IN THE SUPREME COURT OF THE STATE OF DELAWARE

AT&T WIRELESS SERVICES, INC.	)	
	)	
Plaintiff-Below, Appellant	)	
	)	No. 54, 2008
v.	)	
	)	
NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA., and ST. PAUL MERCURY INSURANCE COMPANY,	)	Court Below: Superior Court in and for New Castle County C.A. No. 03C-12-232-WCC
Defendants-Below, Appellees.	)	

REPLY BRIEF ON APPEAL OF PLAINTIFF-BELOW, APPELLANT AT&T WIRELESS SERVICES, INC.

MORRIS, NICHOLS, ARSHT & TUNNELL LLP
Donald E. Reid (#1058)
Jason A. Cincilla (#4232)
1201 North Market Street
P.O. Box 1347
Wilmington, Delaware 19899-1347
(302) 658-9200
Attorneys for Plaintiff-Below, Appellant, AT&T Wireless Services, Inc.

OF COUNSEL:

William F. Cronin
Michael A. Moore
Laurie M. Thornton
CORR CRONIN MICHELSON BAUMGARDNER & PREECE LLP
1001 Fourth Avenue, Suite 3900
Seattle, Washington 98154
Telephone: (206) 625-8600

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INTRODUCTION

National Union and St. Paul ("the Insurers") have failed to meaningfully distinguish the controlling precedent of this Court. In *AT&T v. Clarendon*, 931 A.2d 409 (2007), this Court held that, unless a controlling state's law expressly requires otherwise, insurance coverage is not forfeited because insured directors do not personally obligate themselves to fund a settlement. The Insurers fail to fully acknowledge this holding or show how Virginia law supports a forfeiture of coverage here. Similarly, this Court held in *AT&T Corp. v. Faraday Capital Ltd.*, 918 A.2d 1104 (2007) that the term "claim" in an exclusion does not encompass entire lawsuits so as to exclude coverage for individual causes of action that are otherwise covered. In direct contravention of *Faraday*, National Union argues for the same sweeping definition of a "claim" already rejected by this Court.

The Insurers also violate the basic principles that govern appellate review of motions to dismiss. The Insurers dispute well-pleaded allegations that must be taken as true on appeal, place before this Court materials that were never considered below and ask this Court to accept facts that are either disputed or can only be evaluated after discovery. None of this is proper argument on appeal.[1]

What remains clear is that the Trial Court committed prejudicial error below by ruling that the insureds forfeited coverage because the TeleCorp directors did not personally obligate themselves to make a $47.5 million settlement payment. The Trial Court also erred in ruling that Exclusion K in the AWS policies precluded coverage for AWS because a cause of action in the underlying lawsuit allegedly implicated AWS nominees to the TeleCorp board.

This Court should also correct the Trial Court's choice of law errors and reinstate and apply Washington law to AWS' extra-contractual claims. While Virginia has no interest in these claims (as demonstrated by the Insurers' failure to even argue that Virginia has any interest), Washington undeniably does. Furthermore, even if Virginia law does apply, several claims are viable under Virginia law and should not have been dismissed below. Finally, this Court should find that the Trial Court abused its discretion in denying AWS' motion for

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[1] *See Precision Air v. Standard Chlorine of Del.*, 654 A.2d 403, 405-06 (1995) (all well-pleaded allegations must be accepted as true, as well as all reasonable inferences therefrom); *Delaware Elec. Co-op, Inc. v. Duphily*, 703 A.2d 1202, 1207 (1997) (material not found in record may not be considered on appeal).

voluntary dismissal where there was no identifiable legal prejudice to the Insurers in allowing AWS to prosecute its claims in Washington.

ARGUMENT

I. THE SETTLEMENT WAS A COVERED "LOSS" UNDER THE TELECORP POLICIES.

A. This Court's Decision in *Clarendon* Confirms that the Settlement Payment at Issue was a Covered "Loss."

1. AWS' Settlement Payment Was a Covered Loss Under Virginia Law.

This Court's ruling in *AT&T Corp. v. Clarendon Am. Ins. Co.*, 931 A.2d 409 (2007) holds that insurance coverage is not forfeited simply because insured directors are not personally obligated to make settlement payments or pay a judgment unless the controlling state's law requires a contrary result. *Id.* at 416, 418 (question is whether controlling state's law holds that "such adherence to form is essential for D&O coverage to attach" and "AT&T's commitment – without which the At Home Directors would have been entitled to coverage of their defense and settlement costs under the D&O policies – divested those Directors of that entitlement"). Like the *Xebec* case relied on by the Court in *Clarendon* as a source of California law, the Virginia case of *Beckner v. Twin City Fire Ins. Co.*, 58 Va. Cir. 544, 552-53 (Va. Cir. 2002) makes it clear that Virginia law does not allow insurers to escape their obligations to provide coverage merely because of technicalities like those asserted by the Insurers here. *Id.* (rejecting insurer's argument that coverage did not attach because settlement and covenant not to execute did not impose actual financial liability on insured).

While St. Paul makes no real attempt to address Virginia law or *Beckner*, National Union asserts that "[t]he Virginia rule is clear: there is no legal obligation to pay where there is no judgment or contract to pay." National Union fails to cite a single case supporting this proposition. There is no such authority.

National Union instead claims that *Beckner* should be interpreted to "implicitly" stand for the proposition that a legal obligation to pay arises only where an actual judgment exists. National Union Answering Brief at 19. *Beckner* says no such thing. Moreover, National Union misses the point of *Beckner's* significance: *Beckner* holds that an obligation to make payment is not a requirement of coverage. There is no basis, therefore, for the Insurers' claim that Virginia law is any different from the California law upon which this Court relied in *Clarendon*.

2. The Clarendon Decision Applies to AWS' Claim for Coverage Under the TeleCorp Policies.

Having failed to distinguish Virginia law, the Insurers next contend that *Clarendon* does not apply to AWS' claims for other reasons. None of these arguments has merit.

