NO. SCWC–29467

IN THE SUPREME COURT OF THE STATE OF HAWAI'I

CHARLES MITCHELL HART and LISA MARIE HART,

Plaintiffs-Appellants,

vs.

TICOR TITLE INSURANCE COMPANY,

Defendant-Appellee.

Civil No. 1RC08-1-3865

BRIEF OF *AMICUS CURIAE,* UNITED POLICYHOLDERS IN SUPPORT OF PLAINTIFFS-APPELLANTS-PETITIONERS CHARLES MITCHELL HART AND LISA MARIE HART'S APPLICATION FOR A WRIT OF CERTIORARI

INTERMEDIATE COURT OF APPEALS OF THE STATE OF HAWAI'I

HON. CRAIG H. NAKAMURA
HON. ALEXA D.M. FUJISE
HON. KATHERINE G. LEONARD

DISTRICT COURT OF THE FIRST CIRCUIT, HONOLULU DIVISION, STATE OF HAWAI'I

HON. CHRISTOPHER P. MCKENZIE

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STATEMENT OF RELATED CASES

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I. INTRODUCTION

The principal issue in this appeal concerns the duty to defend where the allegations against the insured have no merit. Specifically, if a pleading is susceptible to a motion to dismiss, does the insurer have a duty to defend against the defective claim until the claim is decided or abandoned?

United Policyholders believes that the Hawai'i Intermediate Court of Appeals (the "**ICA**") gravely erred in answering this question in the negative. The ICA contravened this Court's directive that the duty to defend is not outcome-determined. By concluding that no "claim for escheat" had been made because certain procedural requirements had not been satisfied or followed, the ICA made the insurer's duty to defend depend on the outcome or merits of the allegations made against Plaintiffs-Appellants-Petitioners Charles Mitchell Hart and Lisa Marie Hart (together, the "**Harts**"). The ICA's decision has grave implications for policyholders who have paid their premiums and reasonably expect that they will be defended by their insurers when claims—even deficient and meritless claims—are made against them.[1]

Rather than look to the State of Hawaii's (the "**State**") compliance with pleading requirements, the ICA should have taken as true the State's assertion of title to any interest in the property that "may have escheated" to the State. The State was not merely preserving for the future "any claims based on escheat," as the ICA concluded. The State specifically sought

[1] In addition, for the reasons set forth in the Harts' Application, the ICA erred in relying on a subsequent concession by the State of Hawai'i that it was not pursuing its escheat claim.

interests in the property that may "have" already escheated and wanted those interests noted against the Harts' title. This was not a defense, but a counterclaim.

The Application for a Writ of Certiorari filed by the Harts should be accepted and the ICA's Judgment on Appeal should be reversed. For efficiency, United Policyholders adopts and endorses the questions presented, statement of prior proceedings, and statement of the case set forth in the Harts' Application.

II. ARGUMENT

A. The ICA Gravely Erred by Making the TICOR's Duty to Defend Depend on the Outcome of the State's Allegations.

This Court has held that "[t]he duty to defend is not outcome-determined but merely depends on a potential for coverage . . . ." *Commerce & Indus. Ins. Co. v. Bank of Hawaii*, 73 Haw. 322, 327, 832 P.2d 733, 736 (1992). In *First Ins. Co. v. State*, 66 Haw. 413, 665 P.2d 648 (1983), the Court rejected an insurer's "flaw[ed]" argument that "attempt[ed] to define [the insurer's] duty to defend on the basis of the relationship between its policy provision and the ultimate outcome of the [underlying] case." *Id.* at 420, 665 P.2d at 653. The Court concluded that the outcome was "not determinative of the issue of [the insurer's] duty to defend." *Id.* "An insurer's ultimate non-liability should not free it from its concurrent contractual duty to defend." *Id.* (quotations omitted).

