing. His job was to be a resource to insureds and brokers for claims and underwriting issues, and to provide brokers and insureds access to the NU's claims departments, including NU. Mr. Jensvold prepared and sent (Ex. 92) a painstakingly detailed letter to Mr. Harless expressing the reasons he disagreed with NU's DOC. (Ex. 97)

122. In response, on August 10, 2007, Mr. Harless wrote to Mr. Jensvold: "Per our discussion, I will look into this for you." (Ex. 93)

123. On August 10, 2007, Mr. Jensvold wrote the following to PSI's retail agent:

waiving those provisions. I obviously can't promise anything, but I am encouraged that I seem to have a sympathetic ear in AIG. My argument was that if AIG has coverage issues, they should issue a Reservation of Rights Letter and not issue the letter they did. I will keep you posted. Marcus Jensvold

(Ex. 94)

124. Mr. Jensvold's "argument . . . that if [NU] has coverage issues, they should issue a Reservation of Rights Letter and not issue the [DOC] they did" (¶ 123, above) was not given consideration by NU.

125. On August 22, 2007, Mr. Jensvold emailed Mr. Harless:

Mitch - Have you had a chance to delve into this denied claim? (AIG claim No. 169-207156). I need to start marketing the renewal of the CGL and Umbrella, so would like to see where we are at. Again, I believe that the AIG claims person handling this and Ms Adams (at Sedgwick) are "off base" on most of the issues raised and premature on some. I have been in the business for 40 years now and have gotten very good at predicting when a "train wreck" is about to happen, and this has all of the earmarks of one. Please let me know what you find out. Thank you. Marcus Jensvold

(Ex. 96, at 96-5) Mr. Jensvold was prescient once again (*see* ¶ 119, above).

126. On August 27, 2007, Mr. Jensvold emailed Mr. Harless and Mr. Dauchy again:

Mitch - I don't believe there will be any litigation right away, but I'm sure El Paso and Pipeline Strategies and their respective attorneys are certainly thinking about it. That letter did not give them any other choice. I don't believe this is going to go away. I see a long protracted battle brewing. The only thing I can ask of you is to please have this action reviewed by others in AIG. Maybe there is someone in a position of authority that can say -" Whoa, this denial letter was premature and AIG may be asking for trouble. Let's rescind it and instead go with a R.O.R. Letter." Please let me know. Thank you. Marcus Jensvold

(Ex. 96, at 96-3). Yet again, Mr. Jensvold called it to a 'T'.

127. Mr. Jensvold spoke to and emailed with Mr. Harless. (Ex. 93) In addition to expressing his opinion about the 'insured contract' issue, Mr. Jensvold wrote to Mr. Harless on August 28, 2007:

Mitch - The only two policy provisions that could be at issue, in my estimation, are Professional & Pollution. I don't know if Mr. Brack is a
P.E. or not. If he is not, I wouldn't think that operating a magnetometer
would be a professional job. Maybe not even if he is a P.E. Carpenters
and plumbers use them - no one would try to impose a professional exclusion
on them. As to Pollution, I believe there have been similar cases

(Ex. 96)

128. Mr. Harless passed this information on to Mr. Muscarella and the claims unit which had denied the claim.

129. Mr. Muscarella did not take Mr. Jensvold's concerns into consideration regarding the DOC on the basis of the Professional Services exclusion. Nor did any concerns expressed by Mr. Harless cause Mr. Muscarella or NU to undertake any re-evaluation of their position.

130. Mr. Harless conceded that he was an appropriate person in the NU hierarchy to contact their claims department and express the concerns of PSI and Mr. Jensvold.

131. Mr. Harless told Mr. Jensvold that he (Mr. Jensvold) and PSI had raised some legitimate issues, including the applicability of the Professional Services Exclusions, and that he would investigate.

132. Despite his painstaking efforts to have NU reconsider, Mr. Harless did not get back to Mr. Jensvold.

133. After follow up by Mr. Jensvold, Mr. Harless emailed Mr. Jensvold on October 22, 2007 (Ex. 103, at 103-1):

I noticed in your string of emails below that you indicated you have visited with the Regional Claim V/P and that he "pretty much agreed with me".
Obviously you are talking about me. Just so the wrong impression is not left on anyone, what I agree with is that you have raised some legitimate issues relative to some of the coverage positions. For example, I agree the professional exclusion warrants some discussion. Also, I need

At trial, Mr. Harless parsed the word 'legitimate' and claimed that he actually meant that the issues raised by Mr. Jensvold and PSI were 'legitimate to bring to the attention of the NU claims department' as opposed to being 'legitimate' in the sense of 'having merit.' The Court found this testimony coached and non-credible.

134. There is no documentation in Mr. Jensvold's detailed file that Mr. Harless ever got back to him. Mr. Harless had no documentation to show that he got back to Mr. Jensvold to communicate the position of the claims department. Mr. Harless testified that he "had a sense" that he communicated to Mr. Jensvold that NU was not going to reconsider. The Court does not find that testimony credible and finds that Mr. Harless never got back to Mr. Jensvold regarding the 'legitimate issues' which he raised on PSI's behalf. Nor did anyone else (*e.g.,* Mr. Muscarella, Mr. Romeo, or their superiors) at NU respond to Mr. Jensvold's concerns.

135. Mr. Jensvold also wrote to NU's Senior Underwriter, Richard Dauchy. Mr. Dauchy understood that Mr. Jensvold was very upset about the denial of coverage to PSI.

136. Mr. Dauchy notified his supervisor, Mr. Christy, and they had a phone conference with Mr. Harless. Mr. Harless was to conduct further investigation, but never got back to Mr. Dauchy.

137. In late 2007, Mr. Jensvold met with Messrs. Harless and Dauchy in Houston. At that time, Mr. Dauchy opined that the Professional Services Exclusion did not apply.[11]

## IX. Change in Business Relationship between PSI and El Paso

138. In the summer of 2007, El Paso began pulling work from PSI. This decision was triggered by the fact that NU had denied coverage. Because El Paso was self-insured for the first $10 million and relied on its contractors to have insurance which would provide coverage to El Paso as an additional insured under the Insured Contract clause of the contractor's policy (see ¶ 8,

[11] In deposition, Mr. Dauchy testified that, in his view as an underwriter, mere 'inspection' or 'surveying' would not trigger the Professional Services Exclusion; rather, it would have to be inspection or surveying by a licensed 'professional' in order to trigger the Exclusion. Mr. Dauchy disavowed this testimony at trial and claimed that he was mistaken in his deposition. He contended that, during the 2007 meeting in Houston, he said that if Mr. Brack was doing nothing more than using a metal detector, that would not in his underwriting view rise to the level of professional services. The Court did not find Mr. Dauchy to be a credible witness in general.

above), El Paso made a business decision that it could not continue to do business with PSI until its insurance issues had been resolved.