First, the Insurers repeatedly make reference to the fact that *Clarendon* involved a claim brought by AT&T as the assignee of insured directors, while this case involves a claim for coverage by AWS as an "insured organization". This is a meaningless distinction here because the TeleCorp policies expressly provided coverage for claims brought by insured directors and for claims brought by insured organizations such as AWS who indemnified insured directors. A70. The Insurers fail to provide any explanation of how this alleged distinction has any affect on the applicability of *Clarendon*. It does not.

Second, the Insurers argue that *Clarendon* allegedly established a so-called "carve out" of coverage for monies paid by third parties. The *Clarendon* decision did not establish any such exception. To the contrary, the *Clarendon* opinion merely indicates that the failure to include a "carve out" in coverage for payments made by third parties like AT&T was additional evidence that the *Clarendon* insurers intended to cover such payments. *Clarendon*, 931 A.2d at 416 ("the unavoidable inference" arising from the insurers failure to carve out from coverage payments made by third parties is "that such indemnified 'Losses' were intended to be covered").

Third, even if *Clarendon* did establish a carve-out for third party payments (as opposed to payments by insured organizations), that carve-out has no application here. As discussed at length below, AWS seeks coverage for payments that it made on behalf of the TeleCorp Directors as the "insured organization" under the TeleCorp policies, not as a "third party." The so-called carve-out has no application to AWS.

3. AWS Succeeded to TeleCorp's Indemnification Obligations, Indemnified the TeleCorp Directors, and Succeeded to TeleCorp's Rights Under the TeleCorp Policies.

Ignoring the controlling standard on a motion to dismiss and precedent directly on point, the Insurers wrongly assert that AWS is not entitled to recover under Insuring Clause No. 2 of the TeleCorp policies because AWS allegedly:

(1) was not an "insured organization"; and (2) did not indemnify the TeleCorp Directors. These claims are meritless for several reasons.

First, the Insurers' arguments completely ignore the controlling standard on this appeal. This appeal centers on the Trial Court's dismissal of claims against the Insurers on a motion to dismiss. The Insurers must accept all "well-pleaded" allegations contained within AWS' complaint as true for purposes of this appeal, as well as all reasonable inferences therefrom . . . ." *Precision Air v. Standard Chlorine of Del.*, 654 A.2d 403, 405-6 (Del. 1995). AWS' complaint alleged that:

- "AWS succeeded to TeleCorp's rights under the TeleCorp D&O Policies, as well as TeleCorp's obligations to indemnify its Directors";
- While the TeleCorp policies' definition of "insured organization" included TeleCorp, "[a]s of the merger, AWS ha[d] succeeded to TeleCorp's rights as an Insured Organization under" the TeleCorp policies;
- The AWS/TeleCorp merger "was finalized on February 15, 2002, and TeleCorp simultaneously ceased to exist as an independent entity";
- "AWS, as successor in interest to TeleCorp, agreed to pay the $47.5 million settlement sum on behalf of all of the TeleCorp Director Defendants, and, to the extent the Director defendants did not object to the settlement and provided plaintiffs with a release, the plaintiffs agreed to release all of the defendants from any further claims of liability";
- "As the successor to TeleCorp and TeleCorp's indemnification obligations to the TeleCorp Directors, AWS ha[d] granted indemnification to the former TeleCorp Directors for both their defense fees and costs and their settlement liability arising from the claims made against them in the TeleCorp Shareholder Litigation."

A36, 40, 43, 47, 48. These well-pled allegations cannot fairly be disputed by the Insurers for the purposes of this appeal. To the extent the Insurers wish to dispute these allegations, they can do so only after discovery and, if necessary, at trial.[2]

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[2] For example, if there is a genuine issue about AWS' successor-in-interest status under the policy (and AWS disputes that there is), that issue would normally be the subject of discovery and possibly trial – as it was in AWS' claim for recovery

(Continued . . .)

Second, even if it is assumed that the Insurers are somehow correct in their assumption that the Court can ignore these well-pled allegations (and they are not), TeleCorp's rights under the policies transferred to AWS at the time of the parties' merger. *Imperial Enterprises, Inc. v. Fireman's Fund Ins. Co.*, 535 F.2d 287, 292-93 (5th Cir. 1976) (surviving corporation emerging from a statutory merger succeeded to the benefits of the pre-merger corporation's insurance); *Emhart Indus. v. Home Ins. Co.*, 515 F. Supp. 2d 228, 233 (D.R.I. 2007) ("a successor corporation inherits the rights and benefits of a predecessor corporation's" insurance); *Knoll Pharm. Co. v. Auto. Ins. Co.*, 167 F. Supp. 2d 1004, 1011 (N.D. Ill. 2001) (insurance policies transferred "as a matter of law through the [] merger" to the surviving entity). Delaware law similarly recognizes that the property and rights of a pre-merger entity are transferred to the surviving entity. *See* Del. Corp. § 259 (upon a merger, "all property, rights, privileges, powers and franchises, and all and every other interest shall thereafter be effectually the property of the surviving or resulting corporation").

Third, none of the Insurers' legal arguments regarding AWS' post-merger status as an insured organization has merit. The Insurers' argument that AWS should not be considered an insured organization because the relevant policy definition referred only to TeleCorp is directly at odds with the well-pled allegations of AWS' complaint and the precedent cited above confirming that the surviving entity becomes an insured after a merger. National Union's claim that treating AWS as the insured organization would amount to an impermissible assignment of its policy is equally meritless. It is well settled that transfers of insurance policies that occur due to the operation of law (including mergers) are permissible even in the face of express non-assignment provisions because they do not expand the scope of the insurer's obligations. *Imperial Enterprises*, 535 F.2d at 292-293 (refusing to enforce non-assignment clause in policy where "the transfer of the policy to [merged entity] occurred by operation of law" through a "statutory merger" because the merger "caused no increase in the risks or hazards incurred by" insurer); *National American Ins. Co. v. Jamison Agency, Inc.*, 501 F.2d 1125, 1130 (8th Cir. 1974) (same); *Federal Ins. Co. By & Through Associated Aviation Underwriters v. Purex Indus.*, 972 F. Supp. 872, 889 (D.N.J. 1997) (same); *Knoll Pharm. Co.*, 167 F. Supp. 2d at 1010 (same).

