THE TRAVELERS INDEMNITY COMPANY, as subragee of Tourism and Sports Authority, DBA Arizona Sports & Tourism Authority, Plaintiff - Appellant, v. CROWN CORR INC., an Indiana corporation, Defendant - Appellee.

No. 12-15170, No. 12-16663

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

2014 U.S. App. LEXIS 21101

March 11, 2014, Argued and Submitted, San Francisco, California
October 31, 2014, Filed

NOTICE: PLEASE REFER TO *FEDERAL RULES OF APPELLATE PROCEDURE RULE 32.1* GOVERNING THE CITATION TO UNPUBLISHED OPINIONS.

PRIOR HISTORY: [*1] Appeal from the United States District Court for the District of Arizona. D.C. No. 2:11-cv-00965-JAT. James A. Teilborg, Senior District Judge, Presiding.
Travelers Indem. Co. v. Crown Corr, Inc., 2012 U.S. Dist. LEXIS 90326 (D. Ariz., June 29, 2012)
Travelers Indem. Co. v. Crown Corr, Inc., 2011 U.S. Dist. LEXIS 148529 (D. Ariz., Dec. 27, 2011)

DISPOSITION: AFFIRMED.

CASE SUMMARY:

OVERVIEW: HOLDINGS: [1]-An insurer's parol evidence was properly rejected in considering its contract claim based on the subrogation waiver provision in an agreement for the construction of a stadium because the disputed contract provision was not reasonably susceptible to the insurer's proffered interpretation, and thus consideration of the insurer's interpretation of the provision and its parol evidence were not warranted; [2]-Under the parties' agreement, the insured could waive the subrogation rights of a property insurer hired after the property in question was completed, and thus, the subrogation waiver applied to the insured and barred its contract claims; [3]-The contractual subrogation waiver, which was distinct from a disfavored exculpatory clause, precluded the insured's tort claims, as well as contract claims, and thus, the insured's negligence claim was properly rejected.

OUTCOME: Decision affirmed.

COUNSEL: For THE TRAVELERS INDEMNITY COMPANY, as subragee of Tourism and Sports Authority, DBA Arizona Sports & Tourism Authority, Plaintiff - Appellant (12-15170): Susan Freeman, Attorney, Lewis Roca Rothgerber LLP, Phoenix, AZ; James Keller LaRoe, III, Esquire, Attorney, Law Offices of James K. LaRoe PC, Dallas, TX.

For CROWN CORR INC., an Indiana corporation, Defendant - Appellee (12-15170): James Lawrence Blair, Attorney, William W. Drury, Jr., Denise J. Wachholz, Renaud Cook Drury Mesaros, PA, Phoenix, AZ.

For THE TRAVELERS INDEMNITY COMPANY, as subragee of Tourism and Sports Authority, DBA Arizona Sports & Tourism Authority, Plaintiff - Appellant (12-16663): William G. Voit, Attorney, Susan Freeman, Attorney, Lewis Roca Rothgerber LLP, Phoenix, AZ;

James Keller LaRoe, III, Esquire, Attorney, Law Offices of James K. LaRoe PC, Dallas, TX.

For CROWN CORR INC., an Indiana corporation, Defendant - Appellee (12-16663): James Lawrence Blair, Attorney, William W. Drury, Jr., Kevin Richard Myer, Denise J. Wachholz, Renaud Cook Drury Mesaros, [*2] PA, Phoenix, AZ.

JUDGES: Before: THOMAS, FISHER, and BERZON, Circuit Judges.

OPINION

MEMORANDUM*

> * This disposition is not appropriate for publication and is not precedent except as provided by *9th Cir. R. 36-3*.

Plaintiff-appellant The Travelers Indemnity Co. ("Travelers") appeals the district court's decision to grant defendant-appellee Crown Corr, Inc.'s ("Crown Corr") motion to dismiss Travelers' two contract claims and one tort claim. Because the parties are familiar with the facts and procedural history of the case, we need not recount them here.

We have jurisdiction under *28 U.S.C. § 1291*. "We review de novo a dismissal under [*Fed. R. Civ. P.] 12(b)(6)* for failure to state a claim." *Kaiser Aluminum & Chem. Corp. v. Catellus Dev. Corp., 976 F.2d 1338, 1340 (9th Cir. 1992)*. We also "review a district court's application of state substantive law in diversity actions de novo." *Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 872 (9th Cir. 2007)*. For the reasons discussed below, we affirm the district court's decision.

I

A

The district court dismissed Travelers' contract claims on the basis of the subrogation waiver in Section 11.4.6 of the Design/Build Agreement ("agreement"), which set out parameters for the construction of the University of Phoenix Stadium ("stadium"). Section 11.4.6 reads, in its entirety:

> The Parties waive subrogation against one another, the Design/Builder, Design Consultants, Subcontractors, and their respective agents and [*3] employees on all property and consequential loss policies that may be carried by any of them on adjacent properties and under property and consequential loss policies purchased for the Facility.

When Arizona courts interpret contracts, they "attempt to ascertain and give effect to the intention of the parties at the time the contract was made if at all possible." *Taylor v. State Farm Mut. Auto. Ins. Co., 175 Ariz. 148, 854 P.2d 1134, 1139 (Ariz. 1993)* (internal quotation marks omitted). The Arizona Supreme Court has instructed that a "judge first considers the offered evidence and, if he or she finds that the contract language is 'reasonably susceptible' to the interpretation asserted by its proponent, the evidence is admissible to determine the meaning intended by the parties." *Id. at 1140*. However, a court "need not waste much time if the asserted interpretation is unreasonable or the offered evidence is not persuasive." *Id. at 1141*.

The district court did not err in concluding that Section 11.4.6 was not "reasonably susceptible" to Travelers' proffered interpretation and therefore rejecting Travelers' parol evidence. Travelers contends that the district court erred in interpreting the term "Facility" in Section 11.4.6 to mean "the Stadium after it is fully operational." However, Travelers fails to put forth a narrower [*4] reading that shows the term refers *only* to the stadium *before* substantial completion. At most, Travelers establishes that the term refers to the stadium *both* before and after substantial completion. For example, Travelers notes that in Recital A of the agreement, "Facility" is used as a shorthand version of the term "multipurpose stadium facility" and that the Recital states that the Authority is empowered to "construct, finance, furnish, maintain, improve, own, operate, market and provide" the "Facility." Travelers argues that because the agreement envisions "construct[ing]" and "financ[ing]" the Facility, both of which will occur before completion, the term could apply to the stadium before completion. Similarly, Travelers argues that the terms "Work" and "Project," refer to the services necessary to complete the stadium and the construction process, not the precompletion stadium itself, so that "Facility" could still be used pre-completion. Even if Travelers is correct as to both of

these arguments, it only succeeds in showing that the term applies to the stadium before and after completion. Indeed, if the fact that Recital A uses "construct" and "finance" in describing the early stages of the stadium shows [*5] that the term "Facility" could apply to the precompletion stadium, the fact that "maintain," "operate," and "market" are also used shows that "Facility" must also apply to the stadium after completion and throughout its lifetime.

Travelers also cites several sections, including Sections 1.5, 1.8.1, and 2.1.1, that use adjectives beyond the term "Facility" itself to describe the "completed and fully operational Facility." It argues these phrases show that "Facility" cannot refer only to the post-completion stadium. But, again, Travelers' argument does not establish that "Facility" refers only to the *pre-completion* stadium. Moreover, in other provisions, like Recitals A and B, and Sections 1.7.1.10, 2.8.1.b, 11.4.1.m, the contract refers to "Facility" in a way that describes a post-completion stadium. Indeed, Recital B forecasts that the Arizona Cardinals football team will play football games "at the Facility for thirty (30) years." In that context, the term envisions a fully completed stadium over the course of three decades. In short, the term "Facility" means the stadium at *any time*. The waiver therefore still applies today and is not "reasonably susceptible" to Travelers' more restrictive view.

The broader context of the Design/Build [*6] Agreement confirms our view of the subrogation waiver. Section 11.4.6 does not include any language as to how long it will be in effect. Travelers argues that the agreement was written to facilitate construction of the stadium and, as a result, it only mentions duration when a provision, like Section 2.2.20, is meant to apply beyond substantial completion. *See, e.g.*, Agreement § 2.2.20 ("The provisions of this Article [2] shall survive the completion, suspension or termination of this Agreement."). However, other sections, like Section 11.4.1, explicitly state that they will apply through substantial completion only.

Other provisions in Section 11.4 are written narrowly as well. Section 11.4.3 explains the extent to which the Authority and the Cardinals may occupy the partially completed stadium (labeled in this provision "the Work" and not "the Facility"). Section 11.4.5 contains a waiver of rights due to loss or damage to equipment used during construction. Section 11.4.4 includes a waiver of rights "for damages caused by perils covered by insurance provided under Section 11.4."

Section 11.4.6 is different from each of these provisions. It contains a subrogation waiver by the Parties against all others involved, including subcontractors, "under property or consequential loss policies purchased for the Facility." [*7] It does not limit itself to injuries or harm arising from "the Work," and it does not include the Section 11.4.4 restriction that the waiver applies only to "insurance provided under Section 11.4." Instead, the language is far broader.

In sum, we conclude that Section 11.4.6 is not reasonably susceptible to Travelers' narrow interpretation. The district court did not err in rejecting that interpretation and refusing to consider Travelers' parol evidence.[1]

> 1 Both Travelers and Crown Corr cite to a number of cases from other states. These cases are of limited relevance because, unlike this case, they all involve the American Institute of Architects' ("AIA") form contract, or some close variation thereof.

B

Travelers also challenges the district court's conclusion, assuming the subrogation waiver applies to Travelers, that the Authority had the ability to waive the subrogation rights of a post-construction property insurer.

Arizona courts recognize the right of an insured, when the insured is waiving its own rights, to waive its insurer's subrogation rights. *Monterey Homes Ariz., Inc. v. Federated Mut. Ins. Co., 221 Ariz. 351, 212 P.3d 43, 47 (Ariz. Ct. App. 2009)* (noting that "an insurer's right to subrogation derives from its insured's right to recover against a third party" and concluding that "if the insured releases its claims against [*8] the third party--even without the insurer's consent--the insurer will be barred from asserting that claim against the third party by way of subrogation").

The Authority waived its rights against Crown Corr. Section 11.2, in general, requires the Design/Builder (i.e., Hunt) to carry liability insurance. In Section 11.2.5, the agreement provides that Hunt, and its consultants and subcontractors via separate agreements, releases the Authority and other "Released Parties" "from any and all

claims or causes of action" which Hunt or its consultants or subcontractors possess "resulting in or from or in any way connected with any loss covered and actually paid . . . by an insurance policy as agreed by the Parties hereunder." In return, that same provision states that

> [t]he Released Parties . . . release the Design/Builder . . . [and] Subcontractors . . . from any and all claims or causes of action whatsoever which any of the Released Parties might otherwise possess resulting in or from or in any way connected with any loss to the extent it is covered and actually paid by any insurance policy provided hereunder or any other insurance policy otherwise available to the Released Party or that should have been covered by any insurance [*9] policy any Released Party was required to maintain.

Hunt's agreement with Crown Corr, at Section 8.3, contains a similarly broad release provision. Crown Corr also notes that Travelers' insurance policy explicitly acknowledges that an "Insured," like the Authority, "may waive its rights against another party by specific written agreement." As a result, Travelers has implicitly acquiesced to the subrogation waiver in Section 11.4.6. Moreover, savvy insurers like Travelers have several options available, when negotiating an insurance contract, for limiting the effect of a subrogation waiver. *See Bakowski v. Mountain States Steel, Inc., 2002 UT 62, 52 P.3d 1179, 1186 (Utah 2002)*.

In sum, we conclude the district court did not err in determining that the Authority could waive the subrogation rights of a property insurer hired years after the property in question was completed. As a result, we conclude that the subrogation waiver in Section 11.4.6 applies to Travelers and bars its contract claims against Crown Corr.

II

The district court rejected Travelers' negligence claim under Arizona's economic loss doctrine. We affirm on a separate ground, namely that the subrogation waiver in Section 11.4.6. precludes tort claims as well as contract claims. *See Atel Fin. Corp. v. Quaker Coal Co., 321 F.3d 924, 926 (9th Cir. 2003)* ("We may affirm the district court's judgment on any ground supported by [*10] the record, whether or not the decision of the district court relied on the same grounds or reasoning we adopt.").

Generally, subrogation waivers apply "regardless of the nature of the claim." 2 Philip L. Bruner & Patrick J. O'Connor, Jr., Bruner & O'Connor on Construction Law, Analysis of AIA General Conditions: Waivers of Subrogation, § 5:231 (2014). Travelers argues the waiver of subrogation in this case nonetheless should not apply to tort claims because: (1) Arizona law requires waivers of liability for negligence to be expressed in "clear and unequivocal terms," *Sirek v. Fairfield Snowbowl, Inc., 166 Ariz. 183, 800 P.2d 1291, 1295 (Ariz. Ct. App. 1990)*, and the Design/Build Agreement does not contain the necessary language; (2) the Design/Build Agreement, in Section 15.8.1, notes that nothing in the agreement should be read to limit rights and remedies available to the parties by law; and (3) the *Arizona Constitution, article XVIII, section 5*, requires that defenses in tort cases of contributory negligence or assumption of risk be heard by a jury.

Travelers is correct that exculpatory clauses, which exempt a negligent tortfeasor from liability and leave a victim with no recourse, are disfavored and construed strictly in Arizona, because such clauses"may encourage carelessness." *Sirek, 800 P.2d at 1294-96*; *see also Bothell v. Two Point Acres, Inc., 192 Ariz. 313, 965 P.2d 47, 51 (Ariz. Ct. App. 1998)*; *Morganteen v. Cowboy Adventures, Inc., 190 Ariz. 463, 949 P.2d 552, 553-56 (Ariz. Ct. App. 1997)*; *Mauer v. Cerkvenik-Anerson Travel, Inc., 181 Ariz. 294, 890 P.2d 69, 73-74 (Ariz. Ct. App. 1994)*.

However, subrogation waivers are different from traditional exculpatory clauses. Subrogation waivers do not present [*11] the same dangers as exculpatory clauses, because no risk exists that the injured party will be left without compensation, and subrogation waivers serve important policy goals. *Lexington Ins. Co. v. Commc'n Servs., Inc., 275 Neb. 702, 749 N.W.2d 124, 130-31 (Neb. 2008)*; *see also Am. Motorist Ins. Co. v. Morris Goldman Real Estate Corp., 277 F. Supp. 2d 304, 307-08 (S.D.N.Y. 2003)* (noting that a "waiver of subrogation clause is an allocation of risk provision, which places the ultimate risk of loss on the insurer," and that subrogation waivers "are not true exculpatory clauses").

The cases Travelers cites all relate to exculpatory

clauses. Although Arizona does not appear to have ruled explicitly on whether a subrogation waiver applies to a tort claim, Travelers cites no case law that would compel us to conclude Arizona would depart from the general rule. Travelers points to language in the Arizona constitution and to language in the Design/Build Agreement itself. But subrogation waivers are also different from the assumption of risk waivers contained in many form contracts and targeted by the Arizona Constitution, again because the injured party is not left without recompense. And while Section 15.8.1 of the agreement clarifies that nothing in the agreement serves as "a limitation of any duties, obligations, right and remedies otherwise imposed or available at law," Travelers cites no authority [*12] that supports construing such a provision to constrain a subrogation waiver--a common type of waiver found in many contracts in the construction context. Moreover, although neither is completely factually analogous, both *United States Fidelity and Guaranty Co. v. Farrar's Plumbing and Heating Co., 158 Ariz. 354, 762 P.2d 641, 641-43 (Ariz. Ct. App. 1988)*, and *Fire Insurance Exchange v. Thunderbird Masonry, Inc., 177 Ariz. 365, 868 P.2d 948, 952-53 (Ariz. Ct. App. 1993)*, lend support to the general proposition that a valid subrogation waiver encompasses tort claims. Thus, because we conclude that the Authority waived its rights against Hunt and subcontractors and that the subrogation waiver applies against Travelers as to its contract claims, we also conclude the waiver applies to Travelers' tort claim.[2]

2 Travelers also contends that, even if the subrogation waiver applies to its tort claim, "the scope of that waiver could extend only to damage to property that was the subject of the subcontractor's work" and not to other property--such as the separate roof system and sound system speaker clusters--that was allegedly damaged by the falling roof panels in this case. We conclude that the district court did not err in deciding that the subject of the Design/Build Agreement, and the subrogation waiver specifically, was the entire completed stadium and that Travelers has not sufficiently supported its argument that certain portions of [*13] the stadium are so separate and distinct as to constitute "other property" outside the scope of the agreement and waiver.

III

Because we affirm the district court's decision to grant Crown Corr's motion to dismiss, we also affirm the court's decision to grant attorneys' fees to Crown Corr.

AFFIRMED.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE TRAVELERS INDEMNITY COMPANY, as subrogee of Tourism and Sports Authority, DBA Arizona Sports & Tourism Authority, Plaintiff-Appellant, vs. CROWN CORR INCORPORATED, an Indiana corporation, Defendant-Appellee.	No. 12-15170 D.C. No. 2:11-cv-00965-JAT District of Arizona, Phoenix

OPENING BRIEF OF PLAINTIFF-APPELLANT THE TRAVELERS INDEMNITY COMPANY

LEWIS AND ROCA LLP
Susan M. Freeman
William G. Voit
40 North Central Avenue
Phoenix, Arizona 85004-4429
(602) 262-5311

and

THE LAW OFFICE OF JAMES K. LAROE, P.C.
James K. LaRoe
700 Premier Place
5910 N. Central Expressway
Dallas, Texas 75201
(214) 219-9000

Attorneys for Plaintiff-Appellant
The Travelers Indemnity Company

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, Plaintiff-Appellant The Travelers Indemnity Company, a non-governmental corporate party, hereby states that it is 100% owned by Travelers Insurance Group Holdings, Inc., which is 100% owned by Travelers Property Casualty Corp., which is 100% owned by The Travelers Companies, Inc. The Travelers Companies, Inc. is the only publicly held company in the corporate family.

TABLE OF CONTENTS

Page

Page

Page

TABLE OF AUTHORITIES

Case **Page**

Federal Cases

Case **Page**

State Cases

Case **Page**

Other Authorities

Page

INTRODUCTION

During a storm in Glendale, Arizona on July 29, 2010, thirty-eight exterior panels on the University of Phoenix Stadium detached and tumbled across the Stadium's roofs, causing millions of dollars in damage. Plaintiff-Appellant The Travelers Indemnity Company, the property insurer on the Stadium at the time, has paid enormous sums for this damage. Travelers seeks to hold accountable Defendant-Appellee Crown Corr Inc. ("Subcontractor"), the subcontractor who designed and constructed the Stadium exterior, because the wind speeds during the storm were far below those that Subcontractor promised the exterior would resist.

Travelers' insured, to whose claims it is subrogee, is Stadium owner the Tourism and Sports Authority, d/b/a Arizona Sports & Tourism Authority. The Stadium was constructed under a three-way agreement between the Authority; B&B Holdings, Inc., d/b/a The Arizona Cardinals (the NFL franchise based in the Stadium); and Hunt Construction Group, Inc. (the general contractor).

Interpretation of this Design/Build Agreement is the main issue in this case. The District Court dismissed Travelers' complaint against Subcontractor for defective work in breach of its Subcontract, agreeing with Subcontractor that the Agreement contains a perpetual waiver of subrogation that bars all Stadium insurers—forever—from asserting subrogation for property damage to the Stadium. This proposition is completely contrary to precedent and to the language,

and very purpose, of the Design/Build Agreement.

While there is a clause prohibiting subrogation before completion of the Stadium, applicable to insurance during that period in order to prevent disruption to ongoing construction, nothing suggests that this clause waives subrogation for insurers like Travelers, whose policy was purchased *three years* after completion by the property owner. Such an interpretation ignores that the clause is part of an integrated insurance section that applies "during the term of this Agreement and until Substantial Completion," not for all eternity. Subcontractor's argument is also contrary to the expressly alleged intent of the parties.

Even if Subcontractor's interpretation were permissible, that certainly does not mean that Travelers' interpretation is not also reasonable. Under Arizona law, the court should not have dismissed the case, but should have considered the extrinsic evidence of contrary intent and sent the matter to the jury.

Also at issue is Arizona's economic loss doctrine. Subcontractor argued, and the district court agreed, that the doctrine barred Travelers' negligence claim even though there is indisputably no contract between Subcontractor and the Authority. This is directly contrary to the recent holding of the Arizona Supreme Court, which rejected cases applying the doctrine in the absence of privity and required "a contract between the plaintiff and defendant."

The dismissal should be reversed in all respects.

JURISDICTIONAL STATEMENT

The district court had jurisdiction over Travelers' claims pursuant to 28 U.S.C. §1332 because there is complete diversity between the parties and the amount in controversy exceeded $75,000 (ER224[1]). The district court's order granting dismissal and the judgment, both entered December 27, 2011, disposed of all claims and are final and appealable under 28 U.S.C. §1291 (ER1-21). Travelers timely filed its notice of appeal on January 24, 2012 (ER245-47).

[1] "ER___" references are to Appellant's Excerpts of Record; "CR___" references are to the district court clerk's record.

ISSUES PRESENTED

1. Did the court err in dismissing Travelers' contract claims under its interpretation of a subrogation waiver clause even though the court was required to accept allegations that the parties did not intend for it to apply to owner's post-Substantial Completion property insurance, and where numerous clauses make the contract reasonably susceptible to that interpretation?
2. Did the court err in dismissing Travelers' negligence claim under Arizona's economic loss doctrine where there was no "contract between the plaintiff and defendant," as required by Arizona law, and also where Travelers pled damage to "other property" not encompassed by the Subcontract?

STATEMENT OF THE CASE

Travelers filed its original complaint on May 16, 2011, and amended it three times (CR1, 14, 17; ER223-41). The Third Amended Complaint with Supporting Affidavit was filed on July 25, 2011 (ER223-41). On August 11, 2011, Subcontractor moved to dismiss and to strike the affidavit (CR22, 23). After full briefing of these motions (CR25, 26, 30, 34), on December 27, 2011, the district court entered an order striking the affidavit and dismissing all claims in the Third Amended Complaint (ER2-21). Travelers has appealed from this order and the clerk's judgment (ER1, 245-47).

STATEMENT OF FACTS

I. Factual Background[2]

A. The Authority Contracted for Stadium Design and Construction with Requirements for Hunt to Provide Builder's Risk Insurance.

On August 12, 2003, the Authority, the Cardinals, and Hunt entered into an Agreement for Design/Build Services (the "Design/Build Agreement") in which Hunt agreed to design and construct the Stadium (ER225 ¶6). At all material times, the Authority has owned and operated the Stadium, located in Glendale, Arizona (ER225 ¶5).

As the Design/Builder, Hunt indemnified the Authority and the Cardinals for damages and losses of all kinds caused by negligence or a failure to fulfill the responsibilities of Hunt or its subcontractors (ER93-94 §11.1). Hunt was required to obtain various types of insurance to protect against such claims (ER94-102 §§11.2-11.5). At issue here, the Design/Build Agreement specifically required Hunt to provide builder's risk property insurance "during the term of this Agreement and until Substantial Completion" (ER98 §11.4.1; *see also* ER99 §11.4.1(m)). Upon Substantial Completion, Hunt's warranties to the owner commenced (ER62 §2.7.3).

[2] These are the facts as alleged in the operative complaint. Because this Court is reviewing the district court's dismissal for failure to state a claim, this Court must accept these facts as true and draw all reasonable inferences in favor of Travelers. *Silva v. Di Vittorio*, 658 F.3d 1090, 1101 (9th Cir. 2011).

There are only two references to owner's property insurance in the Design/Build Agreement. One is optional insurance the Authority might obtain against loss of use due to fire or other hazards (ER101-02 §11.4.8). The other says the Authority and Hunt may have a written agreement on "insurance" along with "commencement of warranties required by the Agreement" and other terms if there is a phased turnover of certain identified areas of the Stadium prior to Substantial Completion (ER225 ¶7(a) (citing ER68 §5.4)). No such written agreement is involved here, and the Travelers insurance policy at issue was not obtained pursuant to any such agreement (it did not even exist at the time) (ER231 ¶16).

The Design/Build Agreement contains no provision addressing property insurance policies to be carried by the owner after Substantial Completion (*see generally* ER22-158).

B. The Parties Intended and Agreed that the Waiver of Subrogation Would Apply Only Before Substantial Completion of the Stadium to Prevent Disruption of the Construction Process.

The parties intended and agreed to waive subrogation against each other (ER101 §11.4.6), but only during the design and construction of the Stadium before Substantial Completion, in order to prevent the disruption of ongoing construction (ER226 ¶7(d)). The parties further intended and agreed that the waiver of property insurance subrogation would terminate upon Substantial Completion (*id.*) and would not affect or waive the rights, including subrogation

rights, of any insurer of the Authority after Substantial Completion (ER226-27 ¶8(a)-(c)).