"It is not the belief of any party as to the eventual outcome of the suit that determines a duty to defend, but rather whether the complaint is reasonably susceptible of an interpretation that it threatens an insured interest." *Premier Homes, Inc. v. Lawyers Title Ins. Corp.*, 76 F. Supp. 2d 110, 117 (D. Mass. 1999). Thus, in the title insurance context, the "duty still exists even if there appears to be a strong legal principle protecting title as vested." *Id.* In *Premier Homes*, the court concluded that an insurer had a duty to defend even if the third-party's

claim was "doomed to failure by virtue of the bona fide purchaser rule." *Id.* The title insurer was "not relieve[d] . . . from defending the suit and using that very rule to prevail." *Id.*

Similarly, even an "inartfully drafted" pleading triggers the duty to defend. *Voorhees v. Preferred Mut. Ins. Co.*, 607 A.2d 1255, 1259 (N.J. 1992). An insurer has a duty to defend "against poorly or incompletely pleaded cases as well as those artfully drafted." *Ruder & Finn, Inc. v. Seaboard Sur. Co.*, 422 N.E.2d 518, 521 (N.Y. 1981). "[T]he potential merit of the claim is immaterial: the duty to defend is not abrogated by the fact that the cause of action stated cannot be maintained against the insured either in law or in fact—in other words, because the cause is groundless, false or fraudulent." *Abouzaid v. Mansard Gardens Assocs., LLC*, 23 A.3d 338, 347 (N.J. 2011) (quotations omitted). The duty arises despite the fact that the pleading does "not clearly articulate the facts necessary to prove any specific cause of action." *Voorhees*, 607 A.2d at 1259. "Thus the question is not whether the complaint can withstand a motion to dismiss for failure to state a cause of action." *Ruder*, 422 N.E.2d at 521.

"A third party does not write the complaint to apprise the defendant's insurer of potential coverage." *Voorhees*, 607 A.2d at 1259. "A defendant has no power to amend a complaint which contains an incomplete statement of facts." *Travelers Indem. Co. v. Dingwell*, 414 A.2d 220, 226 (Me. 1980). "Whether he can obtain a defense from his insurer must depend not on the caprice of the plaintiffs' draftsmanship, nor the limits of his knowledge . . . ." *Id.* "The duty to defend need only arguably appear on the face of the pleadings." *Demaray v. De Smet Farm Mut. Ins. Co.*, 801 N.W.2d 284, 287 (S.D. 2011).

"Especially since the advent of notice pleading, in a case where there is doubt as to whether a theory of recovery within the policy coverage has been pleaded in the underlying complaint, the insurer must defend, and its defense obligations will continue until such time as

the claim against the insured is confined to a recovery that the policy does not cover." *Solo Cup Co. v. Fed. Ins. Co.*, 619 F.2d 1178, 1185 (7th Cir. 1980); *cf. In re Genesys Data Technologies, Inc.*, 95 Hawai'i 33, 41, 18 P.3d 895, 903 (2001) (observing that Hawai'i follows a notice pleading standard). "If the complaint is ambiguous, doubts should be resolved in favor of the insured and thus in favor of coverage." *Voorhees*, 607 A.2d at 1259.

Therefore, it is simply "incorrect" to scrutinize a complaint "to determine whether sufficient allegations relative to [the claim] have been stated." *Rio Rouge Development Corp. v. Security First Nat. Bank*, 610 So. 2d 172, 176 (La. Ct. App. 3d Cir. 1992). In *Rio Rouge*, the court held that the insurer had a duty to defend the insured against an "inartfully drawn" claim of defamation even though the plaintiff failed to allege certain facts essential to proving the claim (falsity and the details of the derogatory statements) and even if the insured was ultimately found not liable because such facts could not be proven. *Id.*; *see also Ruder*, 422 N.E.2d at 522–23.

In this case, the ICA concluded that TICOR did not have a duty to defend because the State's escheat allegations were insufficient under and not made in accordance with state law, which requires the State to file an "information" in circuit court and set forth "facts in support of a claim of escheat." SDO at 2. The ICA thus tied the duty to defend to the sufficiency or merits of the State's pleading. In so doing, the ICA gravely erred by making the duty to defend depend on the outcome or ultimate sufficiency of the State's escheat allegations.