(. . . continued)
against Federal which was tried and resulted in a jury verdict against Federal for both bad faith and breach of contract in the full amount of damages sought by AWS.

Chamison v. Healthtrust, Inc., 735 A.2d 912 (Del. Ch. 1999) also does not support St. Paul's claim that AWS was not acting as the successor in interest to TeleCorp when it indemnified the TeleCorp Directors. *Chamison* merely stands for the proposition that indemnity obligations originally held by a pre-merger entity may remain with that entity where it is undisputed that a merger is structured to allow the entity to survive and retain such rights, as well as the obligation and ability to discharge them. There has been no such showing here. Nor can there be without significant discovery on the structure of the merger and the factual question of whether it was intended to allow TeleCorp to survive, retain its indemnity obligations and the ability to discharge them.

The Insurers ignore the reasons why successor-in-interest status either is indisputable or, at least, a subject for discovery. Instead, they proffer new, unsupported factual contentions to advance their argument. For example, the Insurers appear to argue that the Court should credit their factual claims that: (1) the TeleCorp Directors were allegedly never "released by the plaintiff shareholders as a result of the Settlement and are subject to potential contribution claims by AWS"; and (2) "AWS did not act as TeleCorp and indemnify the TeleCorp Directors pursuant to TeleCorp's articles and bylaws." Indeed, St. Paul's brief contains a lengthy factual analysis of the Merger Agreement between AWS and TeleCorp, a document that was not before the Trial Court below. St. Paul Answering Brief at 8 n.23, 19-20. None of St. Paul's factual contentions are permissible grounds for upholding the Trial Court's dismissal.

Finally, without citation to any supporting authority, National Union makes the legal argument that there was no indemnification for purposes of Insuring Clause No. 2 because there was allegedly no actual "loss" incurred by the TeleCorp Directors. This argument ignores the fact that there was a covered loss under *Clarendon* for the reasons discussed at length above, a loss that was not dependent upon entry of an actual judgment as National Union now claims.

B. St. Paul's Lack of Consent Argument Is Meritless.

Misstating the record and again ignoring the proper standard on appeal, St. Paul contends that AWS' alleged failure to secure the TeleCorp insurers' consent to settle bars coverage. St. Paul's argument is meritless.

First, St. Paul misstates the record by claiming that, "[a]s alleged in AWS' Amended Complaint, . . . the primary TeleCorp Insurer, Federal, offered its consent to the Settlement *subject to the TeleCorp Directors receiving complete releases* and the preservation of the TeleCorp insurers' subrogation rights against AWS." St. Paul Answering Brief at 21 (emphasis added). AWS'

complaint does not make this allegation. *See* A46. AWS' complaint instead alleged that Federal "refused to provide [settlement] authority" and expressly conditioned any such authority that it "might later make" on AWS' agreement that Federal could seek repayment of any settlement funding directly from AWS "by subrogation or otherwise . . . ." *Id.*

Second, it is well settled that insurers may not seek to assert subrogation rights against their own insured. *Fed. Ins. Co. v. Ward*, 166 Fed. Appx. 24, 25 (4th Cir. 2006) ("Virginia's anti-subrogation rule provides that an insurance company may not seek indemnification from its insured"). Additionally, an insurer may not enforce its right to consent to a settlement once it fails to honor its own obligation to an insured. *See, e.g., Franklin v. Oklahoma City Abstract & Title Co.,* 584 F.2d 964, 968 (10th Cir. 1978) ("[P]rovisions prohibiting out-of-court settlements between an insured and a claimant without the consent of the insurer are not enforced when the insurer repudiates coverage or denies liability"); *Broadhead v. Hartford Casualty Ins. Co.,* 773 F. Supp. 882, 896 (S.D. Miss. 1991) (insurer's denial of coverage resulted in waiver of consent provision); *Sun-Times Media Group, Inc. v. Royal & Sunalliance,* 2007 Del. Super. LEXIS 402 (Del. Super. Ct.) (consent provision in D&O policy not violated where insured settled after insurer reserved rights refused to recognize coverage obligations). Federal's "condition" on its alleged offer violated this rule.

Moreover, any questions regarding AWS' alleged non-compliance with the consent provision also raise issues of fact that cannot be addressed at this point in the proceeding, much less resolved in favor of the Insurers. *E. I. du Pont de Nemours & Co. v. Admiral Ins. Co.*, 1995 Del. Super. LEXIS 631 (Del. Super.) (summary judgment denied where "the extent to which" insurers "were offered meaningful opportunity for input, protest, objection or any other participation in the drafting, negotiating or consent to [settlement] is a matter of factual dispute"). As set forth in AWS' complaint, (1) AWS became the successor in interest to the TeleCorp polices; (2) AWS provided all reasonably necessary information about the settlement to the Insurers and repeatedly requested their consent; (3) Federal and the remaining TeleCorp Insurers unreasonably withheld their consent to settle, including St. Paul's position that it somehow lacked "sufficient information to make an informed decision" on the proposed settlement in spite of the information provided time and time again by AWS; and (4) Federal improperly conditioned its consent on a right to recover any settlement funds that it did provide from its own insured, AWS. A36, 44-47. In light of these well-pleaded allegations, there is no basis for the Insurers' contention that they retained the right to consent to the settlement. Even if these allegations were insufficient, however, questions regarding any alleged non-

compliance with the consent provision raise material issues of fact that preclude the dismissal at this point. Finally, none of the cases relied upon by St. Paul for the proposition that an insurer may reasonably withhold consent in order to protect its subrogation rights have any bearing here. Those cases do not address a situation where (like here) an insurer (such as Federal) was improperly attempting to retain and assert subrogation rights against its own insured.