C. The Parties Intended and Agreed that the Authority Would be a Third Party Beneficiary of any Subcontracts and that the Authority's Rights Would be Preserved.

In the Design/Build Agreement, the parties agreed that the Authority was a third party beneficiary of Hunt's contracts with its subcontractors (ER227 ¶9 (citing ER34 §1.4)). The parties agreed that the Authority's rights would be preserved and protected, such that no subcontract would prejudice those rights (ER227 ¶9 (citing ER67 §4.3)).

D. Hunt Hires Subcontractor to Design and Construct the Stadium's Exterior.

On August 22, 2003, Hunt hired Subcontractor to design and build the Stadium's Exterior Building Enclosure System (ER227 ¶10; *see also* ER159-222 (the Subcontract)). The scope of Subcontractor's work related only to the design and construction of the Exterior Building Enclosure System and did not include any work related to the roofs or the sound system (ER227-29 ¶10).

E. Travelers Becomes the Authority's Insurer Three Years After Substantial Completion of the Stadium.

The Stadium reached Substantial Completion on July 28, 2006, and opened as the new home of the Arizona Cardinals on August 1, 2006 (ER231 ¶15). It was not until July 28, 2009, some three years later, that Travelers began to insure the

Authority under the insurance policy at issue here, which extended through July 28, 2011 (ER231 ¶16).

F. The Stadium's Exterior Fails During a Rainstorm, Causing Millions of Dollars in Damage.

On July 29, 2010, during a storm, thirty-eight of the exterior metal panels failed near the top of the south and east ends of the Stadium (ER231 ¶17). These panels detached, tumbled across the mechanically-attached and retractable roofs, and caused significant damage, including to the Stadium's facade, roofs, and also to sound system speaker clusters alleged to be the Authority's business personal property (ER231-32 ¶17).

The wind speeds during the storm were far less than the wind speeds that Subcontractor promised its design and construction would withstand (ER232 ¶18). Travelers alleges that the metal panels failed as the result of Subcontractor's actions, inactions, and omissions in designing and constructing the Exterior Building Enclosure System (ER231 ¶17).

As the result of Subcontractor's defective work, the Authority sustained damages (as of the operative Complaint's filing) in excess of $2 million, with Travelers having paid (as of that date) over $1.4 million (ER232 ¶¶19, 20).

II. Procedural History

A. Travelers Files Suit.

Travelers, bringing suit as the Authority's subrogee, filed its original complaint on May 16, 2011 (CR1). The district court sua sponte ordered Travelers to file a First Amended Complaint supplementing its jurisdictional allegations (CR11).

Travelers did so, and Subcontractor responded with a motion to dismiss (CR14, 15). Before Travelers could respond, the district court, again sua sponte, ordered Travelers to file a Second Amended Complaint further supplementing its jurisdictional allegations (CR16). Again, Travelers did so, and Subcontractor responded with an identical second motion to dismiss (CR17, 18). The district court filed an order accepting the jurisdictional allegations in the Second Amended Complaint and denying the motion to dismiss the First Amended Complaint as moot (CR19).[3]

On July 25, 2011, Travelers noticed its voluntary amendment (CR20) and filed its Third Amended Complaint with Supporting Affidavit (ER223-41) (the "Complaint").

The Complaint alleged three causes of action (ER233-39 ¶¶21-34). First, Travelers alleged that Subcontractor breached its Subcontract with Hunt (of which

[3] The court subsequently denied the second motion to dismiss as moot (CR24).

its insured, the Authority, was a third party beneficiary) by improperly designing and constructing the Exterior Building Enclosure System (ER233-36 ¶¶21-26). Second, Travelers alleged that Subcontractor was liable for contractual indemnity under the terms of the Subcontract, which expressly provided that Subcontractor would indemnify the Authority against any and all claims arising out of Subcontractor's work (ER236-37 ¶¶27-29). Third, Travelers alleged that Subcontractor was negligent in its design and construction of the Stadium and therefore breached its duty to Travelers, as subrogee of the Authority (ER237-39 ¶¶30-34).

In support of its allegations, Travelers attached the Affidavit of Gerald W. Murphy, who participated in the negotiations over the insurance provisions in the Design/Build Agreement on behalf of the Authority (ER242-44). Consistent with the allegations in the Complaint, Murphy attested that the parties intended that the subsections bearing on waiver of subrogation rights would not extend beyond Substantial Completion of the Stadium (ER243 ¶5).

B. Subcontractor Moves to Dismiss.

In its Motion to Dismiss, Subcontractor argued that the contract counts had to be dismissed because, in the Design/Build Agreement, the Authority had purportedly waived the subrogation rights of its post-construction property insurer

for all time (CR22 at 5-14). Subcontractor further argued that the economic loss rule barred the negligence count (*Id*. at 15-16).

In its Response to the Motion to Dismiss, Travelers argued that the subrogation waiver provisions were only effective before Substantial Completion of the Stadium and the only owner's property insurance to which they applied concerned possible insurance on areas turned over to the owner during the phased turnover and before Substantial Completion (CR30 at 5-11). Travelers also argued that the negligence claim should stand because there was no contractual relationship between the Authority and Subcontractor, and also because Travelers alleged damage to non-Subcontract property (including the roofs) and to the Authority's business personal property (sound system speaker clusters) (*Id.* at 14-17).

C. The Court Dismisses Without Leave to Amend.

On December 27, 2011, the district court dismissed all claims in the Complaint (ER2-21).[4] For Travelers' contract counts, the court concluded that the term "Facility" in the §11.4.6 subrogation waiver was not reasonably susceptible to being interpreted as referring to the Stadium only prior to Substantial Completion,

[4] In addition, the court granted Travelers' Motion for Extension of Time due to a miscalculation of deadlines and denied Subcontractor's Motion for Summary Disposition (ER2-5). The court also granted Subcontractor's motion to strike the Murphy Affidavit as an improper attachment to a pleading, but it agreed that Travelers properly included its allegations about the parties' intent in the Complaint, and thus the striking had "no effect" on the court's analysis (ER9).

but instead could only be construed as a perpetual post-completion waiver (ER6-16). For the negligence claim, the court concluded that the economic loss doctrine does not require privity and that Travelers did not demonstrate damage to "other property" (ER16-20). The court denied leave to amend and ordered entry of judgment (ER20-21). Judgment was entered the same day (ER1).

SUMMARY OF THE ARGUMENT

On *de novo* review, this Court should reverse the dismissal for all claims. The waiver of subrogation clause in the Design/Build Agreement was not intended to apply after Substantial Completion of the Stadium. The entire purpose of the clause was to prevent disruption to ongoing construction, not to waive, for all eternity, subsequent insurers' ability to bring warranty claims as subrogees. In fact, the clause is part of a broader property insurance section that is specifically limited to only "the term of this Agreement and until Substantial Completion," with no reference to owner's post-completion policies.

The only reasoning behind the court's holding—that the word "Facility" in the clause inherently means the Stadium only after Substantial Completion—is inconsistent with numerous other clauses in the contract that manifestly use the same term to refer to the Stadium before completion. It would also render the numerous contractual references to the "*fully equipped and operational* Facility"

and the like mere surplusage. Because the contract is reasonably susceptible to Travelers' interpretation, under settled Arizona law the court was required to consider Travelers' alleged extrinsic evidence and send the question to the jury.

As to the negligence claim, controlling Arizona caselaw rejects cases applying the economic loss doctrine in the absence of privity and expressly requires "a contract between the plaintiff and defendant." There is no contract between Subcontractor and the Authority, so the doctrine cannot apply. Indeed, the key policy concerns for the doctrine, most importantly the intent of the parties, would be utterly defeated by barring the negligence claim in these circumstances.

The court also erred in concluding that the claim for damages to property beyond the scope of the Subcontract was barred by the economic loss doctrine. Such property, by definition, is "other property" directly exempted from the doctrine. The court compounded its error by engaging in improper fact-finding about one particular item, the sound system speaker clusters.

The district court's dismissal should be reversed on all counts.

ARGUMENT

I. The District Court Erred in Dismissing Travelers' Contract Claims.

A. The Standard of Review is Deferential and *De Novo*.

"Rule 12(b)(6) motions are viewed with disfavor," and "[d]ismissal without leave to amend is proper only in 'extraordinary' cases." *Broam v. Bogan*, 320 F.3d 1023, 1028 (9th Cir. 2003) (quotations omitted). Thus, there is a "deferential standard of review applicable to a motion to dismiss." *Manzarek v. St. Paul Fire & Marine Ins. Co.*, 519 F.3d 1025, 1033 (9th Cir. 2008). To survive, factual allegations need only "be enough to raise a right to relief above the speculative level." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007).

This Court reviews *de novo* a district court's dismissal under Rule 12(b)(6). *Kaiser Aluminum & Chemical Corp. v. Catellus Dev. Corp.*, 976 F. 2d 1338, 1340 (9th Cir. 1992). It likewise reviews *de novo* all issues of law, *United States v. Timberland Paving & Construction Co.*, 745 F.2d 595, 599 (9th Cir. 1984), the interpretation of a contract, *Aetna Casualty & Surety Co. v. Pintlar Corp.*, 948 F.2d 1507, 1511 (9th Cir. 1991), and the application of Arizona's test for whether a contract is "reasonably susceptible" to a proffered interpretation, *Game Tech International v. Trend Gaming, L.L.C.*, 223 F. App'x 736, 738 (9th Cir. 2007) (citing *Taylor v. State Farm Mut. Auto. Ins. Co.*, 175 Ariz. 148, 154, 854 P.2d 1134, 1140 (1993)).

B. In Arizona, Dismissal Is Improper Where the Contract Is Reasonably Susceptible to an Interpretation Supported by Alleged Parol Evidence of the Intent of the Parties.

The essence of the parties' dispute is whether §11.4.6 of the Design/Build Agreement waives subrogation for claims that arise only prior to Substantial Completion, as argued by Travelers (CR30 at 5-11), or in perpetuity, as argued by Subcontractor (CR22 at 9-14). The clause itself provides:

> The Parties waive subrogation against one another, the Design/Builder, Design Consultants, Subcontractors, and their respective agents and employees on all property and consequential loss policies that may be carried by any of them on adjacent properties and under property and consequential loss policies purchased for the Facility.

(ER101 §11.4.6.) The parties agree that Arizona law controls (CR22 at 8; 30 at 14; 34 at 10; *see also* ER110 §13.2).

The goal of the Court's construction of this clause must be to determine and enforce the intent of the parties. *Taylor v. State Farm Mut. Auto. Ins. Co.*, 175 Ariz. 148, 152, 854 P.2d 1134, 1138 (1993) (collecting cases). Judges "must avoid the often irresistible temptation to automatically interpret contract language as he or she would understand the words." *Id.* at 153, 854 P.2d at 1139. Rather, the court should search for and apply the intent of the parties, even if the court might itself read the language otherwise. *Id.*

Travelers alleged express evidence that the intent of the parties was to waive subrogation only for those policies referenced in the Agreement, *i.e.* those

purchased for the construction of the Stadium, not following Substantial Completion (ER226-27 ¶¶7(c)-(d), 8(a)-(c)). These allegations were required to be accepted as true, and the district court, correctly, accepted that these allegations constituted extrinsic evidence of the parties' intent (ER9 ("Plaintiff [Travelers] has properly included all of the allegations of the Parties' intent . . . in the Complaint itself.")).

Nevertheless, the court refused to consider these allegations (ER10-12), reasoning that the contract was not "reasonably susceptible" to Travelers' interpretation under *Taylor*, 175 Ariz. at 154, 854 P.2d at 1140 ("[T]he judge first considers the offered evidence and, if he or she finds that the contract language is 'reasonably susceptible' to the interpretation asserted by its proponent, the evidence is admissible to determine the meaning intended by the parties.").

Thus, to affirm, this Court would have to independently agree that the Design/Build Agreement is not "reasonably susceptible" to Travelers' interpretation. If Travelers' interpretation is reasonable, the Court must reverse because the question is for the jury. *State v. Mabery Ranch, Co., L.L.C.*, 216 Ariz. 233, 241, 165 P.3d 211, 219 (App. 2007) ("Where contract language is susceptible to more than one interpretation, the matter should be submitted to the jury.") (citing *Taylor*, 175 Ariz. at 159, 854 P.2d at 1145).

This is not an onerous burden. The Court's task is to "decide if [the contract] reasonably could be interpreted in different ways, given the language and the factual context surrounding the making of the agreement." *Taylor*, 175 Ariz. at 155 n.2, 854 P.2d at 1141 n.2. This means, to rule for Subcontractor, the Court would have to conclude "that the asserted meaning of the contract language is *so unreasonable or extraordinary* that it is improbable that the parties actually subscribed to the interpretation asserted by the proponent of the extrinsic evidence." *Id.* at 153, 854 P.2d at 1139 (emphasis added).

In other words, the Court should not consider the extrinsic evidence, and may rule as a matter of law, only where the contract is "not susceptible to a *clearly contradicting and wholly unpersuasive interpretation* asserted by the proponent of extrinsic evidence." *Id.* at 154, 854 P.2d at 1140 (emphasis added). The Arizona Supreme Court has likened the type of interpretation that would be rejected under this standard as akin to "testimony that white is black and that a dollar is fifty cents." *Id.* at 153, 854 P.2d at 1139 (quoting 3 CORBIN ON CONTRACTS §579 at 420 (Supp. 1992)).

Travelers' proffered interpretation—that the subrogation waiver applied only during construction, not for all time—easily passes this low threshold, especially in the deferential context of a motion to dismiss.

C. Travelers' Interpretation is Reasonable.

As an initial matter, any interpretation of the clause to affect rights following completion of the design and construction of the Stadium is at odds with the very nature of the contract. The Design/Build Agreement is a design and construction contract, not a long-term operating contract (ER27). In fact, the Design/Build Agreement itself recognizes that there are other agreements that govern use and operation of the Stadium (*see, e.g.*, ER27 Recital B (describing the Cardinals Use Agreement for NFL home games)).

Moreover, the specific property insurance provisions at issue here concern insurance supplied by the general contractor and subcontractors prior to Substantial Completion, and they in no way suggest that they apply to the owner's property insurers who step in years later (*see* ER68, 98-102 §§5.4, 11.4). The entire property insurance section in which the waiver of subrogation appears (§11.4) involves property insurance that is clearly stated to apply only "during the term of this Agreement and until Substantial Completion" (ER98 §11.4.1; *see also* ER99 §11.4.1(m) ("Insurance to apply to the construction term from Commencement of Construction to Substantial Completion or the first major public event at the Facility, whichever is first.")). Subcontractor's interpretation is irreconcilable with these clear statements.

The only owner's property insurance contemplated to be covered by the Design/Build Agreement was in the event of a *pre*-Substantial Completion phased turnover, under which the Authority, as the portions of the Stadium were completed, would assume insurance obligations for those portions before Substantial Completion instead of continuing under the builders risk insurance provided for in the contract (ER68 §5.4). Any such agreements were required to be worked out with the builder's risk carrier, and in connection with warranty rights commencing for the owner earlier than they otherwise would (at Substantial Completion) (*Id.*).

The Travelers policy does not fall within the scope of any type of insurance referenced in the Design/Build Agreement, but was instead purchased three years after Substantial Completion (ER231 ¶¶15-16). Travelers was certainly never a party to the Design/Build Agreement (ER27). Its policy is not the kind of policy the agreement purports to cover.

Even if there were some doubt about that, Travelers' interpretation of the Design/Build Agreement easily meets the permissive *Taylor* test. Whatever can be inferred from the use of the word "Facility" (discussed in detail below), there is certainly no clear and unambiguous language expressly providing that the subrogation waiver applies post-completion. Courts routinely reject the notion that

a waiver of subrogation can apply post-completion in the absence of such clear language.

For example, a case on all fours is *Hartford Underwriters Insurance Co. v. Phoebus*, 979 A.2d 299 (Md. App. 2009). In *Phoebus*, an owner and contractor entered into a contract to build a restaurant, and the contract included a waiver of subrogation for "property insurance applicable to the Work." *Id.* at 302. After completion, the property was damaged in a fire caused by faulty electrical wiring, and the property insurer sued the electrical subcontractors for their defective work. *Id.* at 301. Just like Subcontractor's argument that insurance "purchased for the Facility" includes post-completion insurance, the subcontractors in *Phoebus* argued that insurance "applicable to the Work" included post-completion insurance. *Id.*

The subcontractors in *Phoebus* had convinced the trial court to apply the waiver post-completion by citing to cases applying a form "Completed Project Insurance Clause" created by The American Institute of Architects ("AIA"). *Id.* at 303, 306. Subcontractor made the very same argument below, likewise relying on cases applying the AIA's Completed Project Insurance Clause (CR22 at 15).

The *Phoebus* court of appeals reversed and squarely rejected the subcontractor's argument because there was no such clause in its contract. *Phoebus* recognized that without clear language, waiver of subrogation for post-completion insurance could not be found as a matter of law:

> There is no Completed Project Insurance clause in the Contract. Nor is there any other language plainly addressing the waiver of rights consequences, if any, that flow from the owner's obtaining property insurance on the completed Restaurant. Without a Completed Project Insurance or similar clause, the Waivers of Subrogation clause and the definition of Work reasonably can be read to have more than one meaning, temporally.

Id. at 309. Thus, because there was no language "expressly" or "plainly addressing" waiver post-completion, the word "Work" on its own was "fraught with ambiguity" and reversal was required. *Id.* at 309-10.[5]

Here, the Design/Build Agreement emphatically is ***not*** an AIA form contract. As opposed to those cases where courts have held that the contract's express language providing for coverage "after final payment" waived subrogation, the Subcontract in the present case does not contain an AIA Completed Project Insurance Clause, which provides:

> if *after final payment* property insurance is to be provided on the *completed Project* through a policy or policies *other than those insuring the Project during the*

[5] *See also John L. Mattingly Constr. Co. v. Hartford Underwriters Ins. Co.*, 999 A.2d 1066, 1072-73, 1078 (Md. 2010) (no post-completion waiver of subrogation as a matter of law because "the waivers of subrogation clause was ambiguous as to whether it encompassed losses sustained after completion of construction and final payment," and thus "the court must consider extrinsic evidence which sheds light on the intentions of the parties at the time of the execution of the contract") (quotation omitted); *Auto. Ins. Co. v. United H.R.B. Gen. Contractors, Inc.*, 876 S.W.2d 791, 793-94 (Mo. App. 1994) (where contract "contains no express language as to the duration of the waiver" finding the purported subrogation "waiver was inapplicable after completion of the project and final payment on the contract").

> *construction period*, the Owner shall waive all rights in accordance with the terms of Section 11.3.7 [the waiver of subrogation clause] for damages caused by fire or other causes of loss covered by this separate property insurance.

THE AMERICAN INSTITUTE OF ARCHITECTS, A201-2007 GENERAL CONDITIONS OF THE CONTRACT FOR CONSTRUCTION §11.3.5 (2007) (emphases added).[6] Again, the Design/Build Agreement here is not an AIA agreement and contains no clause extending the waiver of subrogation to post-completion insurance.

In fact, as detailed above, the Design/Build Agreement contains no references *whatsoever* to owner's property insurance on the completed project—only property insurance purchased by Hunt for the period of construction, and possible owner's property insurance on specific portions of the Stadium before Substantial Completion as part of any phased turnover. The contract is express where it purports to make its provisions survive substantial completion (*see, e.g.*, ER49 §2.2.20 ("The provisions of this Article [2] shall survive the completion . . . of this Agreement.")), while §11.4.6 fails to include any such language.

Travelers' interpretation comports with the purpose, language, and structure of the contract. The Complaint's allegations about the intent of the parties only reinforce this commonsense understanding. The contract is reasonably susceptible to Travelers' interpretation. Therefore, dismissal was improper.

[6] Available at http://www.aia.org/groups/aia/documents/pdf/aias076835.pdf (text with AIA commentary).

D. None of the Reasons Cited by the District Court Render Travelers' Interpretation Unreasonable.

The district court, in siding with Subcontractor, offered several explanations for concluding that the Design/Build Agreement was not susceptible to the interpretation advanced by Travelers (ER10-12). None is prohibitive of Travelers' interpretation. In fact, they all support that interpretation.

1. The term "Facility" cannot always mean the Stadium after Substantial Completion.

The court's conclusion mostly rests on its reasoning that "the term 'Facility' is not reasonably susceptible to Plaintiff's interpretation" because its definition must, as a matter of law, "refer to the Stadium after it is fully operational" (ER10-11). The court said that the definition of "Facility" is as follows: "Recital A of the Design/Build Agreement defines Facility as 'a multipurpose stadium Facility,' 'the primary purpose of which will be to accommodate professional football franchises, major college football bowl sponsors, other sporting events, and entertainment, cultural, civic, meeting, trade show or convention events or activities'" (ER10).

This significantly rearranges the language of Recital A, which actually defines "Facility" in a very limited way, simply as "multipurpose stadium facility":

> The Authority is a political subdivision of the State of Arizona empowered by A.R.S. §5-801, et seq., as amended (the "Act") to construct, finance, furnish, maintain, improve, own, operate, market and provide a multipurpose stadium facility (the "Facility"), the primary purpose of which will be to accommodate

> professional football franchises, major collect football bowl sponsors, other sporting events, and entertainment, cultural, civic, meeting, trade show or convention events or activities.

(ER27.) As this shows, the definition of "Facility" is simply (and quite generally) "multipurpose stadium facility." The text about the Stadium's "primary purpose" comes *after* the term is defined and is not part of that definition. That language simply explains how the Facility will be used once complete, which is in no way inconsistent with use of the term to refer to the Stadium prior to Substantial Completion.

What the "purpose" of a stadium "will be" is just as true of the Stadium while it is under construction as when it is completed. If anything, the use of the future tense ("will be") affirmatively counsels that the term refers to the Stadium *before* Substantial Completion. If "Facility" referred to an already completed and operating Stadium, it would make little sense to say what its purpose "will be," and much more sense to say what its purpose "is."

The notion that "Facility" can only "refer to the Stadium after it is fully operational," as the court held, is also directly at odds with the rest of Recital A, which states that the Authority is empowered "to construct, finance, furnish, maintain, improve, own, operate, market and provide" the Facility (*Id.*). Certain of these powers ("to construct," "to . . . finance," "to . . . furnish") make no sense if

they were referring to the Stadium after it is fully operational, as these things inherently take place *before* Substantial Completion.

Read fairly, the single word "Facility," by itself, does not answer the question of whether any given clause applies before or after Substantial Completion. This only makes sense, as the "Facility" is the subject of a nearly 100-page contract and necessarily has to be flexible enough for use in a wide variety of places throughout the document. Rather, it is the *context* in which the term is used that is the key to making that determination. Ripped from context, the word "Facility" is fraught with ambiguity and is not a term that inherently, and beyond all reasonable dispute, must in every single instance refer to the Stadium only after completion.

The court contrasted its reading of "Facility" with its construction of the words "Work" and "Project," concluding that "when the Parties refer to the Stadium before completion, they use either 'Work' or 'Project'" (ER10-11).

First of all, the court's construction of these other terms leaves much to be desired. "Work" is defined as "all design and construction services necessary for the timely and proper design, construction and furnishing of the fully equipped and operational Facility in accordance with this Agreement" (ER37 §1.5). This clearly does not refer to the Stadium itself, but rather to the "design and construction *services* necessary" to construct it.

In fact, this definition confirms that the word "Facility" in and of itself does not specify whether the Stadium is pre- or post-completion, but rather requires additional context to answer that question. The definition of "Work" refers to "the *fully equipped and operational* Facility" (*Id.*). If "Facility" inherently referred to an already completed Stadium, these qualifying words would be redundant and superfluous, which would violate fundamental canons of contract interpretation. *See Miller v. Hehlen*, 209 Ariz. 462, 466, 104 P.3d 193, 197 (App. 2005).

"Project" is defined as "the design, construction and furnishing of the fully equipped and operational Facility" (ER36 §1.5 (incorporating ER41 §1.8.1)). This is much more plausibly read as referring to the construction process—"the design, construction and furnishing"—rather than the Stadium itself. Again, like "Work," this definition actually confirms that "Facility" requires context to mean pre- or post-completion because it refers to "the *fully equipped and operational* Facility" (*id.*), words that would be redundant if Facility already referred to a completed and operating facility.

But ultimately, nothing turns on the court's construction of "Work" and "Project." Even if the court were right that these terms "refer to the Stadium before completion," that in no way compels the conclusion that "Facility" cannot also refer to the same thing based on the context. There is no dichotomy anywhere in the Agreement between these terms. Instead, they all appear in different parts of

the contract (a recital, a definition section, and a substantive section), and the contract provides no indication that they are set up against one another.

Indeed, the court's own logic accepts that more than one term can refer to the Stadium before Substantial Completion (namely, Work and Project). Thus, even assuming the court were correct in its construction of those terms, there is no reason why "Facility" could not be another such term. Nothing in the court's construction of the term "Facility" renders Travelers' interpretation unreasonable as a matter of law.