"[A]n insurer's ultimate non-liability should not free it from its concurrent contractual duty to defend." *First Ins.*, 66 Haw. at 420, 665 P.2d at 653 (quotations omitted). The ICA's decision erroneously relieves insurers of their duty to defend, "a valuable service paid for by the insured." *Woo v. Fireman's Fund Ins. Co.*, 164 P.3d 454, 459–60 (Wash. 2007). The duty

to defend is "one of the main benefits of the insurance contract." *Safeco Ins. Co. v. Butler*, 823 P.2d 499, 504 (Wash. 1992).

Indeed, although the duties of defense and indemnity are distinct, "so far as the insured is concerned, the duty to defend may be as important as the duty to indemnify." *Buss v. Superior Court*, 939 P.2d 766, 773 (Cal. 1997). "The insured's desire to secure the right to call on the insurer's superior resources for the defense of third party claims is, in all likelihood, typically as significant a motive for the purchase of insurance as is the wish to obtain indemnity for possible liability." *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153, 1157 (Cal. 1993).

"If the insurance company refuses to defend, then the insured often must choose to settle the suit as quickly as possible in order to avoid costly litigation, bring a declaratory judgment action against the insurer seeking a declaration that there is a duty to defend, or defend the suit without help from the insurer." *Gen. Accident Ins. Co. v. Ins. Co. of N. Am.*, 540 N.E.2d 266, 271 (Ohio 1989).

The ICA's decision thus has grave implications for policyholders who have paid their premiums and reasonably expect that they will be defended by their insurers when claims—even deficient and meritless claims—are made against them.

B. The ICA Erroneously Construed Against the Harts Any Ambiguity in the Policy and the State's Assertion of Escheated Interests.

Instead of looking to whether a "claim" for escheat had followed pleading requirements, the ICA should have employed rules of construction, looked beyond the effect of the pleadings, and resolved all doubts in favor of coverage. *Sentinel Ins. Co. v. First Ins. Co.*, 76 Hawai'i 277, 287–88, 875 P.2d 894, 904–05 (1994). TICOR's argument and the ICA's decision rely on a narrow, highly technical, and overly legalistic appraisal of the term "claim."

The title insurance policy at issue here (the "**Policy**") provided:

> Upon written request by the insured . . . [TICOR], at its own cost and without unreasonable delay, shall provide for the defense of an insured in litigation in which any third party asserts a claim adverse to the title or interests as insured, but only as to those stated causes of action alleging a defect, lien or encumbrance or other matter insured against by this policy.

1 RA 337.

The Policy does not define the term "claim" and therefore the term must be liberally construed in the Harts' favor, consistent with the reasonable expectations of a layperson. *St. Paul Fire & Marine Ins. Co. v. Hawaiian Ins. & Guar. Co.*, 2 Haw. App. 595, 596, 637 P.2d 1146, 1147 (1981) (construing the term "claim" liberally where the insurance contract contained no definition of the word); *Guajardo v. AIG Haw. Ins. Co.*, 118 Hawai'i 196, 202, 187 P.3d 580, 586 (2008) ("[T]he rule is that policies are to be construed in accord with the reasonable expectations of a layperson." (quotations omitted)). This Court has characterized the word "claim" as the "largest word in law." *High v. Hawaiian Gov't*, 8 Haw. 546, 548-49 (Terr. 1892). The expansive term includes any "interest or remedy recognized at law," *Black's Law Dictionary* 282 (9th ed. 2009), and in particular "an assertion of a right, with the contours and specific nature of the right depending on context," *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512, 516 (Ky. 2006); *accord State v. Great N.E. Prods., Inc.* 945 A.2d 897, 900 (Vt. 2008); *Bird v. Norpac Foods, Inc.*, 934 P.2d 382, 387 (Or. 1997).