139. In January 2008 (Ex. 82), El Paso terminated PSI as a contractor under the Alliance Agreement.

140. As a result of El Paso's decision to terminate the Alliance Agreement with PSI, PSI laid off some 10-15 employees.

141. PSI sustained lost income as a result of El Paso's pullback of work and termination of the Alliance Agreement.

142. Based on the conflicting expert testimony at trial, the Court finds that PSI lost $2,000,000 due to the loss of El Paso's business between 2007 and trial.

**X. El Paso v. PSI – Lawsuit and 'Bashor' Agreement – May 2008**

143. El Paso sued PSI, NU and Gemini in Denver District Court on May 15, 2008. El Paso had paid $3.1 million to settle the Owens' family claim and sought return of that money. Although the primary carrier, Gemini, had agreed that Mr. Owens' death and the property damage caused by the WIC pipeline explosion were covered losses and had tendered its policy limits, Gemini refused to pay its $1,000,000 in primary coverage at that time because it could not obtain a release of El Paso's claims against PSI.

144. At that point, PSI was without a lawyer. Gemini had tendered its limits and NU had denied coverage. Mr. Humberd felt considerable concern about PSI's risk of excess exposure.

145. Gemini provided a defense to PSI because NU had denied coverage.

146. In May 2009, El Paso settled the claim against Gemini and received the $1 million in policy limits which Gemini had tendered in May 2007 (Ex. 8). The $1 million was described at the time as payment for El Paso's property damage as a result of the pipeline explosion. (*Id.*, at 8-5) El Paso's claims against Gemini were dismissed and both El Paso and PSI released all claims they had against Gemini as a result of the pipeline explosion. (*Id.*, at 8-6). The settlement agreement specifically contemplated that El Paso and PSI were

entering into a 'Bashor' Agreement[12] in which they would jointly pursue claims against NU arising out of its denial of coverage to PSI. (*Id.*, at 8-4)

147. PSI and El Paso entered into the 'Bashor' Agreement (Ex. 9) on May 13, 2009. The relevant portions of the 'Bashor' Agreement provided:

a. PSI paid consideration of $1,000 to El Paso;

b. PSI stipulated to damages to El Paso as follows:

i. $3,100,000 for the settlement of the Owens' family claim;

ii. $411,050 in property damages (in excess of the $1,000,000 paid by Gemini;

iii. $97,315.27 in defense costs and attorneys' fees incurred by El Paso in the defense of the Owens' family claims;

iv. $756,216.90 in prejudgment interest.

c. PSI agreed that "El Paso's losses [above] were caused by PSI's negligence and/or the negligence of its employees or agents";

d. PSI agreed, at El Paso's sole discretion, to pursue a bad faith claim against NU in which El Paso "shall provide legal counsel of its selection to PSI and pay any attorneys' fees and costs incurred in connection with the Bad Faith Claim. El Paso shall retain the sole right to direct and/or control the prosecution of the Bad Faith Claim against National Union, including the right to make all strategic and litigation decisions with respect to prosecution of the claim, and/or to settle, or not settle, the claims against National Union at El Paso's sole discretion. PSI warrants that it will fully cooperate with El Paso and any of its counsel or agents in prosecuting the Bad Faith Claim against National Union as outlined herein. All sums recovered by PSI as a result of the Bad Faith Claim shall be immediately endorsed over and paid to El Paso." (Ex. 9)

148. The 'Bashor' agreement was negotiated at arms' length between Mr. Sikora and the attorneys for PSI and Gemini.

149. NU asserts that the clause (¶ 147.c, above) represents a complete exoneration of El Paso for any liability or liability exposure in the pipeline

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[12] *See Bashor v. Northland Ins. Co.*, 480 P.2d 484 (Colo.1970). Issues regarding the 'Bashor' agreement will be discussed below.

explosion and was a collusive agreement between PSI and El Paso designed to damage NU. Mr. Sikora insisted on the inclusion of this language in the 'Bashor' agreement. He denied this was intended to suggest that PSI, and only PSI, was negligent with regard to the WIC pipeline explosion and Mr. Owens' death. Rather, according to Mr. Sikora, this accurately reflected the Wyoming OSHA conclusion and was consistent with his own investigation.

150. Mr. Humberd testified that the 'Bashor' agreement was entered into in good faith and arms length. He had no objection to stipulating to PSI's negligence, given the findings of the OSHA about Mr. Brack.

151. NU asserts that the stipulated damages in the 'Bashor' agreement are also collusive. Mr. Sikora countered that the damage categories represent precisely, and no more than, El Paso's out of pocket losses as a result of the explosion. The Court agrees with Mr. Sikora's position.

152. The 'Bashor' agreement originally provided that any recovery, above the stipulated damages and $1,000, obtained from the bad faith case would be paid to El Paso. (Ex. 9, at 9-9, ¶ 8) Mr. Sikora testified that he 'screwed up' in including this provision and that the agreement should have provided that the bad faith claim would be assigned to El Paso only to cover El Paso's attorneys' fees (which it funded), with the remainder of any recovery going to PSI. NU suggests that this is further evidence of the collusive intent between PSI and El Paso.

153. The 'Bashor' agreement was amended in December 2011 – shortly before Mr. Humberd's deposition – to reflect that PSI would recover any damages from any judgment in the bad faith claim above El Paso's out of pocket damages and costs/attorneys' fees. (Ex. 10) NU suggests that the timing of this modification is further evidence of the collusive intent between El Paso and PSI.

154. El Paso's claimed damages for property damage to the WIC pipeline and loss of natural gas, and attorneys' fees, are $1,541,806.85 (*see* Ex's. 114-119), including legal fees of $126,187.86, property damage of $640,905.39, loss of escaped natural gas[13] of $634,411.25, labor costs of $131,557.92 and miscellaneous expenses for labor of $8,744.43.

[13] Gas from the WIC pipeline rupture escaped for approximately one hour.

155. The only out-of-pocket expenses sustained by PSI to date is the $2,100 OSHA fine and its payment of $1,000 for settlement of the El Paso claim.

**XI. Wyoming Lawsuit**

156. On November 10, 2010, both El Paso (and related entities) and PSI were sued in the District Court, Laramie County, Wyoming, No. 177-090, by Fireman's Fund Insurance Company (Wyoming case).

159. The Wyoming case involves a subrogation claim relating to the bulldozer which was driven by Mr. Owens and damaged in the explosion.

160. NU is currently defending PSI in the Wyoming case under a Reservation of Rights. NU claims that because Gemini has now paid the underlying $1,000,000 in connection with the settlement in this case, its duty of defense was triggered. Plaintiff claims, however, that NU has taken inconsistent positions, denying coverage outright to PSI previously but now, after a bad faith case has been filed, defending PSI under a Reservation of Rights.