C. St. Paul's Lack of Exhaustion Argument Is Meritless.

St. Paul wrongly contends that AWS waived its right to challenge the Trial Court's decision to dismiss claims against St. Paul because AWS did not expressly address its exhaustion argument in AWS' opening brief. St. Paul misstates the scope of the Trial Court's ruling in claiming that AWS had an obligation to address this issue. The Trial Court's ruling relative to exhaustion was expressly predicated on its finding that AWS' $47.5 million settlement payment was not a covered "loss" under the TeleCorp policies. Specifically, the Trial Court indicated that, "*having found no present obligation for Federal Insurance to contribute to the settlement amount* agreed to by AWS, *it logically follows* that there is no obligation under the excess policies issued by National Union and St. Paul." A314 (emphasis added). The Court did not address the issue (arguably a factual one) of whether exhaustion would be an issue if the $47.5 million settlement payment at issue was a "loss" under the TeleCorp policies. There is no basis, therefore, for St. Paul to contend that AWS was obligated to raise and address this exhaustion issue in its opening brief.

Even if there were an exhaustion issue to be addressed, there is no substance to St. Paul's argument for several reasons.

First, as noted above, the Trial Court's decision did not address the issue of whether exhaustion will occur if the $47.5 million settlement payment made by AWS is deemed to be a covered "loss." St. Paul asks this Court to issue a hypothetical ruling on this issue in spite of Delaware's long-standing rule against the issuance of purely advisory opinions on such unripe issues. *See, e.g., Bebchuk v. CA, Inc.*, 902 A.2d 737, 740 (Del. Ch. 2006) (Delaware courts do not rule on cases or issues "unless they are ripe for judicial determination consistent with a well established reluctance to issue advisory or hypothetical opinions"). This question will not be ripe until this Court decides whether the settlement payment was a "loss," the case is remanded to the Trial Court for discovery and further proceedings with regard to the exhaustion issue, and the Trial Court issues a decision squarely addressing exhaustion in light of this Court's ruling on coverage.

Second, none of the cases cited by St. Paul supports the dismissal of the claims against it. Each of these cases involves situations where, unlike here, it was undisputed that the amount of the alleged loss never exceeded the available primary layers, meaning that the loss at issue could *never* exhaust the underlying limits.[3] Indeed, the holding in the *Maryland Casualty* case cited by St. Paul actually confirms that dismissal of an excess insurer is inappropriate where, like here, the amount of a loss is sufficient to implicate an excess insurer's coverage. *Maryland Cas. Co. v. W.R. Grace & Co.*, 1996 U.S. Dist. LEXIS 7795, *15 (S.D.N.Y.) (denying insurer's motion to dismiss because "it is reasonably likely that" insured's loss "will exhaust" primary coverage).

Third, similar to the holding in *Maryland Casualty*, cases actually on point with the situation at hand (a covered loss in an amount sufficient to implicate excess coverage) confirm that St. Paul's request for dismissal must be denied. *See Am. Ins. Co. v. Am. Re-Insurance Co.*, 2006 U.S. Dist. LEXIS 95801, *19-20 (N.D. Cal.) (issues of fact precluded summary judgment on excess insurer's claim of lack of exhaustion when, even "if the underlying policies had not been exhausted, they probably would be exhausted soon"); *ABM Indus. v, Zurich Am. Ins. Co.*, 237 F.R.D. 225, 228 (N.D. Cal. 2006) (claim against excess insurer not futile where amount of loss at issue may implicate excess layer). There is no dispute here that AWS paid $47.5 million or that AWS' payment will implicate St. Paul's policy if the payment is a covered loss.

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[3] *Iolab Corp. v. Seaboard Sur. Co.*, 15 F.3d 1500, 1503 (9th Cir. 1994) (concluding that "Iolab has not established that the . . . loss will ever trigger excess coverage" where claimed loss was $14.5 million and limits on "aggregate primary coverage" was $36 million); *Comerica, Inc. v. Zurich Am. Ins. Co*, 498 F. Supp. 2d 1019, 1020 (E.D. Mich. 2007) ("Comerica's primary insurance carrier, . . . whose policy carried a $20 million limit of liability – ultimately agreed to pay $14 million toward settlement"); *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 161 Cal. App. 4th 184, 187-88 (Cal. App. 4th 2008) ("insured settled a coverage dispute with its primary insurer for an amount less than the primary insurer's policy limit"); *Rees v. Viking Ins. Co.*, 892 P.2d 1128, 1129 (Wash. Ct. App. 1995) (insured settled for "$78,750 less than the $500,000 coverage afforded by the [primary] policy"). Lastly, the *Garcia v. Rivera* case involves a motion for summary judgment seeking dismissal of the excess carrier's third-party complaint and does not even relate to dismissal of claims against an insurer on exhaustion grounds.

II. WASHINGTON LAW SHOULD APPLY TO AWS' EXTRA-CONTRACTUAL CLAIMS AND THE COURT SHOULD REINSTATE THOSE CLAIMS.

The Insurers fail to rebut AWS' assertion that, when the Trial Court eventually undertook a choice of law analysis relative to the claims alleged against Federal,[4] it erred in failing to conduct a separate choice of law analysis for AWS' extra-contractual claims. National Union incorrectly claims that *Travelers Indem. Co. v. Lake*, 594 A.2d 38 (1991) supports the Trial Court's approach. As noted in AWS' opening brief, however, *Travelers* merely established this Court's adoption of the Restatement for both contract and tort claims in Delaware, doing away with the previous distinction in the tests for such claims (Restatement test for contract claims and *lex loci* test for torts). *Travelers* does not stand for the proposition that Delaware courts may undertake only a single choice of law analysis for all claims presented in a case, an approach that directly conflicts with the Restatement. AWS' Opening Brief at 20 n.7.