2. Travelers' interpretation finds support outside of the word "Facility."

The court also said that "[w]ithout reading [Travelers'] interpretation of 'Facility' into the Contract, there is no support for Plaintiff's argument that the Parties to the Design/Build Agreement intended to limit the subrogation waiver to insurance carried only before substantial completion of the Stadium" (ER11). Of course, on the level of the specific clause at issue, this is just a circular statement. Without construing the term "Facility" as the court did, there is no support for its position either.

But the court's conclusion is not correct. Travelers' argument is also supported by the very purpose of the Design/Build Agreement. The purpose of a contract informs the interpretation of terms, *see State ex rel. Goddard v. R.J. Reynolds Tobacco Co.*, 206 Ariz. 117, 120, 75 P.3d 1075, 1078 (App. 2003), and

as explained above, the purpose of this agreement is to provide for and govern "Design/Build Services," not the ongoing ownership or operation of the Stadium.

Travelers' argument is also supported by the nature of §11.4. Context is key when interpreting words in a contract, *see id.*, and context includes reading sections in harmony, *see Chandler Med. Bldg. Partners v. Chandler Dental Grp.*, 175 Ariz. 273, 277, 855 P.2d 787, 791 (App. 1993).

The court's construction fails to analyze the broader context of §11.4 or to harmonize its interpretation of §11.4.6 with its sister provisions. Section 11.4.6 is not an isolated clause. It is an integral sub-part of the broader §11.4, which is repeatedly referred to as an integrated section throughout the Design/Build Agreement.[7] The rest of §11.4 shows that its provisions are referring to property insurance policies purchased for the design and construction of the Stadium, not insurance that follows Substantial Completion.

[7] (*See, e.g.*, ER57 §2.4.10.9 (noting damage coverage "subject to the terms of Section 11.4"); ER69 §5.7 (referring to "casualties covered by the property insurance required under Section 11.4"); ER75 §6.4.2 (terms "assume the Design/Builder will be able to obtain the level of property insurance anticipated under Section 11.4"); ER94 §11.2.1 (agreement to necessary renegotiation and modification of "the language of Sections 11.2 and 11.4"); ER101 §11.4.4 (waiver of certain rights "for damages caused by perils covered by insurance provided under Section 11.4" and discussing the effect if "the Design/Builder fails to purchase and maintain the property insurance required by this Section 11.4"); ER119 §15.12.4 (Design/Builder damage remedies "[s]ubject to the provisions of Section 11.4"); ER120 §15.12.5 ("The provisions of this Section 15.12 are subject to the terms of Section 11.4 above.").

Most prominently, §11.4.1, which provides the insurance requirement on which the entire section is based, is expressly limited to insurance policies that apply before Substantial Completion:

> The Design/Builder shall procure and maintain with an insurer authorized to do business in the State of Arizona, *during the term of this Agreement and until Substantial Completion*, standard all risk of loss builder's risk completed value insurance upon the Work constructed or to be constructed, in whole or in part, by the Design/Builder or the Subcontractors.

(ER98 §11.4.1 (emphasis added)). Likewise, §11.4.1(m) provides that the "Insurance [is] to apply *to the construction term from Commencement of Construction to Substantial Completion or the first major public event* at the Facility, whichever is first" (ER99 §11.4.1(m) (emphasis added)).

That §11.4 is an integrated section that refers to "property insurance" limited to "the term of this Agreement and until Substantial Completion" is further demonstrated by §11.4.3. That section states that "[t]he insurance policy shall provide that the Authority and the Team may occupy such portion of the Work completed or suitable for occupancy prior to final acceptance of the entire Work, if permitted by law, any other provision of the policy to the contrary notwithstanding" (ER101 §11.4.3). This reference to "*the* insurance policy" is to Hunt's builder's risk policy, and its language regarding "the Work completed or suitable for occupancy prior to final acceptance of the entire Work," makes no

sense as some freestanding section, or as reference to any owner's policy that follows Substantial Completion.

The provisions of §11.4.4, covering waiver of rights, also demonstrate that it is a waiver relevant to the integrated whole of §11.4, and specifically to the builder's risk "property insurance" required under §11.4.1 (ER101 §11.4.4 (waiver of certain rights "for damages caused by perils covered by insurance provided under Section 11.4" and discussing the effect if "the Design/Builder fails to purchase and maintain the property insurance required by this Section 11.4").

Section 11.4.5, likewise, which covers waiver of rights for loss "covered and actually paid by any property insurance," clearly refers only to property insurance in effect prior to Substantial Completion of the Work, stating that it is waiver "for loss or damage to any equipment used *in connection with the Work*" (ER101 §11.4.5 (emphasis added)). Even under the court's own construction of the term "Work," that clearly refers to losses incurred *prior* to Substantial Completion.

Finally, §11.4.6 itself is incoherent and inconsistent under the court's construction of the term. The court seemed to believed that the word "all" was the key word in §11.4.6, reasoning that "Section 11.4.6 states that [the Authority] waives subrogation against subcontractors on *all* property policies purchased for the Facility") (ER11). However, the word "all" is just as plausibly read (in fact, much more properly read) to recognize that there may be multiple insurance

policies in place for multiple parties on multiple properties *prior to Substantial Completion*. Section 11.4.6 states that the Parties waive subrogation "on all property and consequential loss *policies* that may be carried *by any of them* on *adjacent properties and under property and consequential loss policies* purchased for the Facility." The only owner's policy that would be included with Hunt and Subcontractor policies under the Agreement would be on phased turnover portions of the project prior to Substantial Completion, which again are not implicated here. Construing the word "all" otherwise, to extend this clause to owner's property policies purchased years after completion of the Stadium, expands this section beyond the scope of §11.4.

Such a construction of the word "all" is also internally inconsistent with the district court's own definition of "Facility." The court reasoned that "*some* insurance polices would only be carried through substantial completion and yet the subrogation waiver states that it applies to *all*" (ER11 (emphases added)), implying that the waiver covered policies applying both before and after Substantial Completion. But under the court's reasoning that "Facility" refers to the Stadium *only after* Substantial Completion, §11.4.6 could not be referring to "all" policies; it would necessarily exclude those policies covering the Stadium before Substantial Completion. Thus, under the court's reasoning, §11.4.6 not only covers post-

completion policies addressed nowhere in the agreement, but it excludes the very pre-completion policies that §11.4 exists to provide.

The court's restrictive interpretation thus does not make sense even under its own reading of the Design/Build Agreement. It certainly does not make sense under the purposes and language of §11.4, which the court turned on its head. Again, even if the Court concludes that Subcontractor's interpretation is permissible, despite all of these flaws, Travelers' contrary interpretation, at the very least, passes that bar as well.

3. The entire contract supports Travelers' interpretation.

The court also stated that its conclusion was further supported by "a careful reading of the entire Contract" (ER10-11). The court offered no explanation of what other parts of the contract it found supportive of its construction, leaving it to speculation. Regardless, the rest of the contract supports Travelers' construction, not the Subcontractor argument.

Perhaps the most important provisions, in addition to those discussed above, are the repeated uses of additional terms to qualify "Facility" when the context is meant to refer to the Stadium after Substantial Completion (*see, e.g.*, ER37 §1.5 (referring to "the *completed and fully operational* Facility" and "the *fully equipped and operational* Facility"); ER41 §1.8.1 ("the *fully equipped and operational* Facility"); ER42 §2.1.1 ("a *fully functional* Facility"); ER43 §2.1.2 ("a *complete*

and fully functional Facility") (emphases added)). Under the court's reasoning, these additional words are all redundant and superfluous.

And there are other places in the Agreement where it is abundantly clear from the context that the term "Facility" is being used in the present tense to refer to the Stadium while under construction (*see, e.g.*, ER41 §1.8.2 ("Design and construction of the Facility *has required to date* and will require hereafter . . . ."); ER44 §2.2.4 (owner has right to assurances "to ensure that the Facility can be and *is being completed* in accordance with this Agreement"); ER46 §2.2.10 ("to ensure that the Facility *is constructed* in a manner that is consistent")).

Perhaps the best example is §2.4.2.3. That section states that "[t]he Design/Builder shall provide temporary utilities, hoisting and all other temporary equipment and services to the Authority's or the Team's contractors that *are performing work on or within the Facility*" (ER52-53 §2.4.2.3 (emphasis added). The term "Facility" cannot possibly mean the completed Stadium in this context.

Indeed, the entire section on achieving "Substantial Completion of the Facility" would make no sense if "Facility" already and inherently referred to the Stadium after Substantial Completion (ER67-68 §5.3). Likewise, the section discussing "Partial Occupancy," which discusses events prior to Substantial Completion and also uses the term "Facility," makes no sense if "Facility" inherently means the completed Stadium (*see* ER68 §5.4 ("certain portions or areas

of the Facility identified in Exhibit O shall be completed and made available to Owner for its occupancy (with public access thereto) by mutually agreeable dates *prior to the date of Substantial Completion*"); *see also id.* (referring to "early occupancy of any portion *of the Facility* by Owner")).

And of course, construing the contract to waive subrogation after completion eviscerates the warranties in the contract for quality work, which are specifically designed to come into force and effect upon reaching Substantial Completion (ER62 §2.7.3). Far from being supported by the rest of the contract, the notion that "Facility" must, as a matter of law, only refer to the Stadium after Substantial Completion is utterly undermined by the contract.

To the extent there is any ambiguity on this point, it should be construed against Subcontractor. The Design/Build Agreement makes clear that the subcontracting is to be construed to protect the rights of the owner, not prejudice those rights (ER65-67 §§4.1, 4.3). Construing the subcontracting process as waiving subrogation is at odds with this purpose.

Thus, none of the rationales on which the court relied puts the Design/Build Agreement into the category of cases in which contract language is so far beyond dispute that any contrary interpretation is like saying "white is black" or "a dollar is fifty cents." *Taylor*, 175 Ariz. at 153, 854 P.2d at 1139 (quoting 3 CORBIN ON

CONTRACTS §579 at 420). The Design/Build Agreement is reasonably susceptible to Travelers' interpretation, and thus reversal is mandated.

E. Caselaw opposes interpreting construction contracts to create perpetual or unilateral waivers of subrogation post-completion.

As noted above, the cases on which Subcontractor relied in arguing for a perpetual waiver of subrogation all involved AIA form contract language—language not found in the Design/Build Agreement because this is not an AIA form contract (or anything even remotely close to one) (CR30 at 10).[8] Where clear language is missing, courts find that the subrogation waiver does *not* apply after completion of the property as a matter of law. *See, e.g.*, *Phoebus*, 979 A.2d at 309.

Here, §11.4.6 does not contain any language applying the waiver to property policies purchased after Substantial Completion, nor does the broader Design/Build Agreement contain the AIA Completed Project Insurance Clause or any similar provision. Thus, it is the cases that fail to contain specific language, and consequently find no post-completion waiver, that are on point.

---

[8] *Argonaut Great Cent. Ins. Co. v. Ditocco Konstruction, Inc.*, No. 06-1488 (JBS), 2007 WL 4554219, at *2, *7-8 (D.N.J. Dec. 20, 2007) (subrogation continuation clause effective after completion because the clause provided form language that "*after final payment* property insurance is to be provided on the *completed Project* through a policy or policies *other than those insuring the Project during the construction period*") (emphases added); *TX. C.C., Inc. v. Wilson/Barnes Gen. Contractors, Inc.*, 233 S.W.3d 562, 565, 572 (Tex. App. 2007) (same); *Midwestern Indem. Co. v. Sys. Builders, Inc.*, 801 N.E.2d 661, 664, 669 (Ind. App. 2004) (same); *Colonial Props. Realty Ltd. P'ship v. Lowder Constr. Co.*, 567 S.E.2d 389, 390, 392 (Ga. App. 2002) (same).

Moreover, even if the Design/Build Agreement purported to waive Travelers' subrogation rights, caselaw would still oppose finding such a waiver because Travelers was not a party to the Design/Build Agreement (CR30 at 11-12). The district court recognized that "there is a split among state courts on this issue and Arizona has not expressly dealt with it" (ER13).

The district court sided with those cases that permit subrogation waivers without the insurer's consent based on two notions. The first was the utility of such clauses in construction contracts (ER14). But that issue is not relevant in this particular case. The case on which the court relied, *United States Fidelity & Guaranty Co. v. Farrar's Plumbing & Heating Co.*, 158 Ariz. 354, 355, 762 P.2d 641, 642 (App. 1988), merely said that "[a] waiver of subrogation is useful in such projects because it avoids disruption and disputes among the parties to the project."

As noted by the *Phoebus* court, however, the "consideration behind Waivers of Subrogation clauses in construction contracts pertain to the period of time in which construction is taking place, *and not to the (unlimited) period of time after construction and final payment, when the structure is built and being used and the parties no longer are working together to accomplish that*." 979 A.2d at 311 (emphasis added). The court's expressed concern is not salient here.

The second notion was that the contractual waivers of subrogation "show that the parties mutually agreed to share the burden of any Party's negligence," and

thus that Travelers "either had notice of the subrogation waiver or could have had notice" and was thereby "in the best position to protect [itself] against waivers of subrogation" (ER14-15). This also is not persuasive, for the court's logic is wholly circular. It depends entirely on there having been a manifest subrogation waiver for post-completion insurance. Here, as explained above, Travelers' contrary interpretation was reasonable and it cannot be faulted for insuring the Authority under that interpretation.

The *Phoebus* court, again, dispatched this very same argument, pointing out that given the ambiguity, "what would not have been apparent to [the owner] likewise would not have been apparent to [the insurer] or any insurer with which [the owner] contracted to cover the [property]." 979 A.2d at 310 n.5. Thus, "neither [the insurer] nor its future insurers would have known to obtain policy endorsements, which would have changed the cost of the insurance policy." *Id.*

But even if the Court concludes otherwise, it is alleged, and must be accepted as true, that no one involved actually intended for there to be such a waiver. Rather, the Complaint alleges that all parties to the Design/Build Agreement "intended and agreed . . . [t]o waive subrogation . . . only during the ongoing PROJECT before Substantial Completion to prevent disruption of the ongoing construction" (ER225-26 ¶7(d)). The notion that the parties "mutually agreed" otherwise, as the court reasoned, is a manifest fiction. Enforcing the

actual intent of the parties counsels against finding a waiver here without the insurer's consent.

In sum, there is nothing in the language of the contract or the equities of this case that would prevent Travelers from bringing its contract claims against Subcontractor for the millions of dollars in damages caused by Subcontractor's defective work. The district court should not have ended this case at the very beginning given the key evidentiary issues about the intent of the parties that remained outstanding. Dismissal of the contract claims was error and should be reversed.

II. The District Court Erred in Dismissing the Negligence Claim Under the Economic Loss Doctrine.

A. The Standard of Review is *De Novo*.

Whether the economic loss doctrine was properly applied is a legal issue that will be reviewed *de novo*. *Flagstaff Affordable Hous. Ltd. P'ship v. Design Alliance, Inc.*, 223 Ariz. 320, 322, 223 P.3d 664, 666 (2010); *Giles v. Gen. Motors Acceptance Corp.*, 494 F.3d 865, 872 (9th Cir. 2007).

B. The Economic Loss Doctrine Does Not Support Dismissal.

"[A]s the Arizona Supreme Court has observed, in Arizona there is no 'blanket disallowance for tort recovery for economic losses.'" *Evans v. Singer*, 518 F. Supp. 2d 1134, 1145 (D. Ariz. 2007) (quoting *Salt River Project Agric. Improvement & Power Dist. v. Westinghouse Elec. Corp.*, 143 Ariz. 368, 379, 694

P.2d 198, 209 (1984)). Indeed, "[t]ort law has traditionally protected individuals from a host of wrongs that cause only monetary damage." *Giles*, 494 F.3d at 875.

One limited exception is the economic loss doctrine, which in certain circumstances preserves the distinction between breach of contract and tort remedies. *See generally id.* at 873 (providing an overview of the doctrine).

For many years, the Arizona Supreme Court's seminal case on the doctrine was the *Salt River* case from 1984. The Arizona Supreme Court next addressed the doctrine in its 2010 decision, *Flagstaff Affordable Housing Ltd. Partnership v. Design Alliance, Inc.*, 223 Ariz. 320, 223 P.3d 664 (2010), which now sets the standard in Arizona. The *Flagstaff Affordable Housing* court recognized that during the prior twenty-five years "the [state] court of appeals and the federal courts have reached conflicting conclusions regarding the application of the doctrine under Arizona law." *Id.* at 322, 223 P.3d at 666. Thus the court sought to provide clarity on several key points.

For instance, *Flagstaff Affordable Housing* recognized that it was uncertain whether the doctrine applied "broadly," as some cases had concluded. *See id.* (comparing as inconsistent on this point *Apollo Group, Inc. v. Avnet, Inc.*, 58 F.3d 477, 480 (9th Cir. 1995) (stating that *Salt River* reflects that Arizona applies the doctrine "broadly"), and *Evans*, 518 F. Supp. 2d at 1142-45 (stating *Salt River* "provided anything but" a broad reading of the rule)).

Resolving the conflict, *Flagstaff Affordable Housing* clarified that *Salt River* had in fact "embraced a narrower, case-specific approach," and applied "a narrow version of economic loss doctrine," and thus the court cautioned against "overly broad" formulations of the doctrine or painting with "a broad brush." *Id.* at 323-24, 329, 223 P.3d at 667-68, 673.[9]

Here, the district court erred in applying this narrow exception to the general rule that negligence claims are available, even for economic losses, as set down in *Flagstaff Affordable Housing*.

1. The district court erred in applying the economic loss doctrine in the absence of privity.

Travelers, citing *Flagstaff Affordable Housing*, argued that the negligence claim could not be dismissed because the economic loss doctrine requires a contract between the parties, and the Authority (into the shoes of which Travelers has stepped) did not have a contract with Subcontractor (CR30 at 14). The district court, however, dismissed the negligence claim under the reasoning that, even though there was no contractual privity between the Authority and Subcontractor,

[9] *See also Miidas Greenhouses, LLC v. Global Horticultural, Inc.*, 226 Ariz. 142, 147, 244 P.3d 579, 584 (App. 2010) (recognizing that Arizona has "adopted a narrow version of the economic loss rule" and citing both *Salt River* and *Flagstaff Affordable Housing* for that proposition); Thomas E. Lordan, *Arizona's "Economic Loss Rule" and Flagstaff Affordable Housing*, 4 PHOENIX L. REV. 85, 135 (Fall 2010) (describing *Flagstaff Affordable Housing*, and explaining that on this point "the court sided with *Evans* against *Apollo* in finding that [*Salt River*] did not apply the ELR [economic loss rule] broadly").

there were "interrelated contracts"; namely, the Subcontract and the Design/Build Agreement (ER18).

The court relied on cases from other states that did not require privity to apply the economic loss doctrine, reasoning that "the Arizona Supreme Court did not specifically address applying the economic loss doctrine to agreements between parties not in direct privity" (ER17-18). This reasoning is incorrect.

a. *Flagstaff Affordable Housing* did address and require privity.

Flagstaff Affordable Housing did address the issue of privity, and it requires privity for the economic loss doctrine to apply. In its very definition of "economic loss," *Flagstaff Affordable Housing* said there must be "a contract between the plaintiff and defendant":

> "Economic loss," as we use the phrase, refers to pecuniary or commercial damage, including any decreased value or repair costs for a product or property *that is itself the subject of a contract between the plaintiff and defendant*, and consequential damages such as lost profits.

Flagstaff Affordable Hous., 223 Ariz. at 323, 223 P.3d at 667 (emphasis added). The court also repeatedly explained that the limitations of the rule only applied to "a contracting party." *Id.* at 323, 326, 223 P.3d at 667, 670.

These are not idle turns of phrase. On the issue of privity, the Arizona Supreme Court expressly sided with *Donnelly Construction Co. v.*

Oberg/Hunt/Gilleland, 139 Ariz. 184, 677 P.2d 1292 (1984),[10] over *Carstens v. City of Phoenix*, 206 Ariz. 123, 75 P.3d 1081 (App. 2003). As explained by *Flagstaff Affordable Housing*, "[w]ithout discussing the economic loss doctrine, *Donnelly* correctly implied that it would not apply to negligence claims by a plaintiff who has no contractual relationship with the defendant." 223 Ariz. at 327, 223 P.3d at 671. *Carstens*, on the other hand, had suggested that privity was not required, which the *Flagstaff Affordable Housing* court squarely rejected:

> Although some courts have applied the doctrine in that context, *see, e.g.*, *Carstens*, 206 Ariz. at 127 ¶17, 75 P.3d at 1085 . . . *we decline to do so*. The principal function of the economic loss doctrine, in our view, is to encourage private ordering of economic relationships and to uphold the expectations of the parties by limiting a plaintiff to contractual remedies for loss of the benefit of the bargain. These concerns are not implicated *when the plaintiff lacks privity* and cannot pursue contractual remedies.

Flagstaff Affordable Hous., 223 Ariz. at 327, 223 P.3d at 671 (emphases added).

Secondary authority interpreting the effect of *Flagstaff Affordable Housing* recognizes that privity is required for Arizona's economic loss doctrine to apply. "We may draw the following conclusions from the [*Flagstaff Affordable Housing*] court's formulation of the ELR [economic loss rule] . . . (2) Where parties are not in privity of contract, the ELR *will not* apply to preclude tort claims between

[10] *Overruled on other grounds by Gipson v. Kasey*, 214 Ariz. 141, 144, 150 P.3d 228, 231 (2007).

them[.]" Lordan, *supra*, at 137 (emphasis original). This is because, on the privity issue, "*FAH* in effect overruled *Carstens*, and upheld *Donnelly*." *Id.* at 152.

Indeed, "[t]he key move the court made was to restore the concept of privity of contract to the central place it held in ELR jurisprudence prior to *Carstens*," and "[t]he court rejected the 'overly broad' statements of the ELR from *Carstens* on which subsequent courts relied in applying the ELR in non-privity contexts." *Id.* at 135-36. Thus, "where parties are not in privity of contract, the ELR will not be available to preclude tort claims between them even if the losses are purely economic." *Id.* at 152. By concluding that privity was not a requirement, the district court erred in applying *Flagstaff Affordable Housing*.[11]

Here, there indisputably is no privity. Under Arizona law, privity is the condition of being a party to a contract. *Samsel v. Allstate Ins. Co.*, 199 Ariz. 480, 485, 19 P.3d 621, 626 (App. 2001) ("Privity is that connection or relationship which exists between two or more contracting parties. It arises from the mere fact

[11] Indeed, Arizona commentary in just the few months since the district court's decision has criticized it as failing to apply the privity requirement. *See, e.g.*, Alison R. Christian, *The Best Laid Plans: A Departure from Flagstaff Affordable Housing and the Expansion of the Economic Loss Rule in Arizona*, COMMON DEFENSE, Spring 2012, at 14 (noting that "the *Crown Corr* holding resembled the oft-criticized *Carstens* decision" and that it is "hard to reconcile this holding with existing Arizona law," and ultimately concluding that "[t]he *Crown Corr* holding overlooks the Arizona Supreme Court's treatment of these issues").

of entering into a contract.") (quotation and citations omitted)[12]; *Mac Enters. v. Del E. Webb Dev. Co.*, 132 Ariz. 331, 336, 645 P.2d 1245, 1250 (App. 1982) ("Mac is not a party to the primary lease hence there is no privity of estate or contract between it and Webb.").

Parties are not in privity even when there are, in the court's words, "interrelated contracts." For instance, in *Mac Enterprises*, 132 Ariz. at 336, 645 P.2d at 1250, Webb had a primary lease with Pro Shops, and Pro Shops had a sublease with Mac. The court expressly stated that in these circumstances: "Mac is not a party to the primary lease *hence there is no privity of estate or contract* between it and Webb. Since *there is no privity between them* there can be no waiver of a right, obligation, or undertaking under the primary lease." *Id.* (emphases added). This was so even though the sublease referenced Webb and there were related contracts between Webb and Pro Shops approving of Pro Shops' subleasing. *See id.*

Here, the district court correctly recognized that the parties were "not in direct privity" (ER17). This is beyond dispute. The Authority, while named a third party beneficiary, was not a party to the Subcontract (ER230 ¶12 (citing ER199, 162 §§35.4, 2.2)). Further, the Design/Build Agreement expressly states in

[12] *Vacated on other grounds*, 204 Ariz. 1, 59 P.3d 281 (2002); *see also Mardian Equip. Co. v. St. Paul Fire & Marine Ins. Co.*, No. CV-05-2729-PHX-DGC, 2006 WL 2456214, at *2 (D. Ariz. Aug. 22, 2006) (quoting *Samsel* for this point).

the provision making the Authority a third party beneficiary of subcontracts that it cannot be construed to create "any kind" of "contractual relationship" between any entities other than the direct parties to the agreement (ER34 §1.4; *see also* ER199 §35.4 (Subcontract's similar provision: "Except as expressly provided herein, nothing contained in this Subcontract shall create any contractual or third party beneficiary relationship between any parties other than Hunt and Subcontractor.")).