Here, the State filed two pleadings claiming that it had certain "*interests* in or affecting [the Harts' property (the '**Property**')], which *are* as follows: . . . . 6. *The State reserves any interests in the property that may have escheated to the State.*" 1 RA 342. The State further asked the Land Court to "rule[]" that "*[t]he State has reserved any interests in the property that may have escheated to the State.*" 1 RA 343 (emphasis added). Through the reservation, the State

alleged it had *existing* rights and interests in the Property that "have escheated" and that those rights and interests should be noted against the Harts' Land Court-registered title. It was seeking to take for itself "any interests in the property that may *have escheated* to the State." 1 RA 343 (emphasis added). The State did not explain how any interests in the Property may "have escheated." The State's position was simple: Whatever interests in the Property "may have escheated" belonged to the State. The State's escheat reservation was not prospective or merely saying that the State "not waiving, by its response, any claims based on escheat." *See* SDO at 2.

The term "claim" includes within its definition a "counterclaim." *Black's Law Dictionary* 282 (defining "claim" and referring to the definition of "counterclaim"); *id.* at 402 (defining "counterclaim"). A counterclaim is a demand for affirmative relief and may be included in an answer. *Avnet, Inc. v. Wyle Labs., Inc.*, 461 S.E.2d 865, 867 (Ga. 1995); *Forde v. Forde*, 190 S.W.3d 521, 529 (Mo. Ct. App. 2006). An averment that appears to be a defense may actually be a counterclaim based on the facts alleged if the defendant could have maintained the claim as an independent suit. *Owens v. Ousey*, 241 S.W.3d 124, 132 (Tex. Ct. App. 2007). Courts look to the substance of the pleading to determine whether a pleading has been asserted. *Weber v. Weber*, 908 S.W.2d 356, 359 (Mo. 1995). The Harts' petition only asked for consolidation and the recognition of land loss by erosion. The reservation had nothing to do with the Harts' petition and would not prevent the petition from being granted. 2 RA 845-49; 1 RA 395-97. Indeed, the Harts achieved the relief that they requested before the Land Court had even addressed the State's escheat reservation or any of the State's claims. Rather than a defense to the Hart's petition, the reservation was an independent and affirmative claim to an interest in the Harts' Property.

The State's escheat reservation was an independent and affirmative claim to an interest in the Harts' Property, just like every other "reserv[ation]" made in the State's pleadings. 1 RA 343, 351. For example, the State reserved "the rights of native tenants in the property," and "an easement for the free flowage of waters through, over, under, and across the property." 1 RA 342. The State prevailed on some of those claimed interests and lost on others. 1 RA 396. Those reservations plainly sought to assert "claims." *See Create 21 Chuo, Inc. v. Southwest Slopes, Inc.* 81 Hawai'i 512, 528, 918 P.2d 1168, 1184 (App. 1996) (upholding a finding that native tenants' rights were encumbrances that violated the seller's promise to convey title free and clear of all encumbrances); *Treadaway v. Amundson*, 88 So. 2d 67, 68 (La. Ct. App. 1956) ("It cannot be gainsaid that a purchaser is not required to accept title to property encumbered with an outstanding adverse mineral interest.").

A title free of the escheat reservation, or any other reservation, is superior to one encumbered with a reservation. If the Harts had allowed the reservation to stand unchallenged, the Harts would have plainly conceded something of value. The State's assertion produced a potential loss of value sufficient to create a reasonable expectation of coverage and a duty to defend.

In short, because the State's allegations sought to establish the State's present interests in the Property, the allegations fell within the broad definition of a "claim" under the Policy. By failing to engage in any textual analysis or construction of the word "claim" in determining whether TICOR had a duty to defend, the ICA committed a grave error. When the word is properly defined, the State's allegations are "liberally construed" consistent with reasonable expectations of a layperson, *Ruder*, 422 N.E.2d at 521; *Guajardo*, 118 Hawai'i at 202, 187 P.3d at 586, and any ambiguities are construed in favor of coverage, *Voorhees*, 607