**Conclusions of Law**

**XI. Declaratory Judgment -- Whether WIC pipeline Explosion was a Loss Covered by NU's Excess Policy**

**A. Principles of Interpretation**

The interpretation of an insurance policy is governed by contract law principles and is a question of law for the court. *Farmers Ins. Exch. v. Anderson*, 260 P.3d 68, 71 (Colo. App. 2010). Like any other contract, a court's obligation is to "give effect to the intent of the parties. Whenever possible this intent should be ascertained from the plain language of the policy alone." *Id.*, at 72 (internal citation omitted).

When interpreting the language used in an insurance policy, "it is the duty of the court to examine the contract as a whole, and the determination of whether an ambiguity exists is a question of law for the court." *State Farm Mut. Auto. Ins. Co. v. Mendiola*, 865 P.2d 909, 912 (Colo. App. 1993). Unless the insurance policy demonstrates a contrary intent, words used in the policy must be given their plain and ordinary meaning. Additionally, policy provisions should be read as a whole, rather than in isolation. The court may not rewrite, add, or delete provisions to extend or restrict coverage. *McGowan v. State Farm*

*Fire and Cas. Co.*, 100 P.3d 521, 523 (Colo. App. 2004). "Courts may neither add provisions to extend coverage beyond that contracted for, nor delete them to limit coverage. However, because of the unique nature of insurance contracts and the relationship between the insurer and insured, courts do construe ambiguous provisions against the insurer and in favor of providing coverage to the insured." *Cyprus Amax Minerals Co. v. Lexington Ins. Co.*, 74 P.3d 294, 299 (Colo. 2003).

Exclusionary clauses in an insurance policy "that insulate certain conduct from coverage must be written in clear and specific language, and are to be interpreted against defeat of the coverage." *Bohrer v. Church Mut. Ins. Co.*, 965 P.2d 1258, 1262 (Colo. 1998). "The insurer therefore has the burden of demonstrating that the policy exclusion applies in the particular circumstances at issue and that it is not susceptible of any other reasonable interpretation." *Compass Ins. Co. v. City of Littleton,* 984 P.2d 606, 614 (Colo.1999). To benefit from an exclusionary clause, the insurer must show the exclusion applies in the particular case and that the exclusion is not subject to any other reasonable interpretations. *Am. Fam. Mut. Ins. Co. v. Johnson*, 816 P.2d 952, 953 (Colo. 1991).

If a limitation or exclusion in an insurance policy is unambiguous, then it must be enforced as written. *Mendiola, supra.*

However, ambiguous provisions in an insurance policy or exclusionary clause are to be construed against the insurer and in favor of providing coverage to the insured. *Id.; Cyprus Amax, supra.*

A mere disagreement between the parties concerning interpretation of the policy does not create an ambiguity. *Cary v. United of Omaha Life Ins. Co.*, 108 P.3d 288, 290 (Colo. 2005). Ambiguous terms in an insurance policy or exclusion to coverage are those "that are reasonably susceptible to different meanings," *Pub. Serv. Co. of Colorado v. Wallis and Companies*, 986 P.2d 924, 933 (Colo. 1999), or "susceptible on [their] face to more than one reasonable interpretation." *Union Ins. Co. v. Houtz*, 883 P.2d 1057, 1061 (Colo.1994).

**B. Professional Services Exclusion**

For the following reasons, the Court determines that the terms 'of a professional nature' and 'professional services' in the NU policy, Endorsements 10 and 13, are ambiguous and, as applied to Mr. Brack's activities on the WIC pipeline, do not apply.

As noted, NU did not define either term in the policy or the Endorsements.

While certain activities would clearly be professional, others are unclear – as exemplified by the years of litigation and diametrically opposing viewpoints offered by witnesses in this case.

The intent of the Exclusions is to exclude from general liability coverage of the NU excess policy those activities which would be covered by an E & O policy. While easy to state in those terms, it is difficult to apply with any precision.

Thus, on the one hand, if the explosion had occurred as a result of Mr. Humberd's activities as a licensed, professional engineer in incorrectly preparing drawings or making calculations onto which he affixed his P.E. seal, that would obviously be a 'of a professional nature' as well as a 'professional service.' On the other, if an entry level worker was mowing the grass alongside the pipeline right-of-way, that would not be 'of a professional nature' or a 'professional service.' Mr. Brack's activities demonstrate the width of the spectrum.

As pointed out by NU, Mr. Brack's work activities were important, involved judgment, could lead to stoppage of work on the REX pipeline construction, and, if done improperly, could lead to catastrophic results, as occurred. From that, NU reasons that Mr. Brack must have been acting in a professional nature or providing professional services. The Court disagrees. The same thing could be said of a retired person who works as a school crossing guard: he/she is responsible for the safety of children, must make decisions, can stop traffic and, if done improperly, could lead to a disaster. Yet no one would seriously suggest that a school crossing guard is a professional or that his/her activities represent 'professional services' or are 'of a professional nature.' The same applies to Mr. Brack.

Based on the weight of the evidence at trial, the Court concludes that Mr. Brack's activities as an encroachment inspector were not 'professional services' or 'of a professional nature,' as set forth in Exclusions 10 and 13 to the NU policy. Mr. Brack's responsibility was to learn where the REX construction was occurring, go to those locations and determine, using essentially a metal detector and above-ground markers, whether or not there was a risk of encroachment of the WIC pipeline. The Court credits and finds persuasive the testimony of Messrs. Morgan, Mask and Humberd, individuals who had

extensive personal experience with the pipeline, Mr. Brack, and what Mr. Brack was doing.

The Court therefore concludes that the Professional Services Endorsements 10 and 13 of the NU policy did not apply and did not defeat coverage to PSI.

### C. Insured Contract

The Court concludes that the Alliance Agreement was an Insured Contract within the meaning of the NU policy and that El Paso was an additional insured under the policy. The Court finds that the terms of the Alliance Agreement, along with its application and the understanding of the parties to it, are valid under the Texas 'express negligence' requirements.

The Alliance Agreement provided that "[PSI] agrees to indemnify and hold harmless [El Paso] . . . from all and every kind and character of liability [including personal injury or death to employees or other persons and damage to property] . . . arising from any cause whatsoever growing out of or in Connection with [PSI's] negligent performance of the Work or [PSI's] strict liability. Further, [PSI] . . . shall pay all damages growing out of or in connection with such demand, claim, suit, action, liability or cause of action[.]" Ex. 3.

The following paragraph in the Alliance Agreement – which must be read together with and in context of the preceding – provides an exception, stating that notwithstanding the indemnity agreement, "in no event shall [PSI] be liable to indemnify and hold harmless [El Paso] from any liability, damages, losses, expenses, demands, claims, suits, actions or causes of action arising out of the sole negligence of [El Paso]." (Ex. 3, Art. XIIA)

Considered together, and disregarding the excess and legalistic verbiage, the provision says: PSI agrees to indemnify El Paso for any claims, unless the claim was caused by the sole negligence of El Paso. While perhaps not a model of clear language, the Court finds that the provision sufficiently expresses the intent of the parties that PSI would indemnify El Paso except for claims resulting solely from the negligence of El Paso.