In the absence of a contract between the parties, the test is simply whether a negligence claim is otherwise cognizable:

> *Rather than rely on the economic loss doctrine to preclude tort claims by non-contracting parties, courts should instead focus on whether the applicable substantive law allows liability in the particular context*. For example, whether a non-contracting party may recover economic losses for a defendant's negligent misrepresentation should depend on whether the elements of that tort are satisfied, including whether the plaintiff is within the limited class of persons to whom the defendant owes a duty.

Flagstaff Affordable Hous., 223 Ariz. at 327-28, 223 P.3d at 671-72 (emphasis added); *see also* Lordan, *supra*, at 152 (explaining that "where parties are not in privity of contract" the parties "will have to consult the underlying substantive tort law to see if tort claims are available").

Subcontractor has never disputed that a negligence claim is otherwise available notwithstanding the lack of privity. *Donnelly*, 139 Ariz. at 187, 677 P.2d at 1295 ("There is no requirement of privity in this state to maintain an action in

tort."). Therefore, *Flagstaff Affordable Housing* requires reversal of the district court's dismissal of the negligence claim.

b. Policy interests further demonstrate why the economic loss rule should not apply in these circumstances.

Under the clear language of *Flagstaff Affordable Housing*, the court erred in applying the economic loss doctrine. Thus, this Court need go no further to reverse. However, to the extent the Court finds them relevant, policy considerations also support reversal under these circumstances.

Flagstaff Affordable Housing identified four main policy interests at stake in determining whether to apply the economic loss doctrine. 223 Ariz. at 325, 223 P.3d at 669; *see also* Lordan, *supra*, at 136-37.

The first, and most important, is "upholding the expectations of the parties." *Flagstaff Affordable Hous.*, 223 Ariz. at 325, 223 P.3d at 669. This weighs heavily against applying the economic loss doctrine to bar the negligence claim in these circumstances. The district court based its ruling to the contrary on the notion that the Authority "chose to allow insurance to bear the burden of risk associated with the project" (ER18). First, this presumes the correctness of the court's ruling on the contract counts. Since that ruling is wrong, as explained above, that conclusion cannot support eliminating the negligence claim. The Authority only agreed to rely on insurance (all supplied by other parties, except for the possibility of phased

turnover) during construction and did not agree to give up on warranty claims or subrogation rights after Substantial Completion.

But more importantly, this statement improperly conflates the *Taylor* rule with the economic loss doctrine analysis. Under *Taylor*, as outlined above, a contract can be enforced contrary to what was intended if the contract is not reasonably susceptible to the intended interpretation. That does not mean that the parties' actual intentions are transmogrified as the court effectively ruled.

It was expressly alleged in the Complaint (ER226-27 ¶¶7(d), 8(a)-(c)), and was expressly accepted by the court (ER9), that the parties actually intended that there would be subrogation remedies after Substantial Completion. Thus, even if the court was correct to interpret the Design/Build Agreement under a *Taylor* analysis as barring subrogation remedies, that does not mean that such a result can erase from history the fact that the expectation of the parties was to the contrary.

The district court also noted that the Design/Build Agreement provides that subcontracts could be submitted to the Authority for review and approval (ER17). This also does not suggest that the parties expected the economic loss doctrine to apply. As noted above, the very same section states that the Subcontract "shall expressly preserve and protect the rights of the Owner under this Agreement with respect to the work to be performed by such Subcontractor" and "will not prejudice

such rights" (ER66 §4.1). Thus, this section evinces no intention to limit rights. To the contrary, it expressly provides that the subcontracting process *cannot* do so.

Furthermore, both the Design/Build Agreement and the Subcontract contain clauses disavowing any "contractual relationship"—the very language that is necessary for the economic loss doctrine to apply. Thus, the parties *did* bargain for their status for purposes of the economic loss rule, and it was to exclude any such "contractual relationship." The only way to "uphold[] the expectation of the parties" that the Authority's rights would be preserved would be to decline to apply the economic loss doctrine to bar the negligence claim.

The second policy discussed was the adequacy of contract remedies. *Flagstaff Affordable Hous.*, 223 Ariz. at 325, 223 P.3d at 669. If the district court's interpretation of the contract is correct, then there are no contract remedies. Thus, the inadequacy of a remedy by contract would weigh against applying the economic loss rule in these circumstances. And if the district court's interpretation is incorrect, then this factor still weighs against applying the economic loss doctrine because, as explained below, Subcontractor's negligence also caused damage to other property besides the Stadium. *See id.* ("When a construction defect causes *only damage to the building itself or other economic loss*, common law contract remedies provide an adequate remedy . . . .") (emphasis added).

The third and fourth policies discussed were accident deterrence and loss-spreading. *See id.* These policies also weigh against applying the economic loss rule. Accidents caused by the negligence of a subcontractor will be deterred by having the subcontractor subject to potential liability. Likewise, losses will be spread out only if the economic loss rule is not applied. Otherwise, Travelers is left without any remedy and Subcontractor can escape any liability for the consequences of its negligence.

Finally, an additional policy concern is the clarity of the rule. As explained by one Arizona authority, "it is difficult enough to know when to apply the Rule even as between contracting parties, much less parties who have no contractual relationship." Lordan, *supra*, at 137. "As we have seen, *Carstens* [applying the doctrine in the absence of privity] made a confusing Rule even more confusing." *Id.* The interest of promoting clarity further supports not applying the rule on these facts.

2. The district court erred in dismissing Travelers' allegations of damage to "other property."

In Arizona, the economic loss doctrine bars tort claims for "damage to the property that is the subject of the contract," but it still "allows tort recovery if there is also physical injury to persons *or other property*." *Flagstaff Affordable Hous.*, 223 Ariz. at 328, 223 P.3d at 672 (emphasis added). The district court erred in failing to apply this rule.

a. The district court improperly concluded that "other property" includes property outside the scope of the subcontractor's work.

In its Complaint, Travelers alleged that the Stadium's roof was damaged as a result of Subcontractor's negligence (ER231-32, 238-39 ¶¶17, 32-34). Travelers further alleged, and it is undisputed, that the scope of Subcontractor's work was limited to the Stadium's exterior and that it did no work on the roof or any other part of the Stadium (ER227-29 ¶10). These allegations were required to be taken as true, and thus this non-Subcontract property was "other property" outside the scope of the economic loss doctrine (CR30 at 15-16).

The "other property" exception applies to any property that is not "the subject of the contract" from which the injury is alleged to derive. *Flagstaff Affordable Hous.*, 223 Ariz. at 328, 223 P.3d at 672. Despite this rule, the district court concluded that the roof was not "other property" by reasoning that "both Contracts treat the fully completed Stadium as the property that is itself the subject of the Contracts" (ER19).

First of all, the reference to "both Contracts" is erroneous. Travelers alleged that Subcontractor breached duties assumed in the Subcontract, not the Design/Build Agreement (ER227-30 ¶¶10-12 (obligations and duties assumed in the Subcontract)).

The notion that the subject of the Subcontract is the "fully completed Stadium," rather than the parts of the Stadium on which Subcontractor was employed to work, does not withstand scrutiny. No subcontractor contracted to provide a "fully completed Stadium." Rather, subcontractors contracted to provide *particular parts* of the Stadium.

The Subcontract's text is clear that the parties are contracting only with regard to a "specific portion" of the Stadium construction project: "Hunt and Subcontractor expressly desire to contract *with respect to a specific portion of the work* for the design/build project hereinafter described" (ER161 (emphasis added)).

Indeed, Attachment II of the Subcontract, entitled "Subcontractor's Scope of Work," expressly defined the Subcontract as being limited to the specific work on the Stadium exterior: "The scope of work of this subcontract is to provide design build services *to complete the Exterior Building Enclosure System*[.]" (ER204 (emphasis added)).

Attachment II goes on to list 35 items that comprised the "*specific* scope of work [that] is included in this subcontract," and all of these involve the Stadium exterior; none of them involve the roof, the speaker systems, or anything other than the work Subcontractor contracted to perform (ER204 (emphasis added)).

The court's conclusion that the subject of the Subcontract was something beyond the contract's scope also does not make any logical sense. The "subject" of something is the matter being governed. *See* BLACK'S LAW DICTIONARY 1465-66 (8th ed. 2004) (defining "subject" as "the matter of concern over which something is created"). The entire Stadium is not governed by the Subcontract, which only provides for the design and construction of the exterior building system. It is simply incongruous and illogical to say that the subject of the Subcontract is anything beyond its scope.

Finally, the district court erred in failing to address how the Arizona Supreme Court would answer this question. As described above, *Flagstaff Affordable Housing* set up a narrow rule focused on privity—*i.e.*, focused on the *specific* contract at issue. It would not accept generalizing or conflation of different contracts in applying this rule. Moreover, as also explained above, the crux of the economic loss doctrine is upholding the expectations of the parties. Where, as here, the parties repeatedly describe the nature of the Subcontract as involving the "specific" work undertaken by the subcontractor, and not the entire project (ER204), it would frustrate the expectations of the parties to construe the subject of the Subcontract otherwise.

Instead of undertaking this inquiry, the court relied on a single inapposite, non-Arizona case, *Indianapolis-Marion County Public Library v. Charlier Clark &*

Linard, P.C., 929 N.E.2d 722 (Ind. 2010). First, *Indianapolis* is not inconsistent with Travelers' argument. That case involved an owner who contracted with a general contractor to renovate a library, and the general contractor, in turn, contracted with two subcontractors to perform the architectural and engineering work for the entire renovation project. *Id.* at 724. The owner alleged that the structural integrity of the whole project was compromised by the architectural and engineering work, and all construction had to be suspended due to the integral nature of their work to the complete project, which resulted in a claim for damages to remedy harm to the entire library. *Id.* at 725-26.

In this context, where "the Library purchased a *complete refurbishing of its library facility* from multiple parties," and "purchased a complete renovation and expansion of *all the components of its facility* as part of a single, highly-integrated transaction," the *Indianapolis* court found that the damage to the building was not damage to "other property," as "the product or service that the Library purchased was the renovated and expanded library facility itself." *Id.* at 731.

Such a holding makes sense; the particular subcontractors were performing services on the *entire* project, so there would be no reason that any part of that work would be outside the scope of the work they were employed to perform. This case does not suggest that "other property" is not defined by the scope of the work undertaken; to the contrary, it confirms that principle.

But even if *Indianapolis* stood for such a proposition, that would hardly be dispositive, as the district court seemed to believe. To the contrary, if the court was going to look to non-Arizona law, it should have also considered the cases Travelers cited, which are directly on point and hold that the scope of the subcontract, not the scope of the general contract, defines the scope of the economic loss doctrine's bar of negligence claims.[13]

As a matter of fact, it is the *Indianapolis* case that identifies the key differences between Indiana and Arizona law. *Indianapolis* recognizes that Arizona is a state where privity is required, and *Indianapolis* expressly distinguished *Flagstaff Affordable Housing* as setting forth the narrower rule for Arizona that the economic loss doctrine is the exception, not the default, when the parties are not in privity:

[13] *See, e.g.*, *Goose Creek Consol. Indep. Sch. Dist. v. Jarrar's Plumbing, Inc.*, 74 S.W.3d 486, 495 (Tex. App. 2002) ("[T]he injury [the owner] alleged, the invasion of sewage and sewer gas into the school buildings [which the general contractor contracted to build], constitutes an injury to property that *was not the subject matter of the contract*, that portion of the contract [the owner] had with [the general contractor] for which [the general contractor] contracted with [the subcontractor], namely the plumbing. Therefore, the injury alleged did not constitute pure economic loss for which Goose Creek could recover only in contract.") (emphasis added); *Thomson v. Espey Huston & Assocs., Inc.*, 899 S.W.2d 415, 422 (Tex. App. 1995) ("In [a distinguishable case], the plaintiff's right to the house derived entirely from his contract with the defendant. *Here, on the other hand, the contract with [the subcontractor engineer] provides only one portion of a larger whole, and damage to other parts of the complex is not merely economic loss to the subject of the contract itself*. . . . If, as [plaintiff] alleges, incompetent engineering services have damaged his building, then [the subcontractor] may be liable for that negligence in tort.") (emphasis added).

> [O]ur default position in Indiana is that in general, there is no liability in tort for pure economic loss caused unintentionally. . . . *Arizona appears to take a different approach in this regard. Instead of using the economic loss rule as its default position in respect of non-contracting parties, it directs Arizona courts to "focus on whether the applicable substantive law allows liability in the particular context*."

Indianapolis, 929 N.E.2d at 736 & n.17 (quoting *Flagstaff Affordable Hous.*, 223 Ariz. at 329, 223 P.3d at 673). Thus, it is *Indianapolis* that has essentially no bearing on Arizona law and should not have been considered.

The court erred in concluding that non-Subcontract property was not "other property" under Arizona's economic loss doctrine.

b. The district court also engaged in improper fact-finding in concluding that the speaker systems were not "other property."

Even if the economic loss doctrine could apply, it would not bar the negligence claim for damages to the speaker systems, which (in addition to being outside the scope of the Subcontract) were specifically alleged to be business personal property.

The district court applied the economic loss doctrine to bar Travelers' claims for damages to the speaker systems by saying that Travelers "provided no argument" and "failed to demonstrate" that the speaker clusters were other property (ER19-20). As an initial matter, the statement that Travelers "provided

no argument" is manifest error. Travelers specifically argued this issue below (CR30 at 14-15).

The court also erred in stating that Travelers "failed to demonstrate" that the speaker clusters were other property. This was a motion to dismiss; Travelers was not required to "demonstrate" anything. All Travelers was required to do was make sufficient allegations in the Complaint to give Subcontractor fair notice of its claims under Rule 8(a).

Travelers clearly met the Rule 8(a) threshold. In the Complaint, Travelers alleged damage not only to the Stadium's facade and its mechanically attached and retractable roofs, but also to "AZSTA's [the Authority's] business personal property," specifically identifying the "sound system speaker clusters" (ER231-32 ¶17). The pleading standard for "other property" has been held satisfied based on much less. *See, e.g.*, *Miidas Greenhouses*, 226 Ariz. at 145, 244 P.3d at 582 (plaintiff "adequately pled damage to 'other property'" by "alleg[ing] damage to [the property] several times" in the complaint and seeking damages that "can be read to encompass not only lost profits, but the lost [property] for which damage was alleged").

Nor should the court have been weighing, as it did, whether there was some "other purpose for such speaker clusters" or whether these were "speaker clusters specifically designed for and built into a football stadium" (ER19-20). These are

evidentiary questions. No court can reach conclusions about these things *as a matter of law* on a motion to dismiss.

Indeed, the only support the court offered for eliminating the "other property" claim for the speaker clusters was that "Audio/Visual equipment and installation was contemplated in the contract as being part of the Stadium" (ER19). Again, it is the Subcontract, not the Design/Build Agreement, that is at issue for this purpose. But regardless, the document to which the court cited (ER123) simply contains a log of "Design Drawing[s]," which say nothing more than "Audio Visual Service Level Reference Plan," "Audio Visual Main Concourse Reference Plan," and the like.

There is absolutely no way a fair-minded court can look at these vague references to "Audio Visual" design plans and conclude that, as a matter of law, these must be references to the speaker system clusters at issue (or even to any actual Audio Visual equipment, as opposed to the facility layout designs). That would be an improper inference even on summary judgment; it certainly cannot be upheld on a motion to dismiss. Indeed, this is a Stadium that cost *hundreds of millions* of dollars to design and build (ER30 Recital J (project budget of $355.3 million)). The list of permissible inferences for what these entries may be referring to is practically endless; it certainly is not clear as a matter of law. The court had

no basis to conclude that it would be impossible for Travelers to "demonstrate" that the speaker clusters at issue were the Authority's business personal property.

The pleading standard was met and the dismissal should be reversed.

CONCLUSION

For the foregoing reasons, the Court should reverse the district court's dismissal on all claims and remand for further proceedings.

RESPECTFULLY SUBMITTED this 7th day of June, 2012.

LEWIS AND ROCA LLP

By /s/ Susan M. Freeman
Susan M. Freeman
William G. Voit
40 North Central Avenue, Suite 1900
Phoenix, Arizona 85004-4429

and

THE LAW OFFICE OF JAMES K. LAROE, P.C.
James K. LaRoe

Attorneys for Plaintiff-Appellant
The Travelers Indemnity Company

CERTIFICATE OF SERVICE

I hereby certify that on June 7, 2012, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF System and filed four copies of Excerpts of Record in Support of Plaintiff-Appellant's Opening Brief - Volume 1 and Volume 2 via First Class United States Mail, postage prepaid.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system. One copy of Excerpts of Record in Support of Plaintiff-Appellant's Opening Brief - Volume 1 and Volume 2 was served via First Class United States Mail, postage prepaid.

/s/ Jeff A. Siatta

CERTIFICATE OF COMPLIANCE

The undersigned certifies that pursuant to FRAP 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached Answering Brief is proportionally spaced, has typeface of 14 or more points, and contains 13,104 words.

/s/ Jeff A. Siatta

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE TRAVELERS INDEMNITY COMPANY, as subrogee of Tourism and Sports Authority, d/b/a Arizona Sports & Tourism Authority, Plaintiff-Appellant, vs. CROWN CORR INCORPORATED, an Indiana corporation, Defendant-Appellee.	No. 12-15170 D.C. No. 2:11-cv-00965-JAT District of Arizona, Phoenix **STATEMENT OF RELATED CASES**

There are no cases deemed to be related to this matter in this Court.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

The Travelers Indemnity Company, as subrogee of Tourism and Sports Authority d/b/a Arizona Sports & Tourism Authority, Plaintiff-Appellant, v. Crown Corr, Inc., an Indiana corporation, Defendant-Appellee.	Ninth Circuit Docket Nos. 12-15170 and 12-16663 District of Arizona (Phoenix) No. 2:11-cv-00965-JAT

ANSWERING BRIEF OF DEFENDANT-APPELLEE CROWN CORR, INC.

RENAUD COOK DRURY MESAROS, PA
John A. Klecan, #019159
James L. Blair, #016125
Denise J. Wachholz, #011526
Kevin R. Myer, #019919
One North Central, Suite 900
Phoenix, Arizona 85004-4417
Telephone: (602) 307-9900
Facsimile: (602) 307-5853

Counsel for Defendant-Appellee Crown Corr, Inc.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, Defendant-Appellee Crown Corr, Incorporated, a for-profit Indiana "sub-S" corporation, hereby states that it is a family-owned company and is not publically traded.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Other Authorities

Rules

INTRODUCTION

In 2003, the Arizona Tourism and Stadium Authority – the insured of Plaintiff/Appellant The Travelers Indemnity Company ("Travelers") – began contracting for the design and construction of a stadium facility ("the Stadium Facility") in Glendale, Arizona for multiple uses, including serving as the home stadium for the National Football League's Arizona Cardinals. The Stadium Authority signed a Design/Build Agreement with Hunt Construction, and Hunt Construction subcontracted with Appellee Crown Corr, Inc., to design and install the Stadium Facility's metal exterior.

The Stadium Facility was completed in July 2006. In 2009, the Stadium Authority purchased property-insurance coverage through Travelers.

On July 29, 2010, a "microburst" swept through the area surrounding the Stadium Facility, felling nearby power lines and damaging neighboring properties, as well as the Stadium Facility itself. [1] The Stadium Authority made claims against its policy with Travelers to repair storm damage to some of the metal panels Crown Corr had installed on the building's exterior, damage to the Stadium Facility's roof, as well as water damage to equipment within the Stadium Facility's interior.

[1] Counsel for Crown Corr made an offer of proof to this effect during the December 19, 2011 oral argument on the Motion to Dismiss the Third Amended Complaint. [*See* Appellees' Supplemental Excerpts of Record ("SER") 4-5.]

Travelers sued to recover its insurance payments. Crown Corr moved to dismiss the complaint on two grounds: first, because Travelers' claims are precluded by its insured's waiver of subrogation in the contracts, and second, because Travelers' negligence claim is barred by Arizona's "economic loss rule."

The district court correctly dismissed the complaint based on controlling authority that holds insurers to their insureds' waivers of subrogation. The district court correctly rejected Travelers' proffered parole evidence designed to contradict these waiver provisions.

The district court also correctly resolved Travelers' negligence claims based on Arizona's "economic loss rule." Arizona's public policy holds the parties' freedom to contract in the highest regard. Accordingly, Arizona's "economic loss rule" prevents an insurer from side-stepping the highly-detailed and tripartite negotiated contractual arrangements between its insured (the owner), the general contractor, and the subcontractors for large-scale construction projects.

The district court's dismissal of Travelers' complaint is well-founded and free from error. Crown Corr respectfully requests that this Court affirm the dismissal and award Crown Corr its fees and costs on appeal.

JURISDICTIONAL STATEMENT

Defendant-Appellee agrees with the Opening Brief's jurisdictional statement, specifically that:

1) the district court had jurisdiction based on diversity of citizenship;

2) the district court's order of dismissal is final and appealable; and

3) Travelers filed a timely notice of appeal.

ISSUES PRESENTED

1. Did the district court correctly refuse to consider parole evidence offered by Travelers to contradict the clear waiver of subrogation that its insured The Stadium Authority had agreed to in the applicable contacts – a waiver that made no limiting reference to the period the Stadium Facility was under construction?

2. Does Arizona's "economic loss rule" bar a property insurer's cause of action for alleged negligent design or negligent construction by a subcontractor that had contracted with both the insured and the general contractor for damage to the Stadium Facility, which was the product of the construction contracts that the insured had negotiated?

STATEMENT OF THE CASE

Defendant-Appellee Crown Corr has no supplement to Travelers' Statement of the Case. [OB 4.]

STATEMENT OF FACTS

I. Factual Background.

A. This Court Should Disregard Travelers' Arguments Regarding The Parties' Alleged Intent Regarding the Contract.

Crown Corr objects to Travelers' recitation of what the parties intended with regard to the relevant provisions of the Contracts described herein. Travelers clearly bases this section on the Affidavit attached to its Third Amended Complaint. [OB 6-7 (citing ER 226, 7(d), which cites the attached "Murphy Affidavit.").]

Although these assertions were before the district court, not only did Crown Corr contest the admissibility of this Affidavit (as evidenced by its Motion to Dismiss), but the district court rejected this Affidavit as an impermissible attempt to change the meaning of the contract through parole evidence. Although this Court must accept Travelers' well-pled allegations as true, this Court need not, and should not, consider the Murphy Affidavit, which the district court did not consider. *See* Argument, I.C., *infra*.

B. The Stadium Authority as Third-Party Beneficiary.

Crown Corr does not contest that, under its tripartite contractual arrangement, the Stadium Authority was intended to be a third-party beneficiary of Hunt's subcontracts.

/ / /

C. The Scope of Crown Corr's Work.

Crown Corr agrees that Hunt hired Crown Corr to design and install the Stadium's Exterior Building Enclosure System (ER227 ¶10; *see also* ER159-222 (the Subcontract)). Crown Corr agrees that the scope of its work did not relate to the roofs or the sound system. (ER227-29 ¶10.) However, as set forth *infra*, the roof and the sound system were part of the Stadium subject to Hunt's Design/Build Agreement with Travelers' insured. *See* Argument, §II.C., *infra*.

D. Travelers' Coverage Began Years After the Stadium Was Complete, and Travelers' Policy Recognized That The Stadium Authority May Have Waived Its Subrogation Rights.

Crown Corr agrees the Stadium Facility reached Substantial Completion on July 28, 2006 and opened on August 1, 2006. (ER231 ¶15.) Crown Corr further agrees Travelers did not begin to insure the Stadium Facility until July 28, 2009.

Crown Corr separately notes that the policy Travelers issued specifically acknowledged that the Stadium Authority may have waived subrogation rights prior to the policy's commencement and that any such waiver would not affect coverage:

> **X. SUBROGATION AND SUBROGATION WAIVER**
>
> 2. Subrogation- All Other Coverages
>
> If any person or organization to or for whom the Company makes payment under this policy has rights to recover damages from another; those rights are transferred to the

> Company to the extent of such payment That person or organization must do everything necessary to secure the Company's rights and must do nothing after the loss to impair them. The Company will be entitled to priority of recovery against any such third party (including interest) to the extent payment has been made by the Company, plus attorney's fees, expenses or costs incurred by the Company.
>
> *But, the Insured may waive its rights against another party by specific written agreement:*
>
> a *Prior to a loss to Covered Property*.
>
> b. After a loss to Covered Property or Covered Income only if, at time of loss, that party is one of the following.
>
> (1) Someone insured by this insurance;
>
> (2) A business firm owned or controlled by the Insured or that owns or controls the Insured; or
>
> (3) The Insured's tenant
>
> *Such waiver will not invalidate or restrict this insurance.*

[SER 92 (emphasis added); cited and argued at CR15, p.7 – policy is CR15-1.]

E. The Damage to the Stadium.

Crown Corr acknowledges that Travelers has alleged damage as described on Page 8 of the Opening Brief and affirmatively states that contrary evidence regarding the windspeeds was proffered. [*See* SER4-5.]

II. Procedural History.

A. Travelers Files Suit.

Travelers' Third Amended Complaint (the operative version of the Complaint for purposes of this appeal) alleged three causes of action: (1) breach of contract by Crown Corr; (2) a contractual right to indemnity from Crown Corr; and (3) negligence in Crown Corr's performance of its obligations established in the Subcontract. [OB 9-10.]