The Insurers' choice of law analysis also ignores the core principle upon which all choice of law analysis is based: the analysis should result in applying the law of the state that has the most significant relationship and interest in seeing its laws applied to a particular issue. As explained in detail in AWS' opening brief, even if it were assumed that the Section 188 contacts applied to AWS' extra-contractual claims, it is clear that Virginia has absolutely no interest in having its law applied to these claims. Indeed, the Insurers never even argue that Virginia has such an interest here. In contrast, Washington has a strong legal and policy interest in these claims. The conduct and damage at issue occurred in Washington, involved Washington residents (and did not involve any resident of Virginia), and related to some causes of action that are not recognized by Virginia law (such as AWS' claim under Washington's Consumer Protection Act). Washington's Legislature, Insurance Commissioner, and Supreme Court have created an extensive body of law to protect their residents, such as AWS, from insurer misconduct. Washington law must apply to AWS' extra-contractual claims. *Jones v. St. Paul Travelers*, 496 F. Supp. 2d 1079, 1084 (N.D. Cal.

[4] While St. Paul concedes that the Trial Court failed to conduct any choice of law analysis before dismissing AWS' extra-contractual claims against the Insurers, the Insurers do not provide any substantive argument as to why this error should be excused on appeal. On this basis alone, the Court should, therefore, reinstate AWS' extra-contractual claims.

2007); *Stone St. Serv. v. Daniels*, 2000 U.S. Dist. Lexis 18904, *13-15 (E.D. Penn.); *SnyderGeneral Corp. v. Great Am. Ins. Co.*, 928 F. Supp. 674, 678 (N.D. Tex. 1996); *Scottsdale Ins. Co. v. Nat'l Emerg. Servs.*, 175 S.W.3d 284, 296-97 (Tex. Ct. App. 2004).

It is also clear that the Trial Court erred in dismissing all the extra-contractual claims against the Insurers because AWS' claims for waiver and estoppel are viable under Virginia law.[5] The Insurers incorrectly argue in response that AWS' claims for waiver and estoppel are not recognized by Virginia law because they allegedly seek to extend the scope of TeleCorp's coverage. The Insurers misstate both the scope of Virginia law and AWS' claims. While coverage *beyond* the original terms of the policy cannot be created by waiver or estoppel, Virginia law is clear that an insurer can waive or be estopped from asserting otherwise valid defenses to the coverage if it fails to timely notify the insured of its intent to rely upon those defenses. *See* Va. Code § 38.2-2226 (insurer must inform insured of alleged breach of contract within 45 days of discovery or it has waived/is estopped from asserting defense); *Estate of Feury v. Princeton Ins. Co.*, 68 Va. Cir. 330, 334 (Va. Cir. 2005). Nor does the act of sending a reservation of rights letter preserve all insurer defenses to coverage, as National Union suggests. The focus is instead on whether the insurer has provided "adequate notice" of its intent to rely upon particular defenses. If a reservation of rights letter fails to do so, it is ineffective. *See Fuery*, 68 Va. Cir. at 334 (reservation of rights letter ineffective as to one insured for failure to mention correct coverage provisions or defenses).

The Trial Court erred in simply assuming that AWS' extra-contractual claims were not viable under Virginia law and dismissing them on that basis. The issue of whether the Insurers timely and adequately disclosed potential defenses to coverage clearly presents a question of fact for the jury that could not be decided on a motion to dismiss. The Insurers' contention this Court should simply assume disputed facts in their favor by claiming that all of their defenses to coverage "were raised at the appropriate times" again misstates the rules applicable to this appeal. *See* St. Paul Answering Brief at 30.

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[5] AWS' claims for bad faith against the Insurers are also viable under Virginia law if the Court determines that the settlement payments at issue were a covered loss.

III. THE SHAREHOLDERS' CLAIMS AGAINST AWS ARE COVERED BY THE AWS POLICIES.

A. Exclusion K Does Not Preclude Entire Lawsuits.

National Union concedes that the coverage provisions in the AWS policies included coverage for the claims alleged against AWS in the Shareholder Litigation. The only question remaining is whether Exclusion K applies to take away that coverage. National Union's argument that Exclusion K should apply essentially boils down to: (1) AWS had coverage for "Securities Action Claims" and asserts that coverage here; (2) part of the definition of "Securities Action Claim" is a "judicial proceeding"; (3) the definition of "Claims" subject to Exclusion K includes "Securities Action Claim" (ignoring the fact that there are several other alternatives in the definition); (4) therefore, Exclusion K applies to entire "judicial proceedings" and precludes all claims in the Shareholder Litigation. This superficial analysis misses the point.

The definition of "Claim" in the AWS policies has alternative definitions, including "any written or oral demand for damages," as well as a "civil proceeding" and a "Securities Action Claim." A323. This Court in *AT&T Corp. v. Faraday*, 918 A.2d 1104 (2007) looked at the exact same question National Union presents here – whether "Claim" for the purposes of exclusions in the Lloyd's policy equates to an entire lawsuit. The Court rejected that notion. While it is true the Court did not specifically address the "Securities Action Claim" portion of the definition of Claim, it did weigh the first two alternative definitions for "Claim" – a written or oral demand for damages versus "any civil proceeding" – and rejected the insurers' argument that where a demand for damages is made in the form of a lawsuit, the entire lawsuit is the "Claim." National Union's reliance upon the "judicial proceeding" portion of the "Securities Action Claim" definition as opposed to the "civil proceeding" considered in *Faraday* makes no difference. Answering Brief at 25. The impact is the same: "The term 'Claim' means a demand for money damages or other relief, regardless of the form in which that demand is presented."[6] *Faraday*, 918 A. 2d at 1109; *see also CheckRite Ltd. v. Illinois Nat'l Ins. Co.*, 95 F. Supp. 2d 180, 185 (S.D.N.Y. 2000) ("some but not all claims are judicial proceedings and some but not all judicial proceedings are claims. These terms should not be

[6] National Union's only other attempt to distinguish *Faraday* is that the case involved "a claim made on behalf of the directors. Here, the directors make no claim." Answering Brief at 25. The lack of merit in this argument has been addressed *supra* page 3.

conflated.") "[E]ach cause of action in [a] lawsuit may constitute a separate "Claim" within the meaning of the policies at issue." *Faraday* at 1109.