In *Ethyl Corp. v. Daniel Const. Co.*, 725 S.W.2d 705, 708 (Tex.1987), the Texas Supreme Court held that the enforceability of contractual provisions purporting to indemnify one party from the consequences of its own negligence

was dependent on the express negligence doctrine: "We hold the better policy is to cut through the ambiguity of those provisions and adopt the express negligence doctrine. The express negligence doctrine provides that parties seeking to indemnify the indemnitee from the consequences of its own negligence must express that intent in specific terms. Under the doctrine of express negligence, the intent of the parties must be specifically stated within the four corners of the contract." Essentially, the objective of the Texas express negligence doctrine is to require a party seeking to indemnify itself from its own negligence and to shift that risk to another to express that intent in clear and unambiguous contractual language. Later Texas appellate decisions have clarified that "if both contracting parties have actual knowledge of the plan's terms, an agreement can be enforced even if the fair notice requirements were not satisfied," *Storage & Processors, Inc. v. Reyes*, 134 S.W.3d 190, 192 (Tex. 2004), and suggested this principle applies to the *Ethyl* express negligence doctrine in a commercial setting. *E.g., Cabo Const., Inc. v. R S Clark Const., Inc.*, 227 S.W.3d 314, 317 (Tex. App.--Hous. [1st Dist.] 2007).

Here, even if one argued that the Alliance Agreement failed to express clearly and unambiguously the intent of El Paso to indemnify itself from its own negligence and shift that risk to PSI – which, the Court finds, is not the case – the parties' understanding and conduct unequivocally shows that this was their understanding and intent. It is undisputed from both Mr. Williams and Mr. Humberd that they understood that PSI had to indemnify El Paso as a price of doing business with El Paso – and that they intended to do so by obtaining the (original) $1 million/$1 million and then later $1 million/$5 million coverage. This was El Paso's understanding. This is the reason that El Paso did not purchase insurance for this level of claim, as explained by Mr. Sikora. Mr. Jensvold, who was demonstrably knowledgeable about the objectives of his client, PSI, had exactly the same understanding. The policy was accepted for years by NU's underwriter, without question or objection.

The NU policy provided that its exclusion of Contractual Liability would not apply for assumption of liability in a contract or agreement assumed in an Insured Contract, which was defined as "that part of any contract or agreement pertaining to your business under which any Insured assumes the tort liability of another party to pay for Bodily Injury or Property Damage to a third person or organization." That is precisely what the Alliance Agreement stated. In order to be covered, the contractual liability had to occur subsequent to the execution of and prior to the termination of the NU policy. The NU policy also

provided that if the contractual assumption of liability by its insured covered costs and attorneys' fees, so did the NU policy. (Ex. 1, at 1-9 and 1-22).

The Court concludes that the Alliance Agreement was an Insured Contract, as defined in the NU policy and that El Paso was an additional insured under the NU policy. Because PSI agreed to assume El Paso's costs and attorneys' fees under the Alliance Agreement, those are covered by the NU policy as well.

### D. Conclusion

Under CRCP 57, the Court finds that the wrongful death of Mr. Owens, as well as the property damage sustained by El Paso, are covered under the NU excess policy.

## XII. Breach of Contract

"To prove a breach of contract claim, a plaintiff must prove: (1) the existence of a contract; (2) performance by the plaintiff or some justification for nonperformance; (3) failure to perform the contract by the defendant; and (4) resulting damages to the plaintiff." *Marquardt v. Perry*, 200 P.3d 1126, 1129 (Colo. App. 2008); *Western Distributing Co. v. Diodosio*, 841 P.2d 1053, 1058 (Colo. 1992).

In light of the Court's conclusions about the Professional Services Exclusions and Insured Contract provisions of the NU policy, the Court must find that NU breached the insurance contract if the conditions precedent to its application have been fulfilled.

The NU excess policy becomes applicable when "the total applicable limits of [the Gemini policy] have been exhausted by payment of Loss to which this policy applies[.]" The term "Loss" is defined as "those sums actually paid as judgments or settlements."

NU argues that the Gemini policy was not 'exhausted' before it issued the DOC letter on July 31, 2007 because Gemini had not actually paid money to a claimant (and did not pay anything until 2009, when it was sued in this case) and that, therefore, nothing had occurred to trigger either NU's duty to defend PSI or duty to indemnify PSI.[15] NU further argues that the May 8, 2007 tender

[15] An insurer's duty to indemnify is "largely a question of fact" and arises when "the policy actually covers the harm." *Cyprus Amax Minerals Co. v. Lexington Ins. Co.*, 74 P.3d 294, 301

of limits by Gemini was 'improper' and ineffective because the tender was not absolute and did not agree to continue to pay attorneys' fees for PSI's defense.

The Court finds the May 8, 2007 tender from Gemini to El Paso was sufficient to represent 'exhaustion' of the total applicable limits of the underlying Gemini policy.

The issue about exhaustion or complete payment of an underlying policy usually arises in the setting of the insured – along with a claimant and/or the primary carrier – entering into a settlement agreement for less than the full primary policy and then seeking to enforce payment under the excess policy.

Thus, for example, in *U.S. Fire Ins. Co. v. Lay*, 577 F.2d 421 (7th Cir.1978), a trucking company had primary insurance of $100,000 with an excess policy of $1,000,000. The excess policy provided the excess carrier was liable only for sums "in excess of the retained limit . . . ." 577 F.2d at 423. The decedent was killed due to the trucking company's negligence. The primary insurer entered into an agreement with the estate for $70,000, and the estate released the primary carrier from any further payment. They agreed that the trucking company would be "given credit for" any amounts up to $100,000 in the event a judgment over $100,000 entered. The parties then entered into a stipulated judgment of $150,000, which was entered by the trial court. The excess carrier contested its liability for the additional $50,000. The trial court ruled that the primary limits had not been exhausted as required by the policy, which was affirmed:

> We can conceive of good reasons for an excess carrier to be unwilling to accept liability unless the amount of the primary policy has actually been paid. A settlement for less than the primary limit that imposed liability on the excess carrier would remove the incentive of the primary insurer to defend in good faith or to discharge its duty, to represent the interests of the excess carrier. Here the primary insurer had no incentive whatsoever to

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(Colo.2003). An insurer's duty to defend, a much broader duty, arises "from allegations in the complaint, which if sustained, would impose a liability covered by the policy." *Hecla Mining Co. v. N.H. Ins. Co.*, 811 P.2d 1083, 1089 (Colo.1991). To defeat a duty to defend, an insurer must establish that "there is no factual or legal basis on which the insurer might eventually be held liable to indemnify the insured." *Hecla, supra,* at 1090; *Cotter Corp. v. Am. Empire Surplus Lines Ins. Co.*, 90 P.3d 814, 829 (Colo. 2004)

> reach a settlement at a figure between $70,000 and $100,000. Moreover, the settlement agreement terminating [the trucker's] liability of the administratrix made her subsequent wrongful death action against [the trucker] a sham. Neither [the trucker] nor the primary insurer, which purported to defend the action, had any interest whatsoever in the outcome.