B. Subcontractor Moves to Dismiss.

Crown Corr does not dispute Travelers' description of the arguments raised in the Motion to Dismiss papers, which the district court summarized as follows:

> The main dispute between the Parties concerns the contract language contained in Article 11 of the Design/Build Agreement, entitled "Indemnity, Insurance and Waiver of Subrogation" and Section 8 of the Subcontract, entitled "Insurance Requirements." Defendant argues that the waivers contained in Article 11 and Section 8 clearly show that all Parties to both contracts intended to waive the subrogation rights of any and all insurance companies that paid claims for property damage to the Stadium.

[ER 16, pp.5-6.]

C. The Court Denies Leave to Amend.

Crown Corr does not dispute Travelers' description of the trial court's dismissal of this action, except to note that Travelers has not appealed the trial court's denial of leave to amend.

SUMMARY OF ARGUMENT

The district court correctly concluded that Travelers' insured – The Stadium Authority – waived its claims for property damages. Indeed, this Court has held that an insurer is bound by waivers of subrogation executed by its insured; furthermore, Travelers' own policy anticipates such waivers. The district court was correct in concluding that the plain language of the applicable contracts mandated such a result. The only reasonable meaning of the word "Facility" is a completed facility, as used in the contract – a defined term. Questions of verb tense and other descriptions of the term do not change this meaning. The district court was correct in concluding that Travelers' arguments did not warrant submission to the jury.

The district court also correctly concluded that the "economic loss rule" precluded Travelers' claim for negligence. The rule's chief aim is to preserve the parties' right to contract and, thus, the rule is applied to hold parties to the terms for which they had bargained. The Arizona Supreme Court does not require privity in order to apply the economic loss rule, and other courts have recognized any notion of privity is satisfied by the tripartite contractual relationship between the owner, general contractor, and subcontractors in large construction projects. The district court also rejected Travelers' attempt to escape the rule's applicability by characterizing damage to parts of the Stadium Facility as damage to "other property."

ARGUMENT

I. The District Court Correctly Interpreted the Waiver of Subrogation Provisions in the Contracts to Dismiss Travelers' Contract Claims.

The district court began with the basic principle of holding a sophisticated project owner to the terms of its bargain and found no reason to allow a sophisticated property insurer to escape its insured's prior waiver of subrogation rights, a risk specifically contemplated by Travelers' policy. Travelers nonetheless attempts to escape this waiver by offering parole evidence of the parties' alleged (but unexpressed) intent regarding the scope of the waiver and further argued that its suggested interpretation was proper based on a notion that general waivers of subrogation rights are not favored by law.

Because the plain language of the applicable contract provisions demonstrated a general waiver, and because such waivers are recognized by law, the district court saw no basis by which to consider the parole evidence. Because the Stadium Authority had waived its rights of subrogation (a contingency accounted for in Travelers' own policy), the district court properly concluded that Travelers, as the Stadium Facility's insurer, also was bound by that waiver, and hence, Travelers' claims for subrogation must be dismissed.

A. The Standard of Review is *De Novo*.

Crown Corr agrees that this Court must review the district court's evaluation of the parole evidence de novo, just as this Court must review the dismissal

pursuant to Federal Rule of Civil Procedure 12(b)(6) *de novo*. *See, e.g., Kaiser Aluminum & Chem. Corp. v. Catellus Dev. Corp.*, 976 F. 2d 1338, 1340 (9th Cir. 1992).

When a plaintiff's claim is based on contracts that preclude relief, dismissal with prejudice should be granted under Rule 12(b)(6). *See, e.g., Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007); *Smith v. Cent. Ariz. Water Conservation Dist.*, 418 F.3d 1028 (9th Cir. 2005). *See also City of Phoenix v. Leo A. Daly Co.*, 2007 WL 3046758 at *3-*4 (D. Ariz. 2007) (architect's counterclaim for failure to obtain insurance dismissed with prejudice under Rule 12(b)(6), because district court concluded counterclaimant was not third-party beneficiary of construction contract between owner and general contractor).

As is demonstrated below, the district court properly dismissed Travelers' Complaint because the Stadium Authority waived its right to subrogation well before the Stadium Facility was completed. Because Arizona courts recognize waivers of subrogation, and given the acknowledgement in Travelers' own policy that the Stadium Authority "may waive" subrogation prior to the policy's commencement [*see* Statement of Facts, §I.D., *supra*], the district court committed no error in construing the plain language of the policy against Travelers to preclude its claims.

/ / /

B. Arizona Courts Recognize Waivers of the Right tor Subrogation.

The district court's interpretation of the contracts was informed by precedent demonstrating that waivers of subrogation are common contract provisions that are routinely upheld.

The law is well-settled that a "right of subrogation may be modified or *extinguished* by contract," *Hardware Mut. Ins. Co. v. Dunwoody*, 194 F.2d 666, 668 (9th Cir. 1952) (emphasis added), *quoted in Olivas v. U.S.*, 506 F.2d 1158, 1165 (9th Cir. 1974) (construction-site injury case). Furthermore, waivers of subrogation apply to negligence claims against subcontractors. *See, e.g., The Midwestern Indem. Co. v. Sys. Builders, Inc.*, 801 N.E.2d 661, 671 (Ind. App. 2004); *1800 Ocotillo, LLC v. The WLB Group, Inc.*, 219 Ariz. 200, 196 P.3d 222 (2008) (enforcement of liability limitation provision in agreement for professional services between owner of townhouse project and engineer hired to prepare boundary line survey, limiting engineer's liability to amount of fees actually paid). The reason that waiver provisions should be construed against the insurer is because the insurer's subrogation rights are derivative of its insured's rights:

> [A]n insurer "step[s] into the shoes of the insured and assert[s] the insured's rights against the third party." … Subrogation is thus a purely derivative doctrine: "An insurer entitled to subrogation is in the same position as an assignee of the insured's claim, and succeeds only to the rights of the insured. . . . Thus, an insurer cannot acquire by subrogation anything to which the insured has no rights, and may claim no rights which the insured does not have."

Chandler v. State Farm Mut. Auto. Ins. Co., 598 F.3d 1115, 1118 (9th Cir. 2010). (internal citations omitted) (quoting, respectively, *Progressive West Ins. Co. v. Superior Court*, 37 Cal.Rptr.3d 434, 441 (Cal.App. 2006), and *Transcon. Ins. Co. v. Ins. Co. of Pennsylvania*, 56 Cal.Rptr.3d 491, 498 (Cal.App. 2007)).

A property insurer that pays a claim that its insured waived as to subcontractors may not, as Travelers is attempting to do here, sue to recover from a subcontractor. In *U.S. Fid. & Guar. Co. v. Farrar's Plumbing & Heating Co.*, 158 Ariz. 354, 762 P.2d 641 (App. 1988), the Arizona Court of Appeals upheld summary judgment in favor of an allegedly negligent plumbing subcontractor and against the owner's property insurer that paid for a total fire loss, finding the subcontractor to be a third-party beneficiary of the waiver of subrogation in the prime contract. *Id.* at 355, 762 P.2d at 642. As the district court recognized with respect to the holding in *Farrar's Plumbing*, such waivers must apply to subcontractors: "Otherwise, there would have been no reason to include subcontractors in the waiver provision." [ER 12, ln.15-17.] *See also Farrar's Plumbing*, 158 Ariz. at 355, 762 P.2d at 642 ("we believe it clear that Farrar was an intended beneficiary of those clauses. They would make no sense otherwise.").

The district court also relied on *Monterey Homes Arizona, Inc., v. Federated Mut. Ins. Co.*, 221 Ariz. 351, 212 P.3d 43 (App. 2009), for the proposition that

> if the insured releases its claims against the third party-*even without the insurer's consent*-the insurer will be barred from asserting that

claim against the third party by way of subrogation.

[*see* ER13 ln.10-17 (citing *Monterey Homes*, 221 Ariz. at 355 ¶13, 212 P.3d at 47) (emphasis added).] Just as this Court recognized in *Chandler* (*see* above), the Arizona Court of Appeals explained its holding based on the derivative nature of subrogation:

> [B]ecause an insurer's right to subrogation derives from its insured's right to recover against the third party, the actions of the insured may affect the insurer's right to subrogation. … The insurer essentially stands in the shoes of the insured, taking on the insured's rights and remedies as against the third party but also becoming subject to the defenses the third party could assert against the insured.

Monterey Homes, 221 Ariz. at 355 ¶13, 212 P.3d at 47 (internal citations omitted). Regardless whether some jurisdictions are reluctant to bind an insurer to an insured's prior waiver of subrogation rights,[2] the district court correctly noted that Arizona law governs this contract, and "[u]nder Arizona law [*i.e.*, *Monterrey*], there is no doubt" regarding Arizona's willingness to hold insurers to these waivers. [ER13 ln.10-17.] Additionally, given that Travelers' policy explicitly accounted for the possibility that the Stadium Authority may have waived its rights, any argument by Travelers that this provision cannot be construed against their interests is not compelling.

[2] [*See* ER13 n.9 (citing *Universal Underwriters Ins. Co. v. A.Richard Kacin, Inc.*, 916 A.2d 686, 692-93 (Pa. Super. 2007)).]

Furthermore, the district court noted that "[a]n important exception to this rule is that 'an insurer will retain its rights to pursue subrogation from the third party if the third party knew of the insurer's subrogation interests *before* it obtained the release from the insured.'" [*See* ER13 n.10 (quoting *Monterey Homes*, 221 Ariz. at 355 ¶13, 212 P.3d at 47) (emphasis added).] Given that Travelers did not begin insuring the Stadium Facility until three (3) years after its completion, the only exception recognized in Arizona law to binding insurers to their insured's waivers does not apply in this case.

C. Other Courts Recognize Subrogation Waivers That Bar Future Property Insurers.

Crown Corr cited to the district court several cases from other jurisdictions upholding subrogation waivers in construction contracts against property insurers after construction is complete. Such waivers will bar an insurer's lawsuit against contractors for recovery of post-construction losses. *See, e.g., TX.C.C., Inc. v. Wilson/Barnes General Contractors, Inc.*, 233 S.W.3d 562, 567-71 (Tex. App. 2007) (when restaurant burned down three years after construction was completed, property insurer's subrogation action against general contractor, and subcontractor that installed faulty fireplace, dismissed applying waiver of subrogation in construction contract); *Argonaut Great Central Ins. Co. v. DiTocco Konstruction, Inc.*, 2007 WL 4554219 at *5-*8 (D.N.J. 2007) (waiver of subrogation in construction contract applied five years after construction completed to preclude

insurer's lawsuit against contractor for fire damage); *Midwestern Indem. Co. v. Sys. Builders, Inc.*, 801 N.E.2d 661, 669-70 (Ind. App. 2004) (same); *Colonial Props. Realty L.P. v. Lowder Constr. Co.*, 567 S.E.2d 389, 393 (Ga. App. 2002) ("Whe[n] the parties to a commercial construction project agree to shift the risk of loss to the owner's insurer even after the project is completed, an injury to the public interest does not clearly appear."). These courts have found that the plain meaning of the subrogation waiver provisions in the construction contracts before them did not permit the property insurer to recover from the contractors, even after completion.

Travelers attempts to resolve all of these cases in a footnote, claiming that because all of these cases rely involve AIA-approved contracts, these waiver provisions were enforceable because the provisions included language regarding the "final payment," which demonstrates when the waiver would end. [OB 35, n.8.] However, whether these Contracts were based on AIA forms is immaterial; simply because AIA contracts generally have certain provisions, AIA practices do not require courts to read such provisions into all contracts. The ruling in this case must stand or fall on the language of the contracts at issue, not on what general practices in the construction industry might be.

Given these principles – knowing that Arizona law upholds the waiver of subrogation rights and binds a future insurer to decisions, such as an agreement by

its insured to waive those rights, and that other courts have recognized that such waivers can bind future property insurers, as well as the language in Travelers' policy that contemplated such a waiver (*see* Statement of Facts, §I.D, *supra*) – the district court's conclusion that Travelers should not be permitted to introduce parole evidence regarding the parties' intent with respect to the subrogation waiver is justified, as demonstrated below.

D. The District Court Properly Interpreted the Contract.

The district court was mindful of the general principles applicable to interpreting contracts. It is a matter of law for the Court to decide what a contract says, and to then give effect to clear and unambiguous contract provisions. *See, e.g.*, *Hadley v. Southwest Props.*, 116 Ariz. 503, 506, 570 P.2d 190, 193 (1977) (summary judgment granted to defendants on property seller's damage claim because the contract for sale of the property limited seller to forfeiture remedy). *Accord Grubb & Ellis Mgmnt Servs., Inc. v. 407417 B.C., LLC*, 213 Ariz. 83, 86 ¶12, 138 P.3d 1210, 1213 (App. 2007) ("A general principle of contract law is that when parties bind themselves by a lawful contract the terms of which are clear and unambiguous, a court must give effect to the contract as written."); *Sprint Comms. Co. v. Western Innovations, Inc.*, 618 F.Supp.2d 1101, 1118 (D. Ariz. 2009) (citing *Grubb & Ellis*); *Biltmore Bank of Ariz. v. First Nat'l Mortgage Sources, LLC*, 2008 WL 564833 at *7 (D. Ariz. 2008) (citing *Hadley*).

The district court began its analysis with the applicable provision from the Design/Build Agreement that addressed the waiver of subrogation rights:

Section 11.4.6 of the Design/Build Agreement provides,

> The Parties waive subrogation against one another, the Design/Builder, Design Consultants, Subcontractors, and their respective agents and employees on all property and consequential loss policies that may be carried by any of them on adjacent properties and under property and consequential loss policies purchased for the Facility.

[ER7 (citing Design/Build Agreement at 75, § 11.4.6).] Crown Corr notes that this provision does not include any limiting language that suggests that the waiver applies only to the period of construction, as Travelers suggests.

The district court also cited the relevant provision of the Subcontract that released Crown Corr from damages covered by property insurance:

In addition to incorporating the terms of the Design/Build Agreement into the Subcontract, Section 8.3 of the Subcontract provides:

> Release: The Subcontractor hereby releases, and shall cause its subconsultants, subcontractors and suppliers of any level ("Releasing Parties") to release Design-Builder [Hunt Construction Group, Inc.], the Owner [the Arizona Cardinals and Tourism and Sports Authority], and their respective members, managers, officers, directors, consultants, employees and agents (the "Released Parties") from any and all claims or causes of action whatsoever which the Releasing Parties might otherwise possess resulting in or from or in any way connected with any loss covered and actually paid or which would have

> been covered by an insurance policy as agreed by the parties hereunder but for the Releasing Parties' failure to purchase, maintain, or properly file claims under such policy. This release is further intended to bind the Releasing Parties' insurers, and the Subcontractor agrees to inform and obtain permission from it insurers, and further agrees to require the other Releasing Parties to inform and obtain permission from their insurers, to so release the above, so as to effectively waive any subrogation rights of said insurers. *The Released Parties hereby release the Releasing Parties, and their respective members, managers, officers, directors, consultants, subcontractors, employees and agents from any and all claims or causes of action whatsoever which any of the Released Parties might otherwise possess resulting in or from or in any way connected with any loss to the extent it is covered and actually paid by any insurance policy provided hereunder or any other insurance policy otherwise available to the Released Party or that should have been covered by any insurance policy any Released Party was required to maintain. If the policies of insurance referred to in this Section require an endorsement to provide for continued coverage where there is a waiver of subrogation, the owners of such insurance policies will cause them to be so endorsed*.

[ER7-8 (citing Subcontract at 16, § 8.3) (emphasis in original.)]

The district court further concluded that these provisions from the two contracts should be read together:

> Section 2 of the Subcontract provides that the Subcontract and the Design/Build Agreement "are intended to supplement and complement each other and shall, where possible, be so interpreted." Subcontract at 2, ¶ 2.2. Further, the Design/Build Agreement was incorporated by reference into the Subcontract. The Subcontract states, "Subcontractor is bound thereby as if the text of these documents were written verbatim into this Subcontract." Id. at ¶ 2.3. The Subcontract also provides, "The terms and provisions of this

> Subcontract relating to Subcontractor's Work are in addition to and not in substitution of any terms and conditions of the Contract Documents." Id. at 5, ¶ 3.5(f).

[ER7 n.4.]

The district court then noted that Travelers had submitted an affidavit from a consultant for the Stadium Authority that proposed an interpretation of these provisions contrary to their plain language. However, the district court correctly concluded that Travelers' proffered parole evidence could not be admitted because it would change the plain language of the waiver provisions.

E. The District Court Correctly Concluded The Contracts' Provisions Were Not Ambiguous, Thereby Precluding Travelers' Proffered Parole Evidence.

Arizona law does not allow courts to "pervert or do violence to the language used [in a contract] or [to] expand it beyond its plain and ordinary meaning or [to] add something to the contract which the parties have not put there." *D.M.A.F.B. Fed. Credit Union v. Employers Mut. Liab. Ins. Co.*, 96 Ariz. 399, 403, 396 P.2d 20, 23 (1964), *quoted in Emp'rs Mut. Cas. Co. v. DGG & CAR, Inc.*, 218 Ariz. 262, 267 ¶24, 183 P.3d 513, 518 (2008). When, as in this case, the parties' agreement is clearly stated in their contract,

> there is no room for construction or interpretation and a court may not resort thereto.

Goodman v. Newzona Inv. Co., 101 Ariz. 470, 472, 421 P.2d 318, 320 (1966), *quoted in Mining Inv. Group, LLC v. Roberts*, 217 Ariz. 635, 639, 177 P.3d 1207,

1211 (App. 2008) (internal citation omitted).

Citing the precedent found in *Long v. City of Glendale*, 208 Ariz. 319, 93 P.3d 519 (App. 2004), the district court explained why Travelers' affidavit regarding the intent of the parties could not be considered:

> Arizona law provides that, before accepting as true allegations of the intent of the Parties to interpret a written agreement, the Court must first consider the interpretation offered through such allegations. *Id*. Next, the Court should consider the language of the writing. *Id.* If the Court finds that the writing is 'reasonably susceptible' to the interpretation suggested by those allegations, the Court may consider whether that interpretation could entitle the Plaintiff to relief in deciding a motion to dismiss. *Id.* (internal citation omitted).

[ER10 ln.03-09 (citing *Long*, 208 Ariz. at 319 ¶28, 93 P.3d at 528).]

The court in *Long* relied on the Arizona Supreme Court's holding in *Taylor v. State Farm Mut. Auto. Ins. Co.*, 175 Ariz. 148, 152, 854 P.2d 1134, 1138 (1993). *See Long*, 208 Ariz. at 328 ¶27, 93 P.3d at 528 (citing *Taylor*). But, contrary to Travelers' assertions [*see* OB 17], *Taylor* does not hold that a court must consider parole evidence unless the proffered interpretation is so unreasonable or extraordinary as to be absurd. Even *Taylor* held that a trial court's evaluation of the proffered meaning or intent of a contract "*is a matter for sound judicial discretion and common sense*." *Taylor*, 175 Ariz. at 153, 854 P.2d at 1139 (quoting 6 Arthur L. Corbin, CORBIN ON CONTRACTS §579 at 127 (interim ed. 2002)) (emphasis added). Certainly courts following *Taylor* have been able to reject the proffered arguments of some parties; not all alternative interpretations must be given

credence. *See, e.g.*, *IB Prop. Holdings, LLC v. Rancho Del Mar Apartments Ltd. P'ship*, 228 Ariz. 61, 68 ¶27, 263 P.3d 69, 76 (App. 2011) (quoting above citation from *Taylor* and CORBIN and holding, "Here, no interpretation of the easement is required because the meaning of its terms is clear."); *Nahom v. Blue Cross and Blue Shield of Arizona, Inc.*, 180 Ariz. 548, 552, 885 P.2d 1113, 1117 (App. 1994) (same, quoting CORBIN for the proposition that the point at which a judge stops "listening to testimony that white is black and that a dollar is fifty cents is a matter for sound judicial discretion and common sense.").

In this case, the district court considered the allegations raised by Travelers and compared them to the contracts. The district court ultimately concluded that

> the meaning of the term "Facility" is clear on the face of the Design/Build Agreement and is not reasonably susceptible to Plaintiff's interpretation.

[ER11 ln.01-04.] Travelers bases its argument for ambiguity in the waiver provision on two theories: 1) the terms of the contract did not permit the district court to read the term "Facility" as the completed Facility, and 2) without some limiting terms, the waiver in this case is ambiguous. Both of these arguments are unavailing, as addressed below.

F. The District Court's Interpretation of "Facility" Was the Only Reasonable One.

1. The Term "Facility" Means The Completed Stadium.

Travelers first suggests that the district court "significantly rearranged the

language" of the definition of "Facility" found in Recital A of the Design/Build Agreement. [OB 23.] The Definition section (1.5) of the Design/Build Agreement defines "Facility" as "ha[ving] the meaning as set forth in Recital A." [ER 36.] Recital A defines "Facility" as follows:

> The Authority is a political subdivision of the State of Arizona empowered by A.R.S. §5-801, *et seq.*, as amended (the "Act") to construct, finance, furnish, maintain, improve, own, operate, market and provide a multipurpose stadium facility (the "Facility"), the primary purpose of which will be to accommodate professional football franchises, major collect football bowl sponsors, other sporting events, and entertainment, cultural, civic, meeting, trade show or convention events or activities.

(ER27.) The district court focused on the purpose of the Facility:

> Recital A of the Design/Build Agreement defines Facility as "a multipurpose stadium Facility," "the primary purpose of which will be to accommodate professional football franchises, major college football bowl sponsors, other sporting events, and entertainment, cultural, civic, meeting, trade show or convention events or activities." (*Id*. at 1).

[ER10 ln.15-24.] The district court quoted the language precisely from Recital A and even cited the two quoted phrases in the same order found in Recital A. Crown Corr fails to see how this has been "significantly rearranged." Travelers contends that the "purpose" description explains how the Facility will be used when complete. Crown Corr agrees but also submits that this description indicates *when* one should conclude that the Facility is complete, thereby triggering the waiver.

> The argument that the use of the future tense in the description somehow

must limit the meaning of "Facility" to only a less than Substantially Completed stadium [OB 24] is not convincing. The agreement was written before the Facility was completed; at the time of drafting, the Facility did not exist and, therefore, could not be described in the present tense. The description of the Facility's future purpose properly relied on the future tense.

Travelers also notes that Recital A describes activities that would occur during the Stadium's construction and, thus, the term must be limited only to the Stadium before Substantial Completion. [OB 24-25.] However, this description of authority simply refers to the complete range of actions that the Stadium Authority is authorized by statute to undertake; these terms do not limit the definition of the word "Facility" or restrict its application to a period *before* the Facility is complete.

Additionally, Travelers neglects to highlight the actions in Recital A that clearly apply only after the Stadium was Substantially Completed. *See, e.g.*, Recital A ("own, operate, market and provide"). None of these activities could be completed or performed before the Stadium Facility was completed. Thus, none of Travelers' arguments reasonably suggests that the term Facility is ambiguous, thereby requiring parole evidence to interpret the intent of the parties.

As Travelers notes [OB 25-27], the district court contrasted the term "Facility" with the terms "Work" and the term "Project":

> In contrast, the Design/Build Agreement defines "Work" as "all design and construction services necessary for the timely and proper design, construction and furnishing of the fully equipped and operational Facility in accordance with this Agreement. . ." Design/Build Agreement at 11, § 1.5. Similarly, "Project" is defined as "the design, construction, and furnishing of the fully equipped and operational Facility."

[ER10 ln.20-24.] The district court concluded that the "plain meaning conveyed by these definitions" permitted no ambiguity, and that:

> when the Parties refer to the Stadium before completion, they use either "Work" or "Project" and when they refer to the Stadium after it is fully operational, they use the term "Facility."

[ER11 ln.01-05.] Travelers attempts to use the fact that "Work" includes the phrase "the fully equipped and operational Facility," to suggest that those terms are required to further define "Facility," otherwise the words would constitute "surplusage." However, the district court simply recognized the consistency in these terms, in that only the fully equipped and operational Facility could be used for its purpose "to accommodate professional football franchises, major college football bowl sponsors, other sporting events, and entertainment, cultural, civic, meeting, trade show or convention events or activities." ["Recital A," *supra*.]

Nor does the inclusion of the same phrase in the definition of "Project" transform Travelers' desired interpretation of the contract into a reasonable interpretation. Rather than finding ambiguity, the district court found consistency in its interpretation of the Contracts, lending further support to its conclusion that

no ambiguity existed and, thus, parole evidence would be impermissible.

Travelers then argues the converse of its previous argument, suggesting that if these terms do not require its interpretation, they do not preclude its interpretation. [OB 26-27.] This is the *not* the standard for contract interpretation. Rather, it is a tortured effort to reach a preferred conclusion.

The district court used its "common sense" to determine when to "stop listening" to Travelers' argument and conclude that its arguments regarding the parties' intent was not reasonable. *See e.g., IB Prop. Holdings*, 228 Ariz. at 68 ¶27, 263 P.3d at 76; *Nahom*, 180 Ariz. at 552, 885 P.2d at 1117.