In response to this controlling authority, National Union cites one case – an unpublished Washington Court of Appeals decision that: (1) does not hold that the a lawsuit equates to a single "Claim" and (2) cannot be considered by this court. *See* Washington State Court General Rule 14.1 ("A party may not cite as an authority an unpublished opinion of the Court of Appeals"); *Brooks Trust A v. Pac. Media, L.L.C.*, 44 P.3d 938, 942 (Wash. Ct. App. 2002) (imposing sanctions for citation of unpublished case as "direct violation" of court's rules); *AT&T Corp. v. Clarendon Am. Ins. Co.*, 931 A.2d 409, 420 (Del. 2007) (refusing to follow unpublished case that would not be considered authority by issuing court).

Even National Union's one cited authority, though, recognizes a basic principle of insurance law that National Union's interpretation of Exclusion K clearly violates – an insurance policy may cover some causes of action in a lawsuit when other causes of action are excluded, and the insurer must still defend and pay for those claims that are covered. *See Planet Earth Found. v. Gulf Underwriters Ins. Co.*, 2005 Wash. App. LEXIS 3093 at *8 (Wash. Ct. App.); *Nat'l Steel Constr. Co. v. Nat'l Union Fire Ins. Co.*, 543 P.2d 641, 644 (Wash. Ct. App. 1975).

If National Union's interpretation were adopted, any time a lawsuit included a single cause of action potentially subject to an exclusion in the Policy the entire lawsuit would be excluded from coverage. This is an absurd result and contrary to any party's reasonable expectations regarding the scope of coverage. For example, the AWS Policies also contain exclusions for (1) fraud, (2) environmental contamination, and (3) wrongful acts arising subsequent to a takeover. A118 (Exclusions D, G and J). If a lawsuit referred to separate wrongful acts committed both before and after a corporate takeover (Exclusion J), under National Union's argument the entire lawsuit would not be covered – even if the corporate takeover was not at issue in the case. *See, e.g., Okada v. MGIC Indem. Corp.*, 795 F. 2d 1450 (9th Cir. 1986) ("an insurer has a duty to accept defense of the entire suit even though other claims of the complaint fall outside the policy's coverage"); *Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 401 (D. Del. 2002) (holding coverage existed for securities claims that did not fall within exclusion even though claims against same insureds for fraudulent transfer might be excluded); *Baldi v. Fed. Ins. (In re McCook Metals, LLC)*, 2007 U.S. Dist. LEXIS 42067 at *14-15 (N.D. Ill.) (same); *Home Federal S&L Ass'n v. Federal Ins. Co.*, 2007 U.S. Dist. LEXIS 68558 (N.D. Ohio) ("court finds the insured vs. insured exception either does not exclude the other

plaintiffs' claims in the underlying litigation or the exception is unclear. Therefore these claims are covered by the policy.").

B. The Claims Against AWS Do Not Involve Actions By AWS Directors on TeleCorp's Board, So Exclusion K Does Not Apply.

National Union offers nothing but unsupported, conclusory arguments that the claims alleged against AWS in the Shareholder Litigation "involved" the conduct of the AWS nominees on TeleCorp's board simply because the board's approval of the AWS/TeleCorp merger was an issue in the lawsuit. National Union offers no response or explanation for the substantial allegations in the Shareholder Complaint regarding AWS' relationship and agreements with directors Gerald Vento, Thomas Sullivan and others. Instead, National Union argues every claim in the suit is "factually connected" to actions of the TeleCorp board, and thus necessarily "involves" the AWS nominees on the board and subjects the claims against AWS to Exclusion K.

In fact, a simple reading of the claims alleged by the Shareholders against AWS (even without the reasonable inferences AWS is entitled to on a motion to dismiss) reveals that AWS' interactions with the other, non-AWS-nominee members of the TeleCorp board formed the basis of those claims. For example, the count for "Aiding and Abetting" alleges AWS "knowingly and actively participated" in the "breaches of fiduciary duties of care, loyalty and good faith owed by the Director Defendants to TeleCorp's stockholders."[7] A278 at ¶ 186. The Shareholders alleged three actions by AWS support this claim: that AWS (a) caused the TeleCorp board's approval of the Merger, (b) diverted excessive merger consideration to the holders of the Series E and Series C Preferred stock and to TMC, and (c) obtained stockholder votes to approve the merger in exchange for personal benefits. A278 at ¶ 186.

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[7] National Union repeatedly refers to, and attached in its Appendix, the Second Amended Class Action Complaint, which was proposed but never allowed as the operative complaint. B344-414. Because this complaint was never operative, consideration of it is improper. However, for purposes of Exclusion K, the differences in the complaints are irrelevant. While the Shareholders did drop their claim against AWS for allegedly breaching an independent duty to other shareholders, the allegations regarding the remaining aiding and abetting claim against AWS remain the same. As in the First Consolidated Class Action Complaint, the claim focuses on the conduct of, and benefits allegedly provided to, TeleCorp directors such as Vento and Sullivan, not the actions of the AWS nominees on the board. *See* B412.