*Id.* at 423 (internal citations omitted). *See also Comerica Inc. v. Zurich Am. Ins. Co.*, 498 F. Supp. 2d 1019, 1034 (E.D. Mich. 2007)[15]; *Danbeck v. Am. Family Mut. Ins. Co.*, 245 Wis.2d 186, 629 N.W.2d 150 (2001)[16]; *Wright v. Newman*, 598 F.Supp. 1178, 1196 (D.C.Mo.1984). *But see Zeig v. Massachusetts Bonding & Ins. Co.*, 23 F.2d 665, 666 (2nd Cir.1928).[17]

Here, there is no such issue. By the tender offer of May 8, 2007, Gemini expressed its willingness to immediately pay NU the full amount of the primary policy. Although the issue of payment of attorneys' fees (both for PSI and El Paso) remained unresolved, the contractual term "Loss" in the NU excess policy makes no mention of attorneys' fees. By offering the full and complete amount of the primary policy to fund the outstanding $3.1 million offer from the Owens family, Gemini offered exhaustion of its policy and thus triggered the excess NU policy. It would lead to an absurdity if Gemini could offer everything it had to

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[15] "[The insured] could have bargained for a contract under which [the excess carrier] agreed to pay for any liabilities over $20 million, even if the underlying insurer did not actually pay the entire $20 million, or when the insured filled the gap, or a settlement extinguished liability up to the primary insurer's limits, or there was an agreement to give the excess insurer 'credit' up to the amount of the underlying insurance. However, the present agreement does not say that, and it cannot be rewritten now."

[16] Payment of $48,000 with credit and not the full primary policy did not exhaust the primary policy: "While the 'settlement plus credit' approach to exhaustion has the same practical effect as payment of full policy limits, it is not consistent with the plain language of the policy, which unambiguously requires exhaustion *'by payment of judgements or settlements,'* not 'settlement plus credit." (Emphasis in original)

[17] "Such a construction of the policy sued on seems unnecessarily stringent. It is doubtless true that the parties could impose such a condition precedent to liability upon the policy, if they chose to do so. But the defendant had no rational interest in whether the insured collected the full amount of the primary policies, so long as it was only called upon to pay such portion of the loss as was in excess of the limits of those policies. To require an absolute collection of the primary insurance to its full limit would in many, if not most, cases involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable. A result harmful to the insured, and of no rational advantage to the insurer, ought only to be reached when the terms of the contract demand it."

offer under its primary policy without this representing an 'exhaustion' for purposes of triggering the excess policy.

Thus, the Court finds that there was exhaustion of the primary policy as of May 8, 2007 which, as of that date, implicated the NU excess policy. Because there was coverage under the NU policy and NU denied coverage, NU breached the insurance contract.

## XIII. Bad Faith

### A. Legal Standard

Colorado recognizes that insurance contracts involve more than the usual obligations of good faith and fair dealing implied in all contracts. "Rather than entering into a contract to obtain a commercial advantage, insureds enter into insurance contracts 'for the financial security obtained by protecting themselves from unforeseen calamities and for peace of mind....'" and insurance contracts are the result of a "significant disparity in the bargaining power between the insurer and the insured. Therefore, as a result of the 'special nature of the insurance contract and the relationship which exists between the insurer and the insured,' in addition to liability for regular breach of contract, an insurer's bad faith breach of an insurance contract also gives rise to tort liability." *Nunn v. Mid-Cent. Ins. Co.,* 244 P.3d 116, 119 (Colo. 2010)(internal citations omitted). Colorado has therefore imposed "a legal duty upon the insurer to deal with its insured in good faith." *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1141 (Colo. 1984).

"The question of whether an insurer has breached its duties of good faith and fair dealing with its insured is one of reasonableness under the circumstances. The relevant inquiry is whether the facts pleaded show the absence of any reasonable basis for denying the claim, i.e., would a reasonable insurer under the circumstances have denied . . . the claim under the facts and circumstances." *Trimble, supra,* at 1142. The duty of good faith includes the adjustment of the claim, *Dunn v. Am. Fam. Ins.*, 251 P.3d 1232, 1235 (Colo. App. 2010), and "encompasses the entire course of conduct" of the insurer. *Pham v. State Farm Mut. Auto. Ins. Co.,* 70 P.3d 567, 572 (Colo.App. 2003). "Because of the quasi-fiduciary nature of the insurance relationship in a third-party context, the standard of conduct required of the insurer is characterized by general principles of negligence. To establish that the insurer breached its duties of good faith and fair dealing, the insured must show that a reasonable insurer under the circumstances would have paid or otherwise settled the

third-party claim." *Goodson v. Am. Stand. Ins. Co. of Wisconsin*, 89 P.3d 409, 415 (Colo. 2004).

The reasonableness of the insurer's conduct must be determined objectively, based on proof of industry standards. *Bankruptcy Estate of Morris v. COPIC Ins. Co.*, 192 P.3d 519, 524 (Colo.App. 2008).

Under Colorado law, "it is reasonable for an insurer to challenge claims that are 'fairly debatable.' Thus, an insurer will be found to have acted in bad faith only if it has intentionally . . . failed to pay a claim without a reasonable basis. Indeed, even if an insurer possesses a mistaken belief that a claim is not compensable, it may be within the scope of permissible challenge. 'What constitutes reasonableness under the circumstances is ordinarily a question of fact....'" *Schuessler v. Wolter*, ___P.3d ___, 2012 WL 1881002 (Colo. App. 2012)(internal citations omitted).