2. The Balance of Article 11.4 Does Not Make Travelers' Arguments Regarding the Parties' Intent Reasonable.

Travelers next argues that because other provisions in Article 11.4 of The Design/Build Agreement expire at substantial completion, the subrogation waiver also should expire at substantial completion. [OB 29-32.] The district court, as should this Court, easily rejected this argument:

> Moreover, other sections of Article 11 support the Court's conclusion that if the Parties intended to limit the waivers only to insurance carried before substantial completion, they would have clearly stated that intention. For instance, when discussing the Design/Builder's obligation to carry property insurance, the Contract provides, "Insurance to apply to the construction term from Commencement of Construction to Substantial Completion or the first major public event at the Facility, whichever is first." (Design/Build Agreement at 73, § 11.4.1(m)). *This indicates to the Court that the Parties were aware that some insurance policies would only be carried through substantial completion and yet the subrogation waiver states that it*

applies to all "property policies purchased for the Facility."

[ER11 ln.11-19.]

3. The Entire Contract Supports the Court's Interpretation.

Most of the arguments in Travelers' final section of this portion of its brief [OB 32-35] recycle Travelers' earlier claims about surplusage and verb tenses. The only new argument in this section is a self-serving argument that the district court's construction is not reasonable in light of the outcome of application of the waiver.

If a waiver is permitted, Travelers argues, the purpose of the contract is eliminated and the "warranties in the contract for quality work" are "eviscerated." First, as demonstrated herein, other courts have held property insurers bound to the waivers of their insureds. (*See* this section, §I.C, *supra*.) Furthermore, Travelers' own policy recognized that The Stadium Authority might have waived these rights (*see* Statement of Facts, §I.D, *supra*) and nonetheless proceeded to provide coverage.

G. The Use of the Term "Facility," Which Means the Completed Stadium, Removes Any Ambiguity As to the Scope of the Waiver Provision In These Contracts.

Travelers cites *Auto. Ins. Co. v. United H.R.B. Gen. Contractors, Inc.*, 876 S.W.2d 791, 793-94 (Mo. App. 1994), for the proposition that when a contract "contains no express language as to the duration of the waiver," the purported subrogation (Subparagraph 11.3) "waiver was inapplicable after completion of the

project and final payment on the contract" in that case. 876 S.W.2d at 793-94. However, Travelers omits the fact that in *H.R.B.*, the court recognized that the contract also included a provision (Subparagraph 9.9.4.2) that provided the owner with a specific right to continue to pursue construction-defect claims even after completion of the project. *See* 876 S.W.2d at 794 ("This provision expressly reserves the Owner's right to bring claims after final payment for defective work.").

Given this provision that retained the right of the owner to pursue construction-defect claims after completion, the court believed that the only reasonable interpretation of the purported waiver provision (11.3.6) in that case – in light of the retention of subrogation rights in 9.9.4.2 – was to waive claims during construction. Contrary to Travelers' argument, the mere fact that the contract in *H.R.B.* did not have express language on the duration of the waiver was not the sole factor that resulted in the holding of that case.

Travelers also cites *Hartford Underwriters Insurance Co. v. Phoebus*, 979 A.2d 299 (Md. App. 2009), and its opinion on appeal, *John L. Mattingly Constr. Co. v. Hartford Underwriters Insurance Co.*, 999 A.2d 1066, 1072-73, 1078 (Md. 2010), for the proposition that any waiver without a limitation addressing "post-completion" is inherently ambiguous. [OB 21.] However, the operative word in the waiver provision in these cases was the word "Work," which could mean both pre-

and post-completion. *See John L. Mattingly Constr.*, 999 A.2d at 1074 ("Hartford counters that the use of the phrase "the Work" varies throughout the contract, such that the waivers of subrogation clause is rendered ambiguous."); *Phoebus*, 979 A.2d at 305 ("Our initial focus in interpreting the Contract in this case must be on the meaning of the phrase 'other property insurance applicable to the Work,' in the Waivers of Subrogation clause … .").

In this case, the district court recognized the distinction between the use of terms such as "Work" and "Project" in the Contracts, and contrasted those terms with the term "Facility," to conclude that the "Facility" necessarily included sufficient finality to permit this waiver to apply to post-construction claims as well. Because Travelers' cited cases do not deal with similar language or similarly-structured contracts, their authority is inapposite.

H. Conclusion Summary: Subrogation Waiver.

Arizona law makes clear that subrogation rights can be waived. The district court also recognized that many courts have bound future insurers to subrogation waivers previously negotiated and executed by their insureds. The Contracts in this case present such a scenario.

Travelers' only method of setting aside this ruling is to convince this Court that the term "Facility" is somehow ambiguous, thereby requiring parole evidence regarding the parties' intent of the scope of the waiver. However, the district court

correctly applied principles of construction to the contract language and found no ambiguity.

Crown Corr respectfully submits that this Court should uphold the district court's decision to hold Travelers to the terms of the contract that its insured, the Stadium Authority, had negotiated and, accordingly, affirm the dismissal of Travelers' contract claims for subrogation.

II. The District Court Correctly Applied Arizona's "Economic Loss Rule" to Dismiss Plaintiff's Negligence Claims.

The district court dismissed Count III of Travelers' Complaint – a negligence claim – based on the "economic loss rule." The district court explained the applicable principles:

> Under Arizona law, the economic loss doctrine prevents a plaintiff who contracts for construction from recovering in tort for purely economic loss, unless the contract otherwise provides. *Flagstaff Affordable Housing Ltd. P'ship v. Design Alliance, Inc.*, [223 Ariz. 320, 326-27,] 223 P.3d 664, 670-71 (Ariz. 2010). "The doctrine does not bar tort recovery when the economic loss is accompanied by physical injury to persons or other property." *Id.*

[ER 16.] The district court then explained why the economic loss rule should preclude Travelers' recovery in tort for its claimed losses in this case:

> The Contracts were specifically negotiated with the Stadium project in mind and the Parties allocated risks and remedies in their agreements. The Parties did not agree to preserve tort remedies, but instead agreed to waive subrogation against all Parties, subcontractors, and design consultants. Tourism and Sports Authority had plenty of opportunities to assert its right to tort remedies, but instead chose to allow insurance to bear the burden of risk associated with the project. … Accordingly, because all Parties contracted for the risks and remedies related to the project, project, the economic loss doctrine necessarily limits the Parties to their contractual remedies.

[ER 17:ln.03-20.]

The district court recognized that Arizona's objective in applying the "economic loss rule" is to respect the parties' freedom to contract by holding parties to the bargains that they negotiated. To prevent duplicative causes of action

in tort concerning the detailed negotiations of sophisticated parties, in which risk can be allocated and protected against in many ways, the Arizona Supreme Court looks to use the "economic loss rule" to limit the parties to those rights enumerated in contract.

Travelers argues the "economic loss rule" does not apply for two reasons: 1) there was no contractual relationship between Travelers and Crown Corr; and 2) there was damage to "other property," because the falling panels damaged not only the exterior of the Stadium Facility (i.e., Crown Corr's contribution to the project), but also the roofing system and the sound system speaker clusters. As demonstrated below, the district court properly rejected these arguments.

A. The Standard of Review is *De Novo*.

Crown Corr agrees that this Court reviews *de novo* the district court's application of the economic loss rule. *See, e.g., Giles v. Gen. Motors Acceptance Corp.*, 494 F.3d 865, 872 (9th Cir. 2007) (district court's application of state substantive law).

B. The Focus of Arizona's Economic Loss Rule is to Promote the Right and Freedom to Contract.

The Arizona Supreme Court summarized its reformulation of the "economic loss rule" in *Flagstaff Affordable Housing* as follows:

> The economic loss doctrine appropriately applies in [construction defect cases] because construction contracts typically are negotiated on a project-specific basis and the parties should be encouraged to

> prospectively allocate risk and identify remedies within their agreements. These goals would be undermined by an approach that allowed extra-contractual recovery for economic loss based not on the agreement itself, but instead on a court's post hoc determination that a construction defect posed risks of other loss or was somehow accidental in nature.
>
> In sum, in the context of construction defects, we adopt a version of the economic loss doctrine and hold that *a plaintiff who contracts for construction cannot recover in tort for purely economic loss, unless the contract otherwise provides*. The doctrine does not bar tort recovery when economic loss is accompanied by physical injury to persons or other property.

Flagstaff Affordable Housing, 223 P.3d at 670-71 ¶¶32-33.

The Arizona Supreme Court has established an economic loss rule that "may vary in its application depending on context-specific analysis," and focused on the importance of applying the rule to an industry with very developed and negotiated contractual rights:

> [t]he contract law policy of upholding the expectations of the parties has as much, if not greater, force in construction defect cases as in product defect cases. Construction-related contracts often are negotiated between the parties on a project-specific basis and have detailed provisions allocating risks of loss and specifying remedies. In this context, allowing tort claims poses a greater danger of undermining the policy concerns of contract law. That law seeks to encourage parties to order their prospective relationships, including the allocation of risk of future losses and the identification of remedies, and to enforce any resulting agreement consistent with the parties' expectations.

Flagstaff Affordable Housing, 223 P.3d 664, 670-71 ¶¶25. The Arizona Supreme Court uses the word "privity" in *Flagstaff Affordable Housing* to denote when a

claimant may "pursue contractual remedies":

> The principal function of the economic loss doctrine, in our view, is to encourage private ordering of economic relationships and to uphold the expectations of the parties by limiting a plaintiff to contractual remedies for loss of the benefit of the bargain. These concerns are not implicated when the plaintiff lacks privity and *cannot pursue contractual remedies.*

223 Ariz. at 327 ¶38 (emphasis added). The district court recognized this distinction, as well as the importance under the new formulation of the rule to focus on the remedies for which the parties previously had bargained:

> Upon consideration of these policies, the *Flagstaff* court concluded that "in construction defect cases, 'the polices of the law generally will be best served by leaving the parties to their commercial remedies' when a contracting party has incurred only 'economic loss, in the form of repair costs, diminished value, or lost profits.'" The doctrine thus "respects the expectations of the parties when, as will often be true, they have expressly addressed liability and remedies in their contract . . . and if the parties do not provide otherwise in their contract, they will be limited to contractual remedies for any loss of the bargain resulting from construction defects that do not cause personal injury or damage to other property."

[ER17 ln.05-13.] The district court then applied the principles of *Flagstaff Affordable Housing* to this case*:*

> In this case, in both the Design/Build Agreement and the Subcontract, the Parties expressly addressed liability and remedies. In the Design/Build Agreement, the Parties agreed that insurance carried by any of them on the Stadium would cover property damage to the Stadium and they mutually agreed to waive subrogation claims, not only against each other, but also against design professionals and subcontractors. As noted above, Defendant, as a subcontractor, was clearly an intended third party beneficiary of that contract. Further, as noted above, the Design/Build Agreement provided that all

> agreements with subcontractors, like the Subcontract at issue here, "shall be submitted to" [Tourism and Sports Authority] for its review and approval." *See* Design/Build Agreement at 39, § 4.1.

[ER17 ln.18-26.]

The holding of the opinion pertains to the types of transactions to which the rule should apply. Travelers (or, more importantly, its insured, the Stadium Authority) simply does not suffer the same lack of connection and input in this Project that the architect had in *Donnelly Construction Co. v. Oberg/Hunt/Gilleland*, 139 Ariz. 184, 677 P.2d 1292 (1984). In *Donnelly*, the architect was hired by the general contractor and did not have a contractual relationship with the sub-contractor that was hindered by the incorrect plans. In this case, Travelers is "standing in the shoes" of the Stadium Authority, which did have privity of contract with Crown Corr – as an express third-party beneficiary of a sub-contract that the Stadium Authority had the right to review and approve. [ER12 ln.08-09.]

Travelers' reliance on two attorneys' speculation (the articles by Lordan and Christian) is not binding on this Court. [OB 43.] Furthermore, Mr. Lordan's analysis fails to account for the new formulation of the rule. *Flagstaff Affordable Housing* did more than simply resolve a possible tension between *Donnelly* and *Carstens v. City of Phoenix*, 206 Ariz. 123, 75 P.3d 1081 (App. 2003), on the issue of privity. Instead, the court in *Flagstaff Affordable Housing* announced an

overarching purpose for application of the economic loss rule: the importance of holding sophisticated parties of equal bargaining power in specific industries to their heavily-negotiated contracts. The holding of *Flagstaff Affordable Housing* is that construction-defect allegations warrant application of the rule if the parties litigating had negotiated the terms of the contract.

The district court recognized the fundamental requirement of the "economic loss rule" by rejecting Travelers' arguments on privity:

> [b]ecause of the complex contractual relationships in construction defect cases, courts have extended the economic loss doctrine to interrelated contracts where, as here, the Parties have had an opportunity to bargain for their rights." *Id*. (emphasis added), citing *BRW, Inc. v. Dufficy & Sons, Inc*., 99 P.3d 66, 72 (Colo. 2004) ("The policies underlying the application of the economic loss rule to commercial parties are unaffected by the absence of a one-to-one contract relationship. Contractual duties arise just as surely from networks of interrelated contracts as from two-party agreements."); *Rissler & McMurry Co. v. Sheridan Area Water Supply Joint Powers Bd.*, 929 P.2d 1228, 1235 (Wyo. 1996) (holding that although contractor had not contracted directly with engineer on a project, its negligence claims against engineer were barred by economic loss rule, where contractor had opportunity to allocate risks associated with costs of the work when it contracted with water supply joint powers board on the same project.).

[ER18 ln.08-19.] The district court was correct to apply the "economic loss rule" to the facts of this case, given the parties' sophistication and opportunities to allocate risk. The Stadium Authority was not merely in privity of contract with Crown Corr through one agreement but through a tripartite contractual arrangement that allowed the Stadium Authority more than sufficient opportunity to assert its right

to preserve tort actions and allocate fault:

> The Contracts were specifically negotiated with the Stadium project in mind and the Parties allocated risks and remedies in their agreements. The Parties did not agree to preserve tort remedies, but instead agreed to waive subrogation against all Parties, subcontractors, and design consultants. Tourism and Sports Authority had plenty of opportunities to assert its right to tort remedies, but instead chose to allow insurance to bear the burden of risk associated with the project.

[ER18 ln.03-08.] Other courts agree with this approach. *See, e.g., Marion County Pub. Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722, 739 (Ind. 2010) ("We conclude with two cases from other jurisdictions holding that the economic loss rule precludes participants in major construction projects connected through a network or chain of contracts from proceeding against each other in tort for purely economic loss.").

Travelers cites *Mac Enterprises, Inc. v. Del E. Webb Development Co.*, 132 Ariz. 331, 645 P.2d 1245 (App. 1982), for the proposition that "interrelated contracts" do not permit a sufficient finding of privity. As described by Travelers, the *Mac Enterprises* case involved a lease and a sublease: one party had a long-term lease (in that case, Pro Shops' three-year lease) and subsequently attempted to sub-lease that property with minimal input and/or approval (or even interest) from the main landlord. *See* 132 Ariz. at 335, 645 P.2d at 1249.

The nature of the contracts/leases, the standard rights and practices of landlords in a strip-mall, and the public-policy implications found in *Mac*

Enterprises simply are not comparable to a construction project in which many parties jointly negotiated complex contractual provisions that bound multiple parties through multiple agreements and specifically anticipated future provisions.

C. Travelers Seeks Recovery for Losses Described by the Contract, Not Separate Injury to "Other Property."

Travelers also attempts to avoid the "economic loss rule" by claiming that its negligence claim sought recovery of damage to the sound-system speaker cluster, thereby attempting to raise the spectre of "other property" to avoid application of the "economic loss rule." The district court rejected this argument:

> Defendant points to the "TSA/Cardinals Multi-Purpose Facility Schematic Design Drawing Log" to show that Audio/Visual equipment and installation was contemplated in the contract as being part of the Stadium. *See* Design/Build Agreement, Exhibit A. Plaintiff has provided no argument that Tourism and Sport Authority, "a political subdivision of the State of Arizona empowered to construct, finance, furnish, maintain, improve, own, operate, market and provide" the Stadium, owns, as personal property, speaker clusters designed for and built into the Stadium.
>
> ... Because Plaintiff has provided no other purpose for such speaker clusters and the Court can ascertain no purpose for such speaker clusters specifically designed for and built into a football stadium, Plaintiff has failed to demonstrate that these speaker clusters demonstrate "other property," not part of the Stadium, as property not covered by the Contracts. Accordingly, the Court finds that, as applied to the facts of this case and the policy considerations discussed above, Plaintiff's negligence claim is barred by the economic loss doctrine.

[ER19-20 ln.24-08.]

Travelers first argues that the district court erred by referencing both

contracts [OB 50-51]. Travelers claimed that because it had alleged a violation of only the Subcontract, any damage to any portion of the Stadium on which Crown Corr did not work would constitute "other property." However, the district court did not cite both contracts to suggest that Travelers had sued under both, but simply to demonstrate that the purpose of both was to create a completed Facility. The district court's reference to both contracts simply demonstrates that the speakers were always intended to be part of the Stadium itself, rather than some kind of anciliary property.

Travelers then asserts that the district court erred in explaining how *Flagstaff Affordable Housing* would apply to "other property," despite acknowledging that "the crux of the economic loss rule is upholding the expectations of the parties." [OB 52.] Clearly, the district court found that damage to speakers attached to the Stadium would constitute damage to the Stadium, rather than damage to separate, private property:

> Both Contracts address remedies available for damage to the Stadium as a whole. The Parties intended to make insurance available for any damage to the Stadium and to mutually waive subrogation rights against each other. Accordingly, there is no "other property" that was damaged, as both Contracts treat the fully completed Stadium as the property that is itself the subject of the Contracts.

[ER19 ln.11-16.]

As support for the above passage, the district court cited *Indianapolis-Marion County Pub. Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722,

732 (Ind. 2010), which Travelers contends is inapposite. [OB 52-53.] The district court had cited this case for its analysis of what "other property" generally means within the "economic loss rule." In *Marion County Public Library*, the Indiana Supreme Court explained:

> If a component is sold to the first user as a part of the finished product, the consequences of its failure are fully within the rationale of the economic loss doctrine. It therefore is not "other property."

See 929 N.E.2d at 732 (citing *Gunkel v. Renovations, Inc.*, 822 N.E.2d 150, 153 (Ind. 2005)). The court continued:

> [o]nly the supplier furnishing the defective property or service is in a position to bargain with the purchaser for allocation of the risk that the product or service will not perform as expected

Id. (citing *Gunkel*, *id.*). This holding from the *Marion County Public Library* opinion is in accordance with Arizona law. *See, e.g.*, *Cook v. Orkin Exterminating Co., Inc.*, 227 Ariz. 331, 335 ¶20, 258 P.3d 149, 153 (App. 2011) (applying the "economic loss rule": holding that "the parties' expectations favor" limiting the plaintiff's claims "to those in contract," and noting that when "there has been no injury besides that to the *subject property*, *there is no strong policy reason to impose tort liability*.") (emphasis added).

Travelers attempts to distinguish this definition of "other property" by suggesting that, in that case, "the structural integrity of the whole project was compromised by the architectural and engineering work." [OB 53.] But the focus

in evaluating "other property" is not the nature of the contracted-for work but what product had been "contracted for"; in other words, the finished project. In this case, the finished project was a Stadium Facility, and that Facility included the audio-visual equipment.

Travelers cites other cases including *Goose Creek Consol. Indep. Sch. Dist. v. Jarrar's Plumbing, Inc.*, 74 S.W.3d 486, 495 (Tex. App. 2002), and *Thomson v. Espey Huston & Assocs., Inc.*, 899 S.W.2d 415, 422 (Tex. App. 1995). However, in addressing both of those cases, the district court made clear that the owner was not a third-party beneficiary of the contract. Here, the Stadium Authority clearly *was* a third-party beneficiary.

D. The District Court Did Not Err In Concluding Travelers Had Not Sufficient Pled Any "Other Property" Allegation.

Finally, the district court did not err in concluding that Travelers did not sufficiently allege any "other property" allegation that should survive dismissal. [OB 55-57.]

Travelers cites the case *Miidas Greenhouses, LLC v. Global Horticultural, Inc.*, 226 Ariz. 142, 244 P.3d 579 (App. 2010), for the proposition that, under Arizona law, the "pleading standard" for alleging damage to "other property" requires very little. [OB 56.] Aside from the fact that the pleadings standard for a complaint in federal court should be judged by federal law, not state law – *see, e.g., Church of Scientology of Calif. v. Flynn*, 744 F.2d 694, 696 n.2 (9th Cir.

1984) (although state standards should be given some consideration) – the court's opinion in *Miidas Greenhouses* demonstrates, by contrast to the allegation in Travelers' Third Amended Complaint, what a real allegation of damage to "other property" looks like.

In *Miidas Greenhouses*, the parties contracted to purchase peat moss, in which the greenhouse plaintiff then planted seeds – the "other property." When all of the seeds were lost due to "drying out," the greenhouse company sued Global Horticultural on a theory of product liability – alleging that the peat moss had been too acidic – and claimed the loss of the seeds and the potential profit from those seeds as "other property" loss. *See* 226 Ariz. at 144 ¶¶3-4, 244 P.3d at 581.

In the above context, the seeds clearly were "other property," because the product contracted for in that case was the peat moss. The plaintiff in *Miidas Greenhouses* had two sources of damage: first, the lost value for the purchase of the defective product (the peat moss), and second, the damage that defective product caused to property that had nothing to do with the purchased product (the seeds).

By contrast, in this case, Travelers is suggesting that the speakers that were designed to be part of the Stadium Facility somehow constituted "other property," simply because Travelers alleged the speakers to be "other property." The context of the claim makes clear that the speakers, regardless of Travelers' allegation, were

designed and intended to be part of the Stadium Facility.

Travelers is entitled to relief from this Court only if a *well-pled* allegation defeats dismissal. Nothing in the *Miidas Greenhouses* case suggests that the mere assertion that property constitutes "other property" suffices to create an exception to the "economic loss rule" under Arizona law. Nor does such an allegation meet the standard in federal court. Allegations in a complaint must be read together – *see, e.g., Sepulveda–Villarini v. Dep't of Educ.*, 628 F.3d 25, 28–29 (1st Cir. 2010) and must be plausible. *See, e.g., Harris v. Mills*, 572 F.3d 66, 72 (2d Cir.2009) ("[W]e apply a plausibility standard...."); *Fowler v. UPMC Shadyside*, 578 F.3d 203, 210 (3d Cir.2009) ("[*Ashcroft v. Iqbal*, 556 U.S. 662 (2009)] makes clear that the *Twombly* 'facial plausibility' pleading requirement applies to all civil suits in the federal courts.").; *Francis v. Giacomelli*, 588 F.3d 186, 189 (4th Cir. 2009) (applying the *Iqbal* standard of whether the complaint "states plausible claims" for relief). Furthermore, on a motion to dismiss, courts "are not bound to accept as true a legal conclusion couched as a factual allegation." *Papasan v. Allain*, 478 U.S. 265, 286 (1986).

The notion that the speakers somehow constituted "other property" separate and apart from the Stadium Facility is not well-pled, giving this Court no reason to depart from anything other than a full affirmance of the district court's dismissal of this action.

THE DISTRICT COURT'S AWARD OF ATTORNEYS' FEES AND THE CONSOLIDATED APPEAL

Following the dismissal, Crown Corr was awarded attorneys' fees pursuant to contract. Travelers has challenged that award of fees in a separate appeal. However, Travelers notes that its Opening Brief in this matter should serve as the Opening Brief in that matter as well; Travelers is not submitted separate substantive challenges to the amount of the attorneys' fees award. Travelers' consolidated appeal simply asserts that if this Court reverses the dismissal, this Court also should reverse the award of fees as well. [*See* Consolidated Appeal (#12-16663), Dkt. #3 in at 2 ("the only purpose of the [consolidated] appeal is to obtain reversal of the grant of attorneys' fees should this Court reverse in Case No. 12-15170 … .").]

Accordingly, Crown Corr provides no defense either of the propriety of an award of fees or the amount awarded, but nonetheless agrees – as set forth in the above-reference Stipulation – that the separate award of attorneys' fees must "rise or fall" with the substance of this appeal.

CROWN CORR'S INTENT TO REQUEST FOR ATTORNEYS' FEES IF DEEMED PREVAILING PARTY ON APPEAL

Should Crown Corr prevail on this appeal, Crown Corr intends to comply with Local Rule 39-6 and file a separate Motion for Attorneys' Fees.

CONCLUSION

The district court correctly concluded that Travelers' contract claims were barred by the waiver of subrogation provisions found in the Contracts at issue in this case. Subrogation waivers are enforced in various jurisdictions, including Arizona, and such waivers should be construed against a subsequent insured. Travelers attempted to avoid that waiver by submitting an affidavit that claimed the parties did not intend such a waiver. However, the district court correctly concluded that Travelers' allegations did not support the plain language of the contracts and, therefore, excluded that evidence. Because the waiver provision barred the first two of Travelers' claims, the district court correctly dismissed these claims.