While the AWS nominees did participate – along with every other TeleCorp director – in the second vote approving the TeleCorp merger (allegation (a)), there is no allegation anywhere in the Shareholder Complaint that the AWS-nominees either held or negotiated the terms of the conversion for the Series E or Series C preferred stock (allegation (b)) or that they owned or voted shares of TeleCorp stock in favor of the merger in exchange for personal benefits from AWS (allegation (c)). Instead, the Shareholder Complaint repeatedly alleges that the Series C and Series E preferred stock was mostly held by directors Vento and Sullivan (personally) and director Hannon (through JP Morgan Partners). A223 at ¶ 18, A261-262, A270; *see also* A267 (alleging directors Hannon, Desai and Hoak had conflicts of interest over the value given to Series C, Series E and junk bonds in the merger). The other entity AWS allegedly diverted excess consideration to, "TMC," is TeleCorp Management Company, a company wholly-owned by directors Vento and Sullivan. A223, 269. Thus, the Shareholders' allegation that AWS diverted excess consideration to holders of Series C, Series E and TMC exists apart from, and does not "involve," any actions by an AWS nominee on the TeleCorp board.

The allegation that AWS obtained stockholder votes in exchange for personal benefits is similarly independent of any AWS nominee. In addition to repeatedly alleging that AWS purchased Vento and Sullivan's shares and votes and that AWS arranged for several side benefits to Vento and Sullivan, (*e.g.,* A218 at ¶8, A223 at ¶18), the Shareholders alleged that AWS bought the votes of director Anderson (not an AWS nominee), that director Hannon (not an AWS nominee) personally benefited from his firm's ability to liquidate its stock, that director Hoak (another non-AWS nominee) promised AWS his company would vote in favor of the merger and granted irrevocable proxies to AWS, as did director Wendt (not an AWS nominee) for his company CTIHC. *See* A223-26, *see also* A261-63, 267, 270 (further discussing specific directors' personal benefits from merger). The Shareholders made no allegation that the AWS-nominees on TeleCorp's board even held shares of TeleCorp, much less that they voted their shares in favor of the merger and by doing so obtained personal benefit. Therefore, of the three alleged actions supporting the aiding and abetting claim, two clearly stand alone from the AWS-nominees' service on the TeleCorp board and the third refers to actions taken by nine different TeleCorp directors without any elaboration.[8]

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[8] The second claim alleged against AWS, for breach of a fiduciary duty to other shareholders (still operative at the time of settlement), also has no indication that it relates to any specific TeleCorp director whether AWS-nominee or otherwise. It refers only to AWS' actions in "causing the unfair initiation, timing,

(Continued . . .)

There is simply no basis in the Shareholder Complaint for finding that all allegations against AWS "involve" the AWS nominees on TeleCorp's board and therefore AWS' claims are excluded from coverage under Exclusion K. Instead, the allegations against AWS appear to involve the actions of other TeleCorp directors or shareholders. On a motion to dismiss, the Trial Court should have considered "the various factual permutations possible within the framework of plaintiff's allegations and conclude[d] whether any one conceivable set of facts could possibly merit granting plaintiff relief." *In re Valley Corp. Deriv.*, 2001 Del. Ch. LEXIS 13 at *12 (Del. Ch.) (citations omitted). If there is such a conceivable set of facts, and there are here, AWS' claims should not have been dismissed. *Id.* National Union's interpretation of Exclusion K's "involving or arising from" language is simply too broad, and in essence urges a back-door application of its argument (rejected in *Faraday*) that the entire lawsuit should be excluded from coverage simply because one cause of action falls under an exclusion. "This expansive interpretation is at odds with the coverage provisions of the policy." *See Church Mut. Ins. Co. v. U.S. Liability Ins. Co.*, 347 F. Supp. 2d 880, 885 (S.D. Cal. 2004). As the court in *Church* noted, if exclusions are read as "literally and broadly as urged by [the insurer], the language. . .would include any claim connected in any way with a breach . . . no matter how attenuated the connection." *Id.*

Exclusions to insurance coverage must be read narrowly and may not be extended beyond their "clear and unequivocal meanings." *Am. Star Ins. Co. v. Grice*, 854 P.2d 622, 625 (Wash. 1993). National Union's overbroad application of Exclusion K should be rejected and the Trial Court's ruling should be reversed. *See Church*, 347 F. Supp. 2d at 887 (interpreting exclusion narrowly in favor of coverage and insured's reasonable expectation of coverage); *McPeek v. Travelers Cas. & Sur. Co. of Am.*, 2006 U.S. Dist. LEXIS 28619, *12 (W.D. Pa.) (court "unwilling to interpret 'arising out of' so broadly that coverage is precluded upon a showing of a minimal causal connection between the claims asserted against the Insureds and the excluded matter").

(. . . continued)
structuring, disclosure and pricing of the Merger and related contracts." A278 at ¶ 184. As noted in AWS' Opening Brief, the merger was proposed by directors Hannon, Hoak and Desai and negotiated by director Hannon on behalf of TeleCorp and its board. A254, 259-63.

IV. IT WAS AN ABUSE OF DISCRETION TO DENY AWS' RULE 41 MOTION WHEN THERE WAS NO PLAIN LEGAL PREJUDICE.

As both National Union and St. Paul recognize in their briefs, the question of whether to grant a plaintiff's motion to voluntarily dismiss under Rule 41(a)(2) turns on whether granting the dismissal will cause "plain legal prejudice" to the defendants. If there is no such prejudice, the motion should be granted and the case dismissed. *See Draper v. Gardner Defined Plan Trust*, 625 A.2d 859 (Del. 1993). If such prejudice exists, the court may deny the motion. *See, e.g., New Castle County Educ. Ass'n v. Bd. of Educ.*, 428 A.2d 1148 (Del. 1981). Here, as noted by National Union, while the Trial Court did analyze the four factors that determine plain legal prejudice, at the end of that analysis it identified no actual legal prejudice that any defendant would incur if AWS' motion was granted.