**B. Analysis**

The Court finds that NU acted unreasonably and breached its duty of good faith and fair dealing because:

i. Many claims routinely reported to an excess carrier like NU may carry little-to-no-risk of implicating the excess layer of coverage. For others, the reality of excess exposure, far above the limits of the primary and excess policy, is, or should be, obvious from the outset. This was such a case. The gruesome death of Mr. Owens and significant property damage demonstrably put this case into (or above) the excess layer from the outset. Yet, NU had no written guidelines or policies for the evaluation, management or handling of excess claims. All claims were routed to the Segmentation Department and sorted there. The facts of this case should have triggered more than a routine, lackadaisical response by NU.

ii. The case received limited and no more than perfunctory attention from Mr. Gandelsman in the Segmentation Unit between late February 2007 until its transfer in April 2007. The evaluation done during that time was inadequate to the needs of the insured for a reasonably prompt and meaningful evaluation of its exposure and the needs of the case.

iii. Mr. Gandelsman knew, as of March 16, 2007, that there were potential coverage issues, including the Professional Services Exclusions. Yet,

NU adjusters were not permitted to hire coverage counsel while the claim was in the Segmentation Department, so no timely coverage investigation ensued.

iv. When the case was transferred from the Segmentation Unit in April 2007, it was first sent to the Mainstream Department which handles smaller claims. This further delayed the case receiving the attention it deserved from claims handlers appropriately trained to handle large damage claims.

v. NU took the position that the April 19, 2007 settlement conference was 'premature' and, therefore, essentially disregarded it. While there was no *per se* requirement that NU send its own additional representative to attend in person (it was receiving reports from PSI's defense counsel, Ms. Piccone, and El Paso, and had all the records and settlement memoranda available to it), NU's utterly dismissive attitude toward the settlement conference was unreasonable. Its attitude reflected the cavalier, knee-jerk response that NU knew better than those on the scene. The willingness of the Owens family and their attorneys to at least sit down and discuss settlement early on should have prompted at least a reciprocal open-minded willingness to listen by NU. Instead, NU unreasonably did not want to listen to anything.

vi. Through tenacity and insight, Mr. Sikora obtained a settlement offer from the Owens' family – the joint $3.1 million demand to PSI and El Paso to settle all wrongful death claims – which was favorable to NU's insured. A reasonable insurance carrier in NU's position would have also have recognized:

a. The facts surrounding Mr. Owens' death were extremely aggravated. The evidence suggesting that Mr. Owens survived long enough to make it out of the bulldozer and was burned alive while running away made this an especially risky case to take before a jury and made the $3.1 million offer exceptionally reasonable;

b. Although the investigation of the case was incomplete, there was more than ample evidence as of April 19, 2007 to suggest considerable liability exposure of both PSI and El Paso;

c. There was considerable evidence to suggest that El Paso was an additional insured under the NU excess policy;

d. If the case went into suit, PSI would be subjected to a significant risk of excess exposure, above its $6 million in coverage;

e. If the case went into suit, there would be considered 'cross-fire' and 'finger-pointing' among all of the prospective defendants; the prospect for a unified defense among the PSI/El Paso and REX defendants was almost non-existent; this would significantly increase the risk of a plaintiff verdict and PSI's risk of exposure; but,

f. One downside of going forward with an early settlement is that the opportunity for 'looking under every stone' would be lost.

vii. These factors would have lead a reasonable carrier to carefully and thoughtfully evaluate and analyze both the advantages and disadvantages of accepting the $3.1 million offer. NU failed to do this.

viii. NU considered none of the benefits and, instead, dismissively approached the extraordinarily advantageous, time-limited $3.1 million offer while the case remained in the Mainstream Unit.

ix. One of the primary factors which prompted the transfer of case to the Complex Unit (and Messrs. Muscarella and Romeo) was NU's realization that Gemini was likely going to tender its policy limits of $1,000,000 – or, as described in the NU claims file, "Primary is bailing." NU was focused on and concerned about itself –that it might have to undertake the defense and incur the defense costs – rather than focusing on the interests of its insured.

x. By the time the case was transferred to Messrs. Muscarella and Romeo, less than thirty (30) days remained on the time-limited offer. Yet, they did nothing proactively to evaluate the pros and cons of accepting or rejecting the time-limited $3.1 million offer, giving it the attention it deserved. For Messrs. Muscarella and Romeo, it remained a routine case where the possibility of achieving a truly advantageous settlement for their insureds was slipping away by the day.

xi. NU was aware of possible coverage defenses early on, as early as mid-March 2007. Yet, it did not investigate these and did not issue a ROR letter at the time. Even as of May 8, 2007, after receiving the tender of policy limits from Gemini, NU did not issue a ROR letter to PSI.

xii. NU did not reasonably communicate with PSI or its representatives about the $3.1 million settlement offer, the pros and cons of that offer, what PSI wanted, or that Gemini had tendered its $1 million policy limits. Indeed, NU did not communicate with PSI or its representatives about anything.

xiii. Messrs. Romeo and Muscarella failed to conduct any investigation or do anything to put NU in a position of being able to meaningfully evaluate the $3.1 million offer by the time it expired on May 25, 2007.

xiv. Mr. Muscarella's belief that the totality of the claims arising out of the WIC pipeline explosion might be within only the primary layer of coverage and would not extend to NU's excess layer was unreasonable.

xv. It was unreasonable and was bad faith for NU to demand that Mr. Sikora and El Paso waive any bad faith claim which El Paso might have in exchange for allowing El Paso to accept the $3.1 million offer without violating the Voluntary Payments provision of the NU policy. El Paso was backed into a corner by NU's inattention and NU had no legal justification to seek a waiver of any bad faith claims. Moreover, this reflects self-awareness by Messrs. Muscarella and Romeo that NU *had* acted in bad faith.

xvi. NU acted unreasonably and focused on its interests, rather than on PSI's interests, in allowing the May 25, 2007 offer to expire without insuring that PSI would be included in the settlement. As it turned out, PSI was not settled out and the Owens family simply assigned their claim against PSI to El Paso.

xvii. NU's actions were motivated by its displeasure with Gemini potentially "bailing" and NU's desire not to have to assume defense costs rather than by the interests and needs of its insured, PSI, to minimize its exposure to damages in excess of the primary and policy limits.

xviii. NU had no reasonable explanation for and no reasonable basis for rejecting Gemini's tender. Gemini appropriately concluded that the liability of PSI far exceeded its primary policy limits. Gemini decided to abandon its coverage defenses, which was its prerogative. That decision did not compel NU to abandon its coverage defenses. At very least, however, NU could and should have accepted the tender and defense, settled the Owens' family claim and proceeded with a declaratory judgment action on the coverage defenses and issue of who should pay defense costs. Such a course would have protected PSI and El Paso *and* afforded NU the opportunity to further investigate and pursue the coverage defenses. Instead, NU attempted to protect itself and considered only its interests only.

xix. NU was unprepared to evaluate or respond to the Owens' family claim by May 25, 2007.

xx. Despite being given additional time by El Paso to investigate, the evidence demonstrates that NU did not do any independent investigation before it denied coverage in the DOC letter issued on July 31, 2007. Rather, NU merely parroted the potential coverage issues which had been raised by Gemini back on April 25, 2007 (*see* Ex. 1066, at 1066-50 to 1066-52). NU issued the ROR letter on July 10, 2007 and denied coverage twenty-one days later in a nearly identical letter on July 31, 2007. There is no evidence that NU did *anything more* during those twenty-one days to further evaluate the case or which could have justified its decision to proceed from a ROR to an outright denial of coverage.