The district court also correctly dismissed Travelers' negligence claim for negligence pursuant to Arizona's "economic loss rule." The district court correctly recognized that Arizona applies its "economic loss rule" in construction defect cases, because those cases involve heavily-negotiated contracts with "detailed provisions allocating risks of loss and specifying remedies." *Flagstaff Affordable Housing*, 223 P.3d 664, 670-71 ¶25.

/ / /

/ / /

/ / /

For all these reasons, Crown Corr respectfully requests that this Court affirm the district court's judgment of dismissal of Travelers' Complaint and the district court's judgment in this case.

RESPECTFULLY SUBMITTED this 8th day of August, 2012.

RENAUD COOK DRURY MESAROS, PA

By /s/ Kevin R. Myer, #019919
William W. Drury
James L. Blair, #016125
Denise J. Wachholz, #011526
Kevin R. Myer, #019919
One North Central, Suite 900
Phoenix, Arizona 85004-4417

Counsel for Defendant-Appellee
Crown Corr, Inc.

CERTIFICATE OF COMPLIANCE

The undersigned certifies that, pursuant to FRAP 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached Answering Brief is proportionally spaced, has typeface of 14 or more points, and contains 10,320 words.

By /s/ Kevin R. Myer, #019919

CERTIFICATE OF SERVICE

I hereby certify that on August 8, 2012, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF System.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

By /s/ Kevin R. Myer, #019919

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE TRAVELERS INDEMNITY COMPANY, as subrogee of Tourism and Sports Authority, DBA Arizona Sports & Tourism Authority, Plaintiff-Appellant, v. CROWN CORR INCORPORATED, an Indiana corporation, Defendant-Appellee.	Nos. 12-15170 and 12-16663 D.C. No. 2:11-cv-00965-JAT United States District Court Arizona (Phoenix)

REPLY BRIEF OF PLAINTIFF-APPELLANT THE TRAVELERS INDEMNITY COMPANY

LEWIS AND ROCA LLP
Susan M. Freeman
William G. Voit
40 North Central Avenue, Suite 1900
Phoenix, Arizona 85004-4429
(602) 262-5311
and
THE LAW OFFICE OF JAMES K. LAROE, P.C.
James K. LaRoe
5910 North Central Expressway, Suite 700
Dallas, Texas 75201
(214) 219-9000

Attorneys for Plaintiff-Appellant
The Travelers Indemnity Company

TABLE OF CONTENTS

Page

Page

TABLE OF AUTHORITIES

Case **Page**

Federal Cases

Case **Page**

State Cases

Case **Page**

Other Authorities

Page

INTRODUCTION

Subcontractor's Answering Brief largely ignores the contractual language at issue, eschewing a textual analysis of the Design/Build Agreement's specific provisions for generalized citations about waivers of subrogation. This case cannot be resolved by glossing over the contradictory contract provisions and simply saying that subrogation waivers are generally allowed. If there is room for any reasonable disagreement over the meaning of "Facility"—and that low threshold is amply met—then the district court's dismissal cannot stand.

Likewise, on the negligence count, Subcontractor spends much of its Answering Brief discussing the general applicability of the economic loss doctrine to construction defect cases rather than engaging with the specific Arizona authorities and policy arguments rejecting the doctrine in the absence of privity. The presence of so-called "interrelated contracts" does not establish the necessary privity under Arizona law. This is not the kind of case in which Arizona's "narrow" version of the economic loss doctrine would bar a tort claim, but rather falls within Arizona's general rule allowing tort recoveries, even where losses are purely economic.

This Court should reverse the dismissal.

STATEMENT OF FACTS

Subcontractor agrees with essentially all of Travelers' Statement of Facts. Travelers discerns only three points requiring response. First, Subcontractor "objects to Travelers' recitation of what the parties intended with regard to the relevant provisions of the Contracts" based on the notion that "the district court rejected [the Murphy] Affidavit." (AB15.)[1]

While the court did strike the Murphy Affidavit as an unnecessary attachment to a pleading, it expressly held that Travelers "properly included all of the allegations of the Parties' intent, which were contained in the affidavit, in the Complaint itself," and thus striking the Affidavit "ha[d] no effect on the Court's analysis." (ER9.) Subcontractor does not challenge that holding. Thus, the allegations of intent were properly before the court.

If Subcontractor means to suggest that the court should not have considered the parol evidence as part of the reasonable susceptibility inquiry, that is also incorrect. *Taylor v. State Farm Mut. Auto. Ins. Co.*, 175 Ariz. 148, 154, 854 P.2d 1134, 1140 (1993) ("the judge first considers the offered evidence"); 1 ARIZONA PRACTICE, LAW OF EVIDENCE §104:8 (4th ed. 2008) (court receives proffered evidence in determining reasonable susceptibility).

[1] The Opening Brief and Answering Brief are referred to as "OB__" and "AB__."

Second, Subcontractor says that it made an "offer of proof" that the wind speeds during the storm were above the Stadium exterior's tolerance. (AB10, 17.) Travelers doubts that the remark at oral argument to which Subcontractor refers either constituted an "offer of proof"[2] or, even if it did, would establish that the wind speeds were above the tolerance promised. (*See* SER at 4-5 (forecasting during oral argument that if the case went to trial, Subcontractor would be putting on evidence of damage to other properties in the area).)

But the point is academic. Offers of proof are used to preserve objections to error in the exclusion of evidence. *See* 21 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE: EVIDENCE §5040 (2d ed. 2005). On a motion to dismiss, this Court must assume the truth of Travelers' factual allegations (ER232 ¶18). *Silva v. Di Vittorio*, 658 F.3d 1090, 1101 (9th Cir. 2011).

Finally, although Subcontractor generally does not dispute the fact that there was no contract between itself and the Authority, at some points it seems to suggest otherwise. For instance, Subcontractor says that it "contracted with . . . the insured" (AB13), which is not true. The only parties to the Design/Build Agreement were the Authority, the Cardinals, and Hunt (ER27), and the only

[2] "In order to qualify as an adequate offer of proof, the proponent must, first, describe the evidence and what it tends to show and, second, identify the grounds for admitting the evidence." *United States v. Adams*, 271 F.3d 1236, 1241 (10th Cir. 2001).

parties to the Subcontract were Hunt and Subcontractor (ER161). Likewise, Subcontractor's occasional references to there being a "tripartite" agreement between the parties (AB11, 19, 46) are not correct. There was never any contract to which both the Authority and Subcontractor were party.

ARGUMENT

I. The Contract Claims Should Not Have Been Dismissed.

The key issue for the contract claims is whether, as Subcontractor argues and the district court concluded, the word "Facility" in the Design/Build Agreement *can only* "refer to the Stadium after it is fully operational." (ER10-11.) Because Travelers' interpretation otherwise is, at the very least, a reasonable one, the court should have allowed the case to proceed.

A. Subcontractor misunderstands the burden it carries.

Subcontractor repeatedly misstates the *Taylor* inquiry. Subcontractor disputes that a contractual term could both "not require" and "not preclude" a party's interpretation, stating—without authority—that "[t]his is *not* the standard for contract interpretation." (AB at 36 (emphasis original).) Subcontractor claims that Travelers must instead establish that "the terms of the contract did not permit the district court to read the term 'Facility' as the completed Facility." (AB32.)

In fact, *Taylor* expressly recognized that contractual terms may indeed be susceptible to multiple interpretations, and it adopted Professor Corbin's view that

where "the contract language is 'reasonably susceptible' to the interpretation asserted by its proponent, the [parol] evidence is admissible to determine the meaning intended by the parties." 175 Ariz. at 154, 854 P.2d at 1140.

Here, the district court refused to consider alleged evidence of the parties' intent, which was otherwise uncontested, by reasoning that "the term 'Facility' is not reasonably susceptible to [Travelers'] interpretation." (ER10.) The question before this Court is whether this was error: in other words, whether the district court *could only* read the term "Facility" in the way Subcontractor advances. If the term "reasonably could be interpreted in different ways," then under *Taylor* the court should not have refused to consider allegations of the parties' intent and dismissed the case. *Taylor*, 175 Ariz. at 155 n.2, 854 P.2d at 1141 n.2.

Subcontractor also misunderstands the weight of its burden. Subcontractor concedes that the dismissal must be reversed unless the language is "clear and unambiguous" that the waiver applies post-completion. (AB27.) Yet Subcontractor also disputes that the *Taylor* analysis is a liberal standard, stating that "*Taylor* does not hold that a court must consider parole [sic] evidence unless the proffered interpretation is so unreasonable or extraordinary as to be absurd." (AB31.)

To the contrary, *Taylor* directly states that a court should not consider parol evidence when "the court decides that the asserted meaning of the contract

language is *so unreasonable or extraordinary* that it is improbable that the parties actually subscribed to the interpretation." 175 Ariz. at 153, 854 P.2d at 1139 (emphasis added). *Taylor* described the kind of interpretation that would be rejected as one that is "clearly contradicting and wholly unpersuasive" and akin to an assertion "that white is black and that a dollar is fifty cents." *Id.* at 153-54, 854 P.2d at 1139-40. Subcontractor does not address, much less refute, these statements in *Taylor*.

Nor does Subcontractor address the fact that the Arizona standard is recognized as "permissive." 8 ARIZONA PRACTICE, TRIAL HANDBOOK §14:16 (2010) ("Arizona has adopted a more permissive approach to the rule as expressed in [the Restatement and Corbin]."); *Long v. City of Glendale*, 208 Ariz. 319, 328, 93 P.3d 519, 528 (App. 2004) (same). The permissive standard is easily met here.

B. Subcontractor focuses on generalized arguments rather than actual contract language.

Subcontractor's headline argument, and the focus of much of its brief, is the assertion that "Arizona Courts Recognize Waivers of the Right [to] Subrogation." (AB22-25.) No one is disputing that subrogation may in some circumstances be waived. Subcontractor's argument simply begs the *Taylor* question: does the Design/Build Agreement unambiguously, and beyond any reasonable dispute, do

so for post-completion insurance? On that question, Subcontractor has noticeably less to say.

C. Subcontractor concedes, by failing to respond, that most of the contract's provisions are incompatible with its argument.

In the Opening Brief, Travelers detailed at length the many uses of the term "Facility" in the Design/Build Agreement that are incompatible with Subcontractor's contention that the term can only refer to the Stadium after Substantial Completion. (OB18-35.) For the vast majority of these provisions, Subcontractor simply offers no response, thereby waiving any argument on those sections.[3]

- Travelers pointed out that §1.8.2 states that "Design and construction of the Facility *has required to date* . . . ." (ER41 §1.8.2.) How can the "Facility" have "required to date"—i.e., before Substantial Completion—if "Facility" must mean after Substantial Completion? Subcontractor does not respond.

[3] It is standard procedure that "by failing to respond to an appellant's argument in favor of reversal . . . . the appellee 'waives, as a practical matter anyway, any objections not obvious to the court to specific points urged by the appellant.'" *Beazer East, Inc. v. Mead Corp.*, 412 F.3d 429, 437 n.11 (3d Cir. 2005) (quoting *Hardy v. City Optical*, 39 F.3d 765, 771 (7th Cir. 1994)); *see, e.g.*, *Greenawalt v. Ricketts*, 943 F.2d 1020, 1027 (9th Cir. 1991) ("Greenawalt appears to concede [the point] by his failure to argue the issue."); *In re Incident Aboard the D/B Ocean King*, 758 F.2d 1063, 1071 n.9 (5th Cir. 1985) ("We treat the failure to respond to Hydril's arguments as a concession . . . .").

- Section 2.2.4 provides that the owner has the right to assurances "to ensure that the Facility can be and *is being completed* in accordance with this Agreement." (ER44 §2.2.4.) Similarly, §2.2.10 purports "to ensure that the Facility *is constructed* in a manner that is consistent with the Owner approved Construction Documents." (ER46 §2.2.10.) How can the "Facility" be in the process of being completed if "Facility" must mean after Substantial Completion? No response.

- Section 2.4.2.3 discusses Hunt's obligations to coordinate contractors' activities, including the use of temporary equipment and services during construction. (ER52-53 §2.4.2.3.) It expressly refers to contractors performing work in the "Facility" during the construction process:

> The Design/Builder shall provide temporary utilities, hoisting and all other temporary equipment and services to the Authority's or the Team's contractors that *are performing work on or within the Facility* . . . .

(*Id.* (emphasis added).) How can contractors be performing temporary work to complete the "Facility" if the "Facility" means the already completed Stadium? Again, no response.

- Section 5.3 refers to achieving "Substantial Completion of the Facility"—something that has no meaning if "Facility" already refers to the Stadium after Substantial Completion. (ER67-68 §5.3.) And the "Partial

Occupancy" section repeatedly uses the term "Facility" to discuss events that must, by definition, occur prior to Substantial Completion. It states that "certain portions or areas *of the Facility* identified in Exhibit O shall be completed . . . *prior to the date of Substantial Completion*." (ER68 §5.4.) It also refers to "early occupancy of any portion *of the Facility*." (*Id.*) How can there be "early occupancy" of the "Facility," or occupancy of the "Facility" "prior to the date of Substantial Completion," if "Facility" must mean after Substantial Completion? Subcontractor responds to none of this.

At most, Subcontractor seems to offer a generalized criticism, un-tethered to any particular contract language—or any authority—of arguments about "verb tenses." (AB37.) But Subcontractor cannot legitimately dispute that "the grammatical construction of a contract is often a reliable signpost in the search for the intention of the parties." 17A AM. JUR. 2D *Contracts* §365 (2004); *cf. In re Claremont Acquisition Corp., Inc.*, 113 F.3d 1029, 1034 (9th Cir. 1997) (rejecting construction of statute that would render it "grammatically incorrect and nonsensical"). Subcontractor's "verb tenses" statement is no response at all.

- Nor does Subcontractor respond to Travelers' arguments about §§1.5, 1.8.1, 2.1.1, and 2.1.2 of the Design/Build Agreement, each of which uses qualifying language—like "*completed and fully operational* Facility"—that would be redundant if "Facility" inherently meant post-completion. (OB32-33.) All

Subcontractor offers is a vague criticism of arguing "surplusage," citing no authority. (AB37.) There are few canons of construction more well-established than that a court "must interpret a contract in a way that gives meaning to all its material terms *and renders none superfluous*." *Miller v. Hehlen*, 209 Ariz. 462, 466, 104 P.3d 193, 197 (App. 2005) (emphasis added)). Thus, a court "cannot simply ignore" phrases that "must have a distinct meaning" in order to avoid redundancy. *See id.* ("the phrase 'Margaret Miller, doing business as H & R Block' *must* have a distinct meaning from 'Margaret Miller'") (emphasis added).[4]

- Travelers argued that the nature and purpose of the contract is design/construction, not operation (ER27), which is at odds with Subcontractor's interpretation. (OB18, 27-28.) No response.

- Travelers also pointed out that there is no textual dichotomy between "Facility" and "Work" or "Project." (OB25-27.) Subcontractor offers no response to that, or to the fact that even under the district court's own ruling, multiple terms can refer to the Stadium before Substantial Completion (e.g., "Work" and "Project"). (AB34-36.) Indeed, §5.3 refers to "Substantial Completion of the

[4] Similarly, Subcontractor does not dispute Travelers' argument (OB26) that the same qualifying language in the definitions of "Work" and "Project" would be redundant under Subcontractor's interpretation. (AB35-36.) Subcontractor's only response is to say that "the district court simply recognized the consistency in these terms" (AB35), but to say that there is "consistency" in redundant terms does not dispute that they are *redundant*. Indeed, by definition, redundant terms are consistent.

Facility" and "Substantial Completion of the Work" interchangeably (ER67-68 §5.3), demonstrating that "Facility" need not mean something different than "Work." Subcontractor offers no textual analysis.

- Perhaps most astonishingly, Subcontractor has no meaningful response to Travelers' arguments about Section 11.4, the section in which the subrogation waiver appears. Travelers explained at length that Section 11.4 is an *integrated section* that includes other provisions that are incompatible with Subcontractor's interpretation. (OB28-32.) Most notable is the provision describing insurance as applying only "during the term of this Agreement and *until* Substantial Completion." (ER98 §11.4.1 (emphasis added); *see also* ER99 §11.4.1(m) (same limitation).)

Subcontractor does not dispute that §11.4 is an integrated section, and Subcontractor fully concedes that the "other provisions in Article 11.4 of The Design/Build Agreement expire at substantial completion." (AB36-37.) Subcontractor offers no reasoning or analysis to respond to Travelers' arguments about why the court erred in treating §11.4.6 differently. (OB28-32.) It merely quotes the district court's rejection of Travelers' argument. (AB36-37.)

To say that the district court disagreed is no response, for "[d]e novo review means that the reviewing court 'does not defer to the lower court's ruling but freely considers the matter anew, *as if no decision had been rendered below*.'" *Dawson*

v. Marshall, 561 F.3d 930, 933 (9th Cir. 2009) (emphasis added) (quoting *United States v. Silverman*, 861 F.2d 571, 576 (9th Cir. 1988)). The district court's order being reviewed simply is not authority to support Subcontractor's argument.[5]

Subcontractor's failure to engage with these contractual provisions and Travelers' arguments about them is a tacit concession that it has no response.

D. Subcontractor's responses on the remaining provisions actually confirm Travelers' position.

Where Subcontractor does respond, it does not save its case. For instance, Travelers pointed out that the court muddled the definition of "Facility" with its purpose (OB23-24) and ignored those aspects of the language it quoted—e.g., "will be"; "to construct, finance, furnish" (ER27)—that are incompatible with its interpretation (OB24-25). Subcontractor excuses the court for having "focused on the purpose" rather than the definition, but Subcontractor does not dispute that the actual definition of "Facility" is simply "multipurpose stadium facility." (AB32-33.)

Subcontractor then says that Travelers is arguing that "the use of the future tense in the description somehow must limit the meaning of 'Facility' to only a less than Substantially Completed stadium." (AB33-34.) No. The only question for

[5] As noted in the Opening Brief, the district court's logic is also internally inconsistent and contradictory, not persuasive. (OB30-32.) Subcontractor does not respond to these arguments either.

this Court is whether such language—or any of the litany of other sections discussed—renders the term "reasonably susceptible" to Travelers' interpretation. *Taylor*, 175 Ariz. at 154, 854 P.2d at 1140. No one is arguing that it "must" limit the term to Travelers' interpretation.

Subcontractor also proffers the explanation that the future tense could have been used because "at the time of drafting, the Facility did not exist." (AB34.) It would make little sense to refer to something that "did not exist" with a term that can only refer to the Stadium after it is completed—i.e., after it exists—but at most, Subcontractor's argument makes Travelers' point. The language is susceptible to multiple interpretations, and Subcontractor points to nothing in the language at issue that *mandates* its construction.

Subcontractor also argues "that [§11.4.6] does not include any limiting language that suggests that the waiver applies only to the period of construction." (AB28.) But the contract is express where it purports to make its provisions survive Substantial Completion, not the other way around. (*See, e.g.*, ER49 §2.2.20 ("The provisions of this Article [2] shall survive the completion . . . of this Agreement.").) But regardless, again, Subcontractor at best makes Travelers' point. Section 11.4.6 contains no specific language either way and therefore is, at the least, facially susceptible to both interpretations.

Finally, Subcontractor responds to the fact that the Design/Build Agreement qualifies "Facility" with terms that cannot possibly refer to a post-completion Stadium—"to construct, finance, furnish"—by saying that there are *other* terms in the list that could refer to the post-completion Stadium (namely, to "own, operate, market, and provide"). (AB34.) Again, Subcontractor's own argument that the terms cut differently shows how "Facility" is ambiguous, and Subcontractor points to no language that mandates its construction or explains the set of contrary terms.[6]

E. Subcontractor's caselaw uniformly involves AIA form contracts with a post-completion provision.

Subcontractor does not dispute that its caselaw unvaryingly involves AIA form contract language that does not exist in the Design/Build Agreement. (OB19-22, 35-36.) It claims that "whether these Contracts were based on AIA forms is immaterial," asserting that "simply because AIA contracts generally have certain provisions, AIA practices do not require courts to read such provisions into all contracts." (AB25-26.) Subcontractor cites no authority for this argument. (*Id.*)

[6] Subcontractor also suggests, without actually arguing, that the district court may have relied on §8.3 of the Subcontract. (AB28-30.) The court expressly declined to rely on the Subcontract (ER12), doubtless because the Authority was not a party to it (ER161). Regardless, by its terms the waiver in §8.3 applies to the same scope of insurance and thus also expired upon Substantial Completion (ER176 §8.3), and in any event the Subcontract provides that the Design/Build Agreement would control in any conflict (ER162 §2.2).

The fact that the cases on which Subcontractor relies applied subrogation waivers post-completion is a function of the AIA form contract's unique terms, specifically the "Completed Project Insurance" clause providing that the owner waives rights under the waiver of subrogation clause "if *after final payment* property insurance is to be provided on the *completed Project* through a policy or policies *other than those insuring the Project during the construction period*." (OB21-22.)

Every single case Subcontractor cites (AB25-26) relies on the AIA form language, including the "Completed Project Insurance" clause. (OB35.) It is not surprising that courts may find a subrogation waiver to apply after substantial completion in contracts that expressly refer to policies on the "completed Project" and "other than those insuring the Project during the construction period." As one treatise explains, in citing all of the cases on which Subcontractor relies, it is "[t]he waiver of subrogation provision *contained in the standard American Institute of Architects (AIA) documents* [that] has been consistently interpreted to apply to post-completion claims." 4 PHILIP L. BRUNER AND PATRICK J. O'CONNOR, JR., BRUNER & O'CONNOR CONSTRUCTION LAW §11:196.10 (West 2012) (emphasis added); *see, e.g.*, *Middleoak Ins. Co. v. Tri-State Sprinkler Corp.*, 931 N.E.2d 470, 471 (Mass. App. 2010) (citing Subcontractor's cases and explaining that the

"authority holds that *the AIA provisions* regarding waiver of subrogation are not limited to losses during the construction period") (emphasis added).

Indeed, Plaintiff's own caselaw makes this very point. *See, e.g.*, *Midwestern Indem. Co. v. Sys. Builders, Inc.*, 801 N.E.2d 661, 669 (Ind. App. 2004) ("Like the Georgia Court of Appeals [in *Colonial*], we also find that Section 11.3.5 of the AIA construction contract [the Completed Project Insurance clause] is controlling."); *Colonial Props. Realty Ltd. P'ship v. Lowder Constr. Co.*, 567 S.E.2d 389, 391-92 (Ga. App. 2002) (same holding).

This principle is explained in *Hartford Underwriters Insurance Co. v. Phoebus*, 979 A.2d 299 (Md. App. 2009), which like the Design/Build Agreement, involved a contract that lacked the standard AIA "Completed Project Insurance" clause. The *Phoebus* court was cited the very same caselaw Subcontractor now cites, but it distinguished those cases because their contracts "contained a Waivers of Subrogation clause *and* a related 'Completed Project Insurance' clause that must be read and understood together." *Id.* at 306. "Without a Completed Project Insurance or similar clause, the Waivers of Subrogation clause and the definition of Work reasonably can be read to have more than one meaning, temporally." *Id.* at 309.

Subcontractor attempts to distinguish *Phoebus* by arguing that the term there was "Work" and here is "Facility," but it offers no analysis of why that would be

important. (AB38-39.) Subcontractor's superficial distinction misses the actual holding of *Phoebus*, which was that the absence of the AIA form clause rendered the waiver of subrogation ambiguous: "We conclude that the Waivers of Subrogation clause and definition of Work in this Contract, *existing as they do without a related Completed Project Insurance clause*, are not clear as to temporal scope." *Phoebus*, 979 A.2d at 309 (emphasis added).[7] The same is true here.

F. Travelers was not a party to any waiver and could not be bound by it.

Because the contract language is reasonably susceptible to Travelers' interpretation, the Court need not reach whether Arizona would permit an insured to waive Travelers' subrogation rights without Travelers' consent while retaining its own rights to sue. However, if the Court does not reverse based on the language of the waiver, it would necessarily have to reach this issue.

As the district court acknowledged, "there is a split among state courts on this issue and Arizona has not expressly dealt with it." (ER13.)[8] Travelers

---

[7] Subcontractor also attempts to distinguish *Automobile Insurance Co. v. United H.R.B. General Contractors, Inc.*, 876 S.W.2d 791, 793-94 (Mo. App. 1994), without recognizing that Travelers is only arguing that the lack of clear language results in ambiguity, not that its construction is the only one. It is that element of *United H.R.B.*—which in fact rested on "the language of the contract *taken as a whole*" and the reasoning that it "*contains no express language as to the duration of the waiver*"—that is relevant here. *Id.* (emphases added).

[8] Subcontractor says that Arizona permits an insured to release its *own* claim against the third party without insurer consent (AB23-24), but that is not the issue,

provided argument and authority on why the district court was wrong to conclude that Arizona would permit such waivers. (OB36-37.)