A.2d at 1259, it is apparent that the allegations asserted an escheat "claim." The allegations were "reasonably susceptible of an interpretation that [they] threaten[ed] an insured interest." *See Premier Homes*, 76 F. Supp. 2d at 117.[2]

Once the possibility of coverage triggered the duty to defend, TICOR had the duty to defend the entire suit, regardless of whether the allegations were "groundless, false, or fraudulent" or whether some of the claims "fall outside the policy's coverage." *First Ins.*, 66 Haw. at 417, 665 P.2d at 652. The duty to defend continues until the insurer establishes that there is no covered liability under the policy. *Commerce & Indus.*, 73 Haw. at 327, 832 P.2d at 736. Accordingly, TICOR had a duty to defend all of the claims asserted by the State at least until the escheat claim was resolved. TICOR's failure to do so breached this duty and the Policy. It was grave error for the ICA to affirm the District Court's judgment for TICOR on the Hart's breach of contract and bad faith claims.

III. CONCLUSION

The State's escheat claim triggered the duty to defend and TICOR's failure to undertake the defense constitutes breach of contract under the Policy. Because of its concern and

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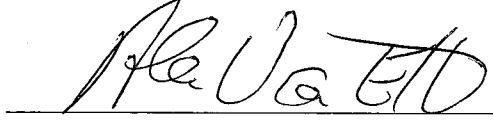
[2] TICOR denied coverage without investigating the State's claims. Under Hawai'i law, "the insurer, as a precondition to refusing the tender on the ground that there is no possibility for coverage, must . . . conduct a reasonable investigation to ensure that the facts of the case do not obligate it to defend the insured." *Dairy Road Partners v. Island Ins. Co., Ltd.*, 92 Hawai'i 398, 414–15, 992 P.2d 93, 109–10 (2000) (citing *Std. Oil Co. of California v. Hawaiian Ins. & Guaranty Co.*, 65 Haw. 521, 654 P.2d 1345 (1982)); *see also Sentinel Ins.*, 76 Hawai'i at 288, 875 P.2d at 905 ("[A]n insurer must look beyond the effect of the pleadings and must consider any facts brought to its attention or any facts which it could reasonably discover in determining whether it has a duty to defend." (quotations omitted)). The "'possibility of coverage must be determined by a good-faith analysis of all information known to the insurer or all information reasonably ascertainable by inquiry and investigation.'" *Std. Oil*, 65 Haw. at 527, 654 P.2d at 1349 (quoting *Spruill Motors, Inc. v. Universal Underwriters Ins. Co.*, 512 P.2d 403, 407 (Kan. 1973)). Here, despite having conceded that escheat stated a covered claim, TICOR refused the tender without any investigation.

desire for a coherent national standard with regards to insurer-insured transactions and dealings, United Policyholders respectfully requests that the Court accept the Harts' Application and reverse the ICA's Judgment on Appeal in this case.

DATED: Honolulu, Hawai`i, January 4, 2012.

Respectfully submitted,

DEELEY KING PANG & VAN ETTEN



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STATEMENT OF RELATED CASES

UNITED POLICYHOLDERS is not aware of any related cases pending in the Hawai`i courts or agencies.

DATED: Honolulu, Hawai`i, January 4, 2012.

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HON. CHRISTOPHER P. MCKENZIE

CERTIFICATE OF SERVICE

I hereby certify that on this date a true and correct copy of BRIEF OF *AMICUS CURIAE,* UNITED POLICYHOLDERS IN SUPPORT OF PLAINTIFFS-APPELLANTS-PETITIONERS CHARLES MITCHELL HART AND LISA MARIE HART'S APPLICATION FOR A WRIT OF CERTIORARI; STATEMENT OF RELATED CASES; and CERTIFICATE OF SERVICE were duly served on the following persons via Notice of Electronic Filing (JEFS):

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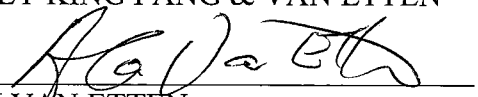

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