xxi. Even had NU been correct that the Alliance Agreement was not an Insured Contract because of the Texas 'express negligence' doctrine (a conclusion the Court has rejected), it did not form the basis for denying coverage to PSI for PSI's own exposure.

xxii. Even if NU felt the need to further investigate Mr. Brack's activities and whether those legitimately fell within the policy Exclusions of 'professional services' or 'of a professional nature,' there is nothing which NU knew, and nothing in the NU file, which justified NU's decision to *deny coverage* based on the Professional Services Exclusions. It would have been a reasonable option for NU to have raised the Professional Services issue as a basis for the ROR and go forward and, if necessary, file a declaratory relief action. However, to use the issues about Mr. Brack as a basis for an outright denial of coverage to PSI was unreasonable and unsupportable – *particularly* when there is nothing to substantiate why NU went from a ROR on this basis to a complete DOC between July 10 – 31, 2007.

xxiii. NU's decision to make an outright denial of coverage based on the Professional Services exclusion is not within the 'fairly debatable' standard. A thorough investigation would have revealed that Mr. Brack's activities with regard to the WIC pipeline were not 'professional.' Perhaps more importantly, NU had no objective evidence or facts which justified going from a ROR to DOC as of July 31, 2007.

xxiv. NU's decision to assert that the Alliance Agreement violated that 'express negligence' requirement of Texas law, without having spoken to Mr. Humberd or Mr. Williams, was unreasonable and unjustified.

xxv. Mr. Jensvold was a 'Cassandra' figure who was disregarded by NU despite his insightful positions and clear foresight of an impending 'train wreck' and serious bad faith case. NU had information from Mr. Jensvold which, at

very least, should have prompted a serious re-evaluation of the DOC. Instead, NU ignored him. This was unreasonable.

xxvi. Mr. Harless failed to reasonably communicate with Mr. Jensvold and PSI. Although Mr. Harless was not in the NU claims department, he was a VP and designated 'liaison' and undertook an intermediary role. Yet, he 'went silent' and acted unreasonably with regard to communicating with NU's insured and agents.

xxvii. Throughout the course of this litigation, NU has implacably insisted on maintaining multiple defenses (including the Pollution Exclusion) which were not and are not well founded.

xxviii. The Court finds that Mr. Romeo, in particular, and Mr. Muscarella were not credible witnesses whose tack was one of trying to justify their actions without objectively looking at the evidence.

xxix. NU's position that its boilerplate language in both ROR and DOC letters asking PSI to send further information if it wanted represented an investigation was disingenuous. NU had a duty to investigate and to determine whether a denial of coverage would be appropriate and made in good faith. It failed to do so.

xxx. The Court finds that NU violated the following sections of the Colorado Unfair Claims Practice Act: §§ 10-3-1104(1)(h):

> (II) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;
>
> (III) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;
>
> (IV) Refusing to pay claims without conducting a reasonable investigation based upon all available information;
>
> (VI) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear; and
>
> (XIV) Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

In sum, the Court finds that NU's conduct was unreasonable considering all the facts and circumstances, that NU's actions were motivated by its own

interests (to avoid defense costs) rather than considerations of the needs of its insureds, that NU merely parroted the coverage issues raised by Gemini and conducted no legitimate investigation and that NU had no legitimate basis to move from a ROR to DOC as of July 31, 2007. Accordingly, the Court finds in favor of Plaintiffs on the bad faith claim.

The Court rejects NU's claim that, somehow, this is inequitable because the parties whose negligence caused the pipeline explosion are being exonerated or do not have to pay for their negligence. This misses the point. As Mr. Humberd very accurately observed, 'This is the reason for insurance.'

### C. Damages

The Court finds the following damages as to PSI have been proven by a preponderance of the evidence. The Court finds that NU's bad faith breach of the insurance contract was a cause of PSI's loss of business from El Paso, and that the following damages have been proven by a preponderance of the evidence:

| | | | |
|---|---|---|---|
| ia. | $3,100,000 | - - | settlement of Owens' family claim |
| ib. | -<$1,000,000> | - - | paid by Gemini |
| ii. | $1,541,525[18] | -- | El Paso's out of pocket expenses/losses |
| iii. | -<$1,000> | -- | paid by PSI |
| iv. | $2,029,749 | - - | Prejudgment interest |
| | **$5,670,274** | | |
| v. | $2,000,000 | - - | lost net profit from loss of business from El Paso |
| | **$7,670,274** | | |

18 The Court has awarded $282 less than claimed in Ex. 114. A review of the attorney bills shows that attorney "MDS" billed 2.20 hours for matters predating the WIC pipeline explosion. (Ex 116, at 116-3)

**XIV. Bashor Agreement**

NU claims that PSI and El Paso collusively entered into the 'Bashor' Agreement (Ex. 9), that the judgment stipulated in that Agreement as to PSI's liability and El Paso's damages was unreasonable, and that the Agreement should not be enforced.

"[W]hen it appears that the insurer—who has exclusive control over the defense and settlement of claims pursuant to the insurance contract—has acted unreasonably by refusing to defend its insured or refusing a settlement offer that would avoid any possibility of excess liability for its insured, the insured may take steps to protect itself from potential exposure to such liability. One way for an insured to protect itself is through the use of an agreement whereby the insured assigns its bad faith claims to the third party, and in exchange the third party agrees to pursue the insurer directly for payment of the excess judgment rather than the insured." *Nunn v. Mid-Cent. Ins. Co., supra,* 244 P.3d at 119-20. *See Old Republic Ins. Co. v. Ross* 180 P.3d 427, 432-33 (Colo.2008)("The denial of coverage and a defense entitles the policyholder to make a reasonable, noncollusive settlement without the insurer's consent and to seek reimbursement for the settlement amount in an action for breach of the covenant of good faith and fair dealing.", *citing Hamilton v. Md. Cas. Co.,* 27 Cal.4th 718, 117 Cal.Rptr.2d 318, 41 P.3d 128, 134 (2002) *Bashor,* 177 Colo. at 466, 494 P.2d at 1294.)

Colorado and other courts have noted concerns where "the judgment results from a pretrial stipulation between the insured and third party rather than an adversarial proceeding before a neutral factfinder. Under these circumstances, it is possible that the stipulated judgment "may not actually represent an arm's length determination of the worth of the plaintiff's claim." *Old Republic,* 180 P.3d at 432 (quoting *Miller v. Byrne,* 916 P.2d 566, 581 (Colo.App.1995)). But, "[w]here an insurer has wrongfully subjected its insured to an excess judgment, ... the risk of collusion may be tolerable in light of the 'relative positions of the parties.'" *Id.* at 434 (quoting Justin A. Harris, Note, *Judicial Approaches to Stipulated Judgments, Assignments of Rights, and Covenants Not to Execute in Insurance Litigation,* 47 Drake L.Rev. 853, 875 (1999)). The Colorado Supreme Court has not held pretrial stipulated judgments *per se* unenforceable "because a stipulated judgment might be the insured's only viable recourse against an insurer that has acted in bad faith." *Id.* at 433.