"Plain legal prejudice" contemplates situations where a defendant's legal interest, legal claim or legal arguments are impaired – for example, where dismissal may deprive a defendant of a right to certain types of damages, a right to a jury trial or alter a statute of limitations defense. *See New Castle County Educ. Ass'n*, 428 A.2d at 1150 (denying Rule 41(a)(2) motion to dismiss divorce petition where doing so would "substantially and unjustly" impair wife's claim for permanent alimony due to statutory change that occurred after filing of the first petition); *Westlands Water Dist. v. U.S.*, 100 F. 3d 94, 97 (9th Cir. 1996) (setting forth situations where courts have found "plain legal prejudice" such as loss of federal forum, right to jury trial or loss of a defense). The Trial Court identified no legal right, interest or claim that would be lost if AWS' claims were dismissed. Nor have the Insurers.

Instead, both the Trial Court and the Insurers focused on the fact that the defendants had filed motions to dismiss, which had been argued before the court but no decision had been entered, and their assumption that AWS was engaging in forum shopping in order to avoid a negative ruling on the defendants' motions. However, neither the fact that the defendants had briefed and argued a motion to dismiss nor the fact that AWS may have gained some tactical advantage by dismissing the case and prosecuting it in Washington constitute "plain legal prejudice." First, all of the defendants' work and activity on the motion to dismiss could be used again in the Washington action so there was no loss to them. *See Davis v. USX Corp.*, 819 F.2d 1270, 1273 (4th Cir. 1987). Second, the mere fact that AWS wished to continue the action in another court that may have a perceived advantage to AWS does not demonstrate "plain legal prejudice" without a showing that defendants would lose some right in that second action. *See In re Marriott Hotel Props. II Ltd. Pshp. Unitholders*, 1997 Del. Ch. LEXIS

128,*17 (Del. Ch.). As there was no "plain legal prejudice" here, the Trial Court abused its discretion in denying AWS' motion.[9]

St. Paul also argues that the Insurers' counterclaims provided another basis for denying the motion. However, Rule 41(a)(2) allows for dismissal even where counterclaims exist. *See* Superior Court Civil Rule 41 (claims can be dismissed if counterclaims can be adjudicated independently); *Mission Primary Care Clinic, PLLC v. Dir., IRS*, 2008 U.S. Dist. LEXIS 31124, *22 (D. Miss.) (granting Rule 41 motion to voluntarily dismiss while defendant's counterclaims remain). The fact that the defendants' counterclaims could remain in Delaware, if defendants chose to continue prosecuting them, while AWS' claims were prosecuted elsewhere did not require denial of AWS' motion. Moreover, AWS simultaneously moved to dismiss the counterclaims along with the filing of its Rule 41 motion because the Insurers' counterclaims merely restated their contention that no coverage existed for AWS' claims and asked for declaratory judgments stating the same. *See* AR12-21, 41-49. The Trial Court ruled AWS' motion to dismiss the counterclaims was moot because it denied the Rule 41 motion. However, where the Insurers' counterclaims are in reality affirmative defenses, the Trial Court was free to either let the counterclaims stand or, pursuant to Rule 8, find that no counterclaim had been pled and dismiss the case under 41(a)(2). *See* Sup. Ct. Rule 8 (c) ("where party has mistakenly designated a defense as a counterclaim, the court . . .shall treat the pleading as if there had been a proper designation"); *Moore v. Irving Materials Inc.*, 2007 U.S. Dist. LEXIS 76628, *9 (W. D. Ky.) (pleading labeled "counterclaim" did not preclude Rule 41(a)(2) dismissal since pleading should have been designated an "affirmative defense"), *citing Hinfin Realty Corp. v. Pittston Co.*, 206 F.R.D. 350, 354-355 (E.D.N.Y. 2002).

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[9] Moreover, any allegation that AWS was seeking to avoid an anticipated adverse ruling on the defendants' motions to dismiss is speculation. The only thing that was known in June, 2005, when AWS voluntarily moved to dismiss under Rule 41, was that the Trial Court's decision had not been issued. In fact, the Trial Court did not issue its final opinion on defendants' motions to dismiss until January 31, 2006 – 11 months after the motion to dismiss hearing, nine months after AWS filed its voluntary motion to dismiss and five months after the Trial Court denied voluntary dismissal.

CONCLUSION

For the foregoing reasons, the Trial Court's orders denying AWS' motion to voluntarily dismiss the case, granting the defendants' motions to dismiss and granting summary judgment on the application of Virginia law to AWS' extra-contractual claims against the TeleCorp Insurers should be reversed.[10]

MORRIS, NICHOLS, ARSHT
& TUNNELL LLP

Donald E. Reid (#1058)
Jason A. Cincilla (#4232)
1201 North Market Street
P.O. Box 1347
Wilmington, Delaware 19899-1347
(302) 658-9200
Attorneys for Plaintiff-Below, Appellant, AT&T Wireless Services, Inc.

OF COUNSEL:

William F. Cronin
Michael A. Moore
Laurie M. Thornton
CORR CRONIN MICHELSON
BAUMGARDNER & PREECE LLP
1001 Fourth Avenue, Suite 3900
Seattle, Washington 98154
Telephone: (206) 625-8600

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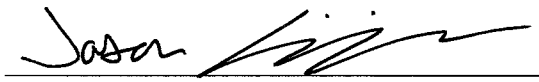
[10] National Union devotes a section of its brief to argue that the Trial Court properly dismissed the bad faith, estoppel and Consumer Protection Act claims allegedly asserted against National Union relative to National Union's excess insurance policy issued to AWS. However, these claims were not alleged against National Union as an AWS insurer. Thus, National Union's arguments as to its AWS policy on these claims are irrelevant.

CERTIFICATE OF SERVICE

I hereby certify that on May 1, 2008, the foregoing Reply Brief On Appeal Of Plaintiff-Below Appellant AT&T Wireless Services, Inc. was served, by LexisNexis File & Serve, on the following attorneys of record:

Edward M. McNally, Esquire
Morris James LLP
500 Delaware Ave., Suite 1500
P. O. Box 2306
Wilmington, DE 19899

Neal J. Levitsky, Esquire
Fox Rothschild LLP
919 North Market Street, Suite 1300
Wilmington, DE 19801



Jason A. Cincilla (#4232)