Although entry of a stipulated judgment in excess of policy limits "is sufficient to establish actual damages for a bad faith failure to settle claim, the actual amount of damages for which an insurer will be liable will depend on whether the stipulated judgment is reasonable." *Nunn, supra,* 244 P.3d at 123-24. The insureds, in this case PSI and El Paso, have the burden of proving the reasonableness of the judgment and, in turn, NU has had "the opportunity to prove that the stipulated judgment is not reasonable. If the [court, as finder of fact in this case] finds that the stipulated judgment is unreasonable, then it may choose to instead award whatever damages, up to the amount of the stipulation, it does find reasonable. As such, the particular amount of the stipulated judgment merely serves as evidence of the value of [PSI's and El Paso's] claims as bargained for and does not represent the presumptive value of the actual damages in the bad faith case." *Id.*

Here, NU argues that the 'Bashor' Agreement is unenforceable because it unreasonably purports to shift all exposure and liability for the WIC pipeline explosion from El Paso to PSI and, NU claims, El Paso was responsible, as demonstrated by the PHMSA final decision and fine. The Court disagrees.

First, the 'Bashor' Agreement does not purport to apportion all liability for the pipeline explosion to PSI or to state that El Paso had no negligence or responsibility. Rather, under the Alliance Agreement, PSI agreed to indemnify El Paso for injuries or damages except when caused by the sole negligence of El Paso. The evidence at trial convincingly establishes that the pipeline explosion was not caused by El Paso's sole negligence; rather, multiple acts and omissions, including those of Mr. Brack, PSI, and the REX contractors, were responsible. There was thus no inappropriate attempt, as argued by NU, to suggest that the explosion was solely the result of PSI's negligence. For purposes of this case, the actual percentage of liability allocated or allocatable to PSI versus El Paso is of no consequence.

Second, the 'Bashor' Agreement did not stipulate to any judgment or damages in excess of El Paso's out-of-pocket losses. It is undisputed that El Paso actually paid $3.1 million to settle the Owens' family claim which, along with the 'Bashor' Agreement, also extinguished PSI's liability for Mr. Owens' wrongful death. Had the parties stipulated to some amount in excess of $3.1 million, NU might have a legitimate argument about collusion. That did not occur.

Third, the Court finds that the 'Bashor' Agreement was the result of an arms' length agreement between PSI and El Paso. Both were represented by

counsel. Both had legitimate concerns and both had legitimate reasons for bringing the litigation to a prompt conclusion. Both were motivated by one common objective: NU's denial of coverage and the effect on PSI and El Paso. And, NU, having abandoned its insureds, is not now in a position to complain about how they effectuated a limitation of their liability. "In effect, [NU in this case] is receiving its chance to be heard. Having rejected the opportunity and waived the chance to contest liability, it cannot reach back for due process to void a deal the insured has entered to eliminate personal liability." *Old Republic, supra,* 180 P.3d at 433 (quoting *Hamilton v. Md. Cas. Co., Inc.,* 41 P.3d at 135).

The Court finds that the 'Bashor' Agreement is enforceable and is not collusive.

**XV. Punitive Damages**

Punitive damages are to be awarded only to punish conduct "attended by circumstances of fraud, malice, or willful and wanton conduct," § 13-21-102(1)(a), C.R.S. 2011, and only if proven beyond a reasonable doubt, § 13-25-127(2), C.R.S. 2011. The amount of punitive damages must be reasonable and cannot exceed an amount which is equal to compensatory damages, § 13-21-102(1)(a), C.R.S. 2011.

Punitive damages may be awarded on a bad faith claim provided the breach is accompanied by circumstances of fraud, malice or willful and wanton conduct. *Ballow v. PHICO Ins. Co.*, 878 P.2d 672, 682 (Colo. 1994).

For the following reasons, the Court finds that NU's bad faith breach of the insurance conduct was accompanied by circumstances of willful and wanton conduct which justifies the imposition of punitive damages:

a. NU merely adopted, whole cloth, the coverage issues initially raised by Gemini, without conducting any independent investigation and without seeking any further information or details, including input from PSI or El Paso about Mr. Brack's activities and the nature of the Alliance Agreement. With no independent investigation of its own about the facts, and merely parroting Gemini's potential coverage issues and adopting those as a basis for an outright denial of coverage rather than a reservation of rights, NU acted with willful and wanton disregard of the rights and interests of its insureds.

b. NU's decision to move from a ROR to an outright DOC between July 10 and July 31, 2007, without any further investigation or information, represents willful and wanton conduct.

c. NU's refusal to accept Gemini's tender was motivated by NU's desire not to assume the costs of defense and by no other legitimate issue. NU looked only to its interests and not those of its insureds.

d. NU demanded El Paso waive any future bad faith claim in order to waive the Voluntary Payments clause and allow NU to settle the Owens' family claims. This demonstrates that NU recognized that its conduct was willful and wanton.

e. After the denial of coverage, NU's cavalier disregard of Mr. Jensvold's multiple attempts to secure a reconsideration demonstrates a willful and wanton disregard of NU's obligations. At the very least, Mr. Jensvold's requests for reconsideration of the DOC should have prompted a thoughtful re-evaluation of NU's position. Instead, NU dug in its heels and refused to budge.

f. The dismissive attitude and smug, hostile demeanor of the primary adjuster, Mr. Romeo was troubling, to say the least. Mr. Romeo's attitude and demeanor mirrored NU's entire approach to the claim. The other NU witnesses (Mr. Muscarella, Mr. Dauchy, and Mr. Harless) similarly reflected utter disregard for NU's insureds and NU's obligations. The NU witnesses seemed not to understand the special relationship which an insurer has to its insured and that the very reason for buying insurance is to obtain "the financial security obtained by protecting [oneself] from unforeseen calamities and for peace of mind...." *Trimble, supra.* Rather than recognizing that the excess insurance contract was obtained precisely to address the type of catastrophic event which occurred on November 11, 2006, the NU witnesses instead seemed hostile to even the notion that NU might have to pay a claim. Mr. Jensvold's repeated entreaties and uncannily accurate predictions went unheeded.

The Court awards punitive damages in favor of PSI in the amount of $5,000,000.00.

**Judgment and Order**

Judgment enters in favor of PSI as set forth above. Plaintiffs shall file a Bill of Costs within twenty-one (21) days. Any response or objection shall be filed by NU within forty-two (42) days. If either party requests

hearing on costs, that shall be set to occur no later than sixty-three days from the date of this Order.

Dated this 28th day of June, 2012.

BY THE COURT:

Edward D. Bronfin
District Court Judge

cc: all counsel