Remarkably, Subcontractor does not dispute, or even acknowledge, Travelers' argument, and Subcontractor makes no substantive defense of allowing such waivers without the insurer's consent. Subcontractor's only response is the conclusory assertion—without analysis of the policy language—that Travelers *did* consent through its insurance policy. (AB16-17.)

First of all, Subcontractor's assumption about the policy language is incorrect. The policy says only that the Insured may waive "its" rights to assert claims—i.e., the *Authority's* rights—not Travelers' rights:

> the insured may waive ***its*** rights against another party by specific written agreement.

(SER92 (emphasis added).) The proximity of "its" to "the insured" (the only entity with rights specified in the sentence) demonstrates that it is the insured's rights, not Travelers', that are referenced. When the provision refers to Travelers' rights, it calls them "the Company's rights." (*Id.*) Furthermore, the only two parties even

---

as the district court recognized (ER12-13). The Authority retained its own claims for damages while at the same time (or so Subcontractor contends) purporting to release its insurer's subrogation claim. (ER101 §11.4.6.)

mentioned in the sentence are "the Insured" and "another party" (the "third party" against whom rights may be waived). The insurer is not mentioned. (*Id.*)[9]

At the very least, this contractual provision would also be reasonably susceptible to multiple interpretations and thus would require fact-finding to be resolved. But in the final analysis, this provision would only beg the question of whether the Authority did waive subrogation here. For the reasons discussed above, it did not. Thus, dismissal of the contract claims was improper.

II. The Economic Loss Rule Does Not Bar Travelers' Negligence Claim.

As Travelers pointed out (OB38-40), Arizona applies "a narrow version of [the] economic loss doctrine," *Flagstaff Affordable Hous. L.P. v. Design Alliance, Inc.*, 223 Ariz. 320, 324, 223 P.3d 664, 668 (2010), because "in Arizona there is no 'blanket disallowance for tort recovery for economic losses,'" *Evans v. Singer*, 518 F. Supp. 2d 1134, 1145 (D. Ariz. 2007) (quoting *Salt River Project Agric. Improvement & Power Dist. v. Westinghouse Elec. Corp.*, 143 Ariz. 368, 379, 694

[9] While there is not much caselaw interpreting this precise phrase, what caselaw exists is skeptical of the notion that it would yield a waiver of the insurer's subrogation. *See Austin Indep. Sch. Dist. v. H.C. Beck Partners, Ltd.*, No. 03-07-00228-CV, 2009 WL 638189, at *1-2 (Tex. App. Mar. 13, 2009) (same clause providing the insured "may waive its rights against another party by specific written agreement" refers to the *policyholder's* rights and "does not waive the insurer's subrogation rights against anyone," reasoning that an effective waiver would require the insured to waive its own rights); *Approach Operating, LLC v. Resolution Oversight Corp.*, No. 03-11-00688-CV, 2012 WL 2742304, at *3 (Tex. App. Jul. 3, 2012) (approving of this discussion in *Austin*).

P.2d 198, 209 (1984)). Subcontractor makes no effort to engage with this narrow test. (AB41-53.) Rather, Subcontractor relies extensively on the district court's order, which simply is not a response on de novo review. *See Dawson*, 561 F.3d at 933. Subcontractor has failed to justify dismissal of the negligence claim under Arizona's narrow version of the doctrine.

A. The court erred in applying the doctrine in the absence of privity.

1. Subcontractor fails to evade the express language of *Flagstaff Affordable Housing*.

In *Flagstaff Affordable Housing*, the Arizona Supreme Court expressly required "a contract between the plaintiff and defendant" for the economic loss doctrine to apply. 223 Ariz. at 323, 223 P.3d at 667. The court explained that the doctrine's concerns "are not implicated *when the plaintiff lacks privity* and cannot pursue contractual remedies." *Id.* at 327, 223 P.3d at 671 (emphasis added). It weighed cases that had suggested there was no requirement of privity to invoke the rule and expressly "decline[d]" to apply the doctrine in that context. *Id.*

Subcontractor argues at length that the economic loss rule applies in construction defect cases (AB42-43), but none of the cited cases address the privity issue. The economic loss doctrine certainly can apply in construction defect cases—but only if there is "a contract between the plaintiff and defendant." *Flagstaff Affordable Hous.*, 223 Ariz. at 323, 223 P.3d at 667.

Travelers also pointed out that Arizona secondary authority has recognized the privity requirement. (OB42-43.) Subcontractor dismisses this authority as "speculation" but offers neither competing authority nor any analysis to impeach its conclusions. (AB45-46.) *Flagstaff Affordable Housing* itself repeatedly relied on secondary authority to define the scope of the rule. 223 Ariz. at 323, 327, 329, 223 P.3d at 667, 671, 673.

The closest Subcontractor comes to engaging with the rule is to argue that "[t]he Arizona Supreme Court uses the word 'privity' in *Flagstaff Affordable Housing* to denote when a claimant may 'pursue contractual remedies.'" (AB43-44, 46-47.) Subcontractor cites no authority for this interpretation, which is at odds with the Arizona Supreme Court's explanation of the privity limitation as requiring "a contract between the plaintiff and defendant." *Flagstaff Affordable Hous.*, 223 Ariz. at 323, 223 P.3d at 667.

It is also at odds with the longstanding definition of privity in Arizona as the condition of being a *party* to a contract. *Samsel v. Allstate Ins. Co.*, 199 Ariz. 480, 485, 19 P.3d 621, 626 (App. 2001) ("Privity is that connection or relationship which exists between two or more contracting parties. It arises from the mere fact

of entering into a contract.") (quotation and citations omitted)[10]; *Mac Enters. v. Del E. Webb Dev. Co.*, 132 Ariz. 331, 336, 645 P.2d 1245, 1250 (App. 1982) ("Mac is not a party to the primary lease hence there is no privity of estate or contract between it and Webb."). Subcontractor fails to respond to this caselaw from the Opening Brief. (OB43-44.)

Subcontractor's argument is also at odds with caselaw recognizing that even entities who can pursue contractual remedies (like third party beneficiaries) are not in privity of contract: "A third-party beneficiary is one who is *not in privity to a contract*, but who is benefited by it and who may maintain a cause of action for its breach." *United States v. Conservation Chem. Co.*, 653 F. Supp. 152, 208 (W.D. Mo. 1986) (emphasis added); *see, e.g.*, *Samsel*, 199 Ariz. at 485, 19 P.3d at 626 (recognizing that "a third-party beneficiary[] may be able to sue to enforce a contract," but still pointing out that privity is the "connection or relationship which exists between two or more contracting parties" and "arises from the mere fact of entering into a contract"); *Stratton v. Inspiration Consol. Copper Co.*, 140 Ariz. 528, 530-31, 683 P.2d 327, 329-30 (App. 1984) (recognizing that third party beneficiaries may maintain contract claims, but nevertheless noting that a "subcontractor or material supplier generally lacks privity with an owner").

[10] *Vacated on other grounds*, 204 Ariz. 1, 59 P.3d 281 (2002); *see also Mardian Equip. Co. v. St. Paul Fire & Marine Ins. Co.*, No. CV-05-2729-PHX-DGC, 2006 WL 2456214, at *2 (D. Ariz. Aug. 22, 2006) (quoting *Samsel* for this point).

Even the district court embraced no such notion. Rather, it frankly conceded that the Authority and Subcontractor were "Parties not in direct privity"; it only cited non-Arizona caselaw to conclude that "interrelated contracts" are enough to trump that deficit. (ER17-18.) However, as discussed, in *Arizona* privity of contract is required and is not established even by "interrelated contracts."

This principle is established by *Mac Enterprises*, where, as here, there was a general and subcontract that referenced one another *See* 132 Ariz. at 336, 645 P.2d at 1250. If anything, *Mac Enterprises* would present an even stronger case for privity than here because there were additional interrelated contracts tying the two parties together. *See id.* Nevertheless, the *Mac Enterprises* court expressly held that "there is no privity of estate or contract between [Mac] and Webb" and "[s]ince there is no privity between them there can be no waiver of a right, obligation, or undertaking under the primary lease." *Id.*

Subcontractor does not cite any Arizona case in which privity was established based on "interrelated contracts." Nor does Subcontractor make any real attempt to distinguish *Mac Enterprises*. (AB47-48.) Subcontractor merely asserts—without further analysis or any authority—that *Mac Enterprises* is "not comparable" because of "[t]he nature of the contracts/leases, the standard rights and practices of landlords in a strip-mall, and the public-policy implications."

(AB47-48.) None of these things are discussed in *Mac Enterprises* as having anything to do with the fact that the interrelated contracts did not create privity.

Rather, the court held that the parties were not in privity for the simple reason that they were not parties to the same contract: "Mac *is not a party to the primary lease* hence there is no privity of estate or contract between it and Webb." *Mac Enters.*, 132 Ariz. at 336, 645 P.2d at 1250 (emphasis added). The district court erred in ignoring the Arizona caselaw and applying the economic loss rule in the absence of a contract between the Authority and Subcontractor.

2. Subcontractor ignores the policy considerations.

Flagstaff Affordable Housing identified four policy interests that may guide whether to apply the economic loss doctrine, and Travelers noted a fifth, providing argument on all five. (OB 46-49.) Subcontractor ignores all of these concerns and offers no response to Travelers' arguments. It only argues—without authority—that the economic loss rule is designed to hold parties to their bargains. (AB46.)

This is of no help to Subcontractor, as both contracts here *expressly disclaim* any kind of "contractual relationship" beyond the contracts. (ER34 §1.4; ER199 §35.4; OB44-45, 48.) This "contractual relationship" finding is precisely what is necessary for the economic loss doctrine to apply. *Flagstaff Affordable Hous.*, 223 Ariz. at 327, 223 P.3d at 671. Subcontractor does not respond to this argument either.

B. The court erred in applying the economic loss doctrine despite allegations of damage to other property.

1. "Other property" includes property outside of Subcontractor's work.

In the Opening Brief (OB50), Travelers explained that the "other property" exception applies to any property that is not "the subject of the contract" from which the injury allegedly derived. *Flagstaff Affordable Hous.*, 223 Ariz. at 328, 223 P.3d at 672. Subcontractor does not dispute this proposition—in fact, it cites additional authority for it. (AB50 (citing *Cook v. Orkin Exterminating Co.*, 227 Ariz. 331, 335, 258 P.3d 149, 153 (App. 2011) (economic loss rule applies only to the "subject of the construction contract" and "where there has been no injury besides that to the subject property")).) Travelers further explained that the subject of the Subcontract was the stadium exterior, not roofs, sound systems, or anything else. (OB50; *see also* AB16 (conceding scope of work).)

Subcontractor does not dispute Travelers' argument (OB50) that the district court purported to examine the subject of "both contracts" (ER19), and Subcontractor concedes that Travelers indeed "alleged a violation of only the Subcontract" and thus the subject of the Design/Build Agreement has no relevance. (AB48-49.)

Yet despite correctly identifying the contract at issue, Subcontractor simply assumes that the subject of the Subcontract is the "Stadium," without addressing the Subcontract itself, which directly states otherwise:

- The Subcontract provides that "Hunt and Subcontractor expressly desire to contract with respect to *a specific portion of the work* for the design/build project hereinafter described." (ER161 (emphasis added).)
- The Subcontract provides that "The scope of work of this subcontract is to provide design build services to complete *the Exterior Building Enclosure System*," not anything else. (ER204 (emphasis added).)
- The Subcontract lists 35 items comprising the "*specific* scope of work [that] is included in this subcontract," all of which involve the Stadium exterior only. (ER204 (emphasis added).)

Subcontractor does not respond to Travelers' arguments about these provisions (OB51-52) or seek to explain them at all. (*See* AB48-51.) Nor does Subcontractor dispute Travelers' argument that the district court undertook no analysis of *Flagstaff Affordable Housing* on this point and made no effort to determine what the Arizona Supreme Court would decide, as was required. *Giles v. Gen. Motors Acceptance Corp.*, 494 F.3d 865, 872 (9th Cir. 2007).

As noted in the Opening Brief, *Flagstaff Affordable Housing* adopts a narrow rule focused on privity involving the specific contract at issue; it would

tolerate neither the conflation of different contracts nor the violation of the parties' expectation that the subject matter of the Subcontract was the "specific" work undertaken by Subcontractor. (OB52.)

Rather than responding to this argument, Subcontractor, like the district court, relies on the single non-Arizona case of *Indianapolis-Marion County Public Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722 (Ind. 2010). (AB49-51.) But *Indianapolis* does not support Subcontractor's conclusion. As explained in the Opening Brief (OB52-53)—and as Subcontractor conspicuously does not dispute (AB50-51)—the subcontractors in *Indianapolis* performed work on the whole library project and thus the whole library was the property at issue for claims against those subcontractors. 929 N.E.2d at 724-26, 731.

Subcontractor responds not by disputing this, but by asserting that the "focus" of the case was "not the nature of the contracted-for work but what product had been 'contracted for'; in other words, the finished product." (AB50-51.) But that is the point: in *Indianapolis*, the "product [that] had been 'contracted for'" with the subcontractors being sued *was* the "finished product." Here, the product contracted for with Subcontractor was *only* the Stadium's Exterior Building Enclosure System, not the entire Stadium. This case alleges negligent performance of duties in the *Subcontract*, not duties assumed in the Design/Build Agreement.

Even if Indiana law did support the proposition Subcontractor endorses, that would hardly mean that the Arizona Supreme Court would adopt it.[11] To the contrary, *Indianapolis* distinguished Indiana's doctrine from Arizona's because of the fundamental difference between the two:

> [O]ur default position in Indiana is that in general, there is no liability in tort for pure economic loss caused unintentionally. *Arizona appears to take a different approach in this regard. Instead of using the economic loss rule as its default position in respect of non-contracting parties, it directs Arizona courts to "focus on whether the applicable substantive law allows liability in the particular context*."

Indianapolis, 929 N.E.2d at 736 & n.7 (emphasis added) (quoting *Flagstaff Affordable Hous.*, 223 Ariz. at 329, 223 P.3d at 673). If Arizona looked to any other state law, it would be the narrow cases holding that when a subcontractor contracts for a particular scope of work, the "other property" exception applies to everything else. *See, e.g.*, *Goose Creek Consol. Indep. Sch. Dist. v. Jarrar's Plumbing, Inc.*, 74 S.W.3d 486, 495 (Tex. App. 2002); *Thomson v. Espey Huston & Assocs.*, 899 S.W.2d 415, 422 (Tex. App. 1995).[12] It was error to dismiss the claim for damage to non-Subcontract property.

---

[11] Subcontractor suggests that its reading of *Indianapolis* is supported by *Cook*, 227 Ariz. at 335, 258 P.3d at 153, but Travelers does not see any parallel. *Cook* does not involve the issue of what constitutes "other property" and merely restates the general rule (as noted above). *See id.*

[12] Subcontractor argues that in these cases "the owner was not a third-party beneficiary of the contract." (AB51.) First, this argument is waived because no such argument was raised below. (*See* CR34 at 10) (making no such argument).)

2. The court engaged in improper fact-finding with regard to the speaker systems.

Independently, the court should not have dismissed the claim for damages to the speaker systems based on the notion that Travelers "provided no argument" and "failed to demonstrate" that they were other property. (OB55; ER19-20.) Travelers *did* argue this, and Travelers was *not* required to "demonstrate" anything to survive a motion to dismiss. (OB55-56; CR30 at 14-15.) Subcontractor fails to dispute either point. (AB51-53.)

Subcontractor's only argument on appeal is that the allegations that the speaker systems were "other property" were not pled with sufficient factual detail. (AB51-53.) This argument is waived because it was never made below. (*See* CR22 at 15-16; CR34 at 9-10.) Subcontractor only argued that Travelers' allegations were "refuted by the Design/Build Agreement" because it "identifies audio-visual equipment as part of the project" (CR34 at 9), an argument Travelers has disproved (OB55-56) and Subcontractor now abandons (AB 51-53).

Subcontractor's new argument is also incorrect. Subcontractor *concedes* that "Travelers alleged the speakers to be 'other property,'" and says, without

---

Cruz v. Int'l Collection Corp., 673 F.3d 991, 999 (9th Cir. 2012). Regardless, this would not help Subcontractor's "other property" argument. *Goose Creek* and *Thomson* certainly attribute no significance to it—in fact, they expressly reject the notion that a lack of third party beneficiary status undermined the negligence claim. 74 S.W.3d at 494; 899 S.W.2d at 421-22.

further analysis, that "[t]he context of the claim makes clear that the speakers, regardless of Travelers' allegation, were designed and intended to be part of the Stadium Facility." (AB52-53.) But the claim is in the *Complaint*, which specifically alleged that the speaker systems were separate from the Stadium and even more specifically alleged that the speaker systems were the Authority's "business personal property." (ER231-32 ¶17.)

These allegations are more ample than those in *Miidas Greenhouses, LLC v. Global Horticultural, Inc.*, 226 Ariz. 142, 145, 244 P.3d 579, 582 (App. 2010),[13] where the plaintiff "adequately pled damage to 'other property'" simply by "alleg[ing] damage to [the property] several times" and seeking damages that "can be read to encompass . . . the lost [property] for which damage was alleged." Subcontractor's analysis of *Miidas* (AB51-52) conflates the court's factual background following a *motion for summary judgment* with its separate analysis of what was necessary to have "adequately *pled* damage to 'other property.'" *Id.* (emphasis added). Here, as there, the pleading was adequate. Dismissal was therefore improper.

[13] While of course the federal pleading standards control, because the issue is "whether the complaint states a cause of action under [state] law . . . the standard for dismissal in state court is *highly relevant*." *Church of Scientology v. Flynn*, 744 F.2d 694, 696 (9th Cir. 1984) (emphasis added).

III. The Attorneys' Fees Award Should be Vacated.

After Travelers filed its Opening Brief, the district court awarded attorneys' fees to Subcontractor as the prevailing party. (CR56, 61.) Travelers filed a supplemental notice of appeal (CR63), and this Court consolidated that appeal with this one (9th Cir. No. 12-15170, Dkt. #26).

In order to avoid further briefing, the parties stipulated that "reversal and remand for further proceedings on any claim in Case No. 12-15170 would require the vacatur of the grant of attorneys' fees (CR56, 61)." (9th Cir. No. 12-16663, Dkt. #3; *see also* AB54.) Thus, if this Court reverses dismissal on any claim, it must vacate the fee award as well.

CONCLUSION

For the foregoing reasons, the Court should reverse the district court's dismissal and vacate the award of attorneys' fees.

RESPECTFULLY SUBMITTED this 27th day of August, 2012.

LEWIS AND ROCA LLP

By /s/ Susan M. Freeman
Susan M. Freeman
William G. Voit
40 North Central Avenue, Suite 1900
Phoenix, Arizona 85004-4429

and

THE LAW OFFICE OF JAMES K. LAROE, P.C.
James K. LaRoe

Attorneys for Plaintiff-Appellant
The Travelers Indemnity Company

CERTIFICATE OF SERVICE

I hereby certify that on this 27th day of August, 2012, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF System.

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system. I further certify that some of the participants in the case are not registered CM/ECF users. I have mailed the foregoing by First Class, postage prepaid, or have dispatched it to a third party commercial carrier for delivery within three calendar days, to the following:

James K. LaRoe
Law Offices of James K. LaRoe, PC
5910 North Central Expressway, Suite 700
Dallas, Texas 75206

s/ Jeff A. Siatta

CERTIFICATE OF COMPLIANCE

The undersigned certifies that pursuant to FRAP 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached Answering Brief is proportionally spaced, has typeface of 14 or more points, and contains 6,975 words.

s/ Jeff A. Siatta

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE TRAVELERS INDEMNITY COMPANY, as subrogee of Tourism and Sports Authority, DBA Arizona Sports & Tourism Authority, Plaintiff-Appellant, v. CROWN CORR INCORPORATED, an Indiana corporation, Defendant-Appellee.	Nos. 12-15170 and 12-16663 D.C. No. 2:11-cv-00965-JAT United States District Court Arizona (Phoenix)

TRAVELERS' RESPONSE TO
CROWN CORR'S PROPOSED SUPPLEMENTAL BRIEF

LEWIS ROCA ROTHGERBER LLP
Susan M. Freeman
William G. Voit
40 North Central Avenue, Suite 1900
Phoenix, Arizona 85004-4429
(602) 262-5311
and
THE LAW OFFICE OF JAMES K. LAROE, P.C.
James K. LaRoe
5910 North Central Expressway, Suite 700
Dallas, Texas 75201
(214) 219-9000

Attorneys for Plaintiff-Appellant
The Travelers Indemnity Company

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

Cases

Page

Page

Page

Statutes

Other Authorities

Page

INTRODUCTION

Appellant The Travelers Indemnity Company maintains its objections to the supplemental briefing process that Appellee Crown Corr Incorporated unilaterally initiated. This multiplication of the appellate proceedings has been occasioned only by Crown Corr's belated concession that the district court erroneously dismissed Travelers' negligence claim under the economic loss doctrine. Crown Corr has confessed error, so the case should be remanded on at least that ground. This Court need only address at oral argument the remaining subrogation waiver issue as to the contract counts.

However, because the Clerk has entered an Order saying that Crown Corr's Proposed Supplemental Brief will be "lodged for any consideration the panel that considers the merits of the case deems necessary," and ordered that Travelers would have to file a Response within 14 days (Dkt. # 51), Travelers cannot let Crown Corr's brief sit before the merits panel unanswered.

Thus, if the Court chooses to address this new issue, it will find numerous independent reasons why Crown Corr's argument fails. First, Crown Corr has waived its argument by failing to preserve it below. Second, the new argument presupposes that a recent Arizona Supreme Court case that expressly disclaimed any discussion of substantive tort rights nevertheless signaled a sea-change in Arizona law on substantive tort rights.

Third, Crown Corr's argument devolves into a strained and incorrect construction of a fragment of a Comment to a draft of Section 6 of the TENTATIVE DRAFT OF THE RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM (hereinafter "Section 6"). The project draft to which Crown Corr points articulates no intent to recommend the wholesale disenfranchisement of an owner's right to sue a contractor with which it has no contract.

But perhaps most notably, Crown Corr fails to inform the Court that Section 6, on which its argument relies, ***is not part of the current Draft Restatement***. Unlike Sections 1-5 in the Tentative Draft, Section 6 was never taken up for consideration by the American Law Institute, much less approved to be part of the Tentative Draft. *See infra* Part II.A. Per the ALI's own rules, it may not even be cited. Thus, even if Section 6 supported Crown Corr's position (which it does not), considerable revision is likely before any version is adopted. As such, this Court certainly should not declare that Arizona would adopt Crown Corr's labored and incorrect interpretation, as it would reverse decades of Arizona Supreme Court case law and would be inconsistent with the reasoning of the most recent enunciations of the Arizona Supreme Court on economic loss issues.

In sum, Crown Corr's Proposed Supplemental Brief ("PSB") should be rejected and its eleventh-hour attempt to save the concededly-erroneous dismissal of the negligence claim denied. The case should be reversed and remanded.

ARGUMENT

I. Crown Corr Has Waived its New Arguments

A. Crown Corr's New Subrogation Argument is Waived

It is curious for a party to start its proposed supplemental briefing with an argument on which it has not asked for additional briefing, yet that is what Crown Corr does. It should be a tip-off to the Court that something is amiss. Crown Corr says "the Court need not reach the issue briefed herein if this Court affirms the district court's dismissal based on the waiver of the subrogation provision," which Crown Corr alleges it argued "in the primary portion of its briefing [AB20-39], which Crown Corr does not seek to supplement." (PSB at 2.)

To the contrary, Crown Corr's Answering Brief never asked this Court to affirm dismissal of Travelers' negligence claim under the wavier of subrogation provision. Crown Corr only argued that "The District Court Correctly Interpreted the Waiver of Subrogation Provisions in the Contracts to Dismiss Travelers' *Contract Claims*."[1] (AB at 20.) Crown Corr never requested affirmance of dismissal of the *negligence* claim based on the waiver of subrogation provision:

> Crown Corr respectfully submits that this Court should uphold the district court's decision to hold Travelers to the terms of the contract that its insured, the Stadium Authority, had negotiated and, accordingly, affirm the dismissal of Travelers' *contract claims* for subrogation.

[1] Throughout this brief, all emphases are added to quotes unless otherwise noted.

(AB at 39; *see also* AB at 56 ("The district court correctly concluded that Travelers' *contract claims* were barred by the waiver of subrogation provisions found in the Contracts at issue in this case."; "Because the waiver provision barred the *first two of Travelers' claims*, the district court correctly dismissed *these claims*.").) The district court relied exclusively on the economic loss doctrine to dismiss the negligence claim, and that was Crown Corr's sole grounds for requesting that the negligence claim dismissal be affirmed. (AB at 41.)

Despite saying in its Proposed Supplemental Brief that it "does not seek to supplement" its waiver of subrogation argument (PSB at 2), Crown Corr thereupon immediately proceeds to cite a case that it never cited in its Answering Brief. (*Compare* PSB at 2 *with* AB.) That, by definition, is an attempt to "supplement." Perhaps most tellingly, Crown Corr never previously argued that the Court "need not reach" the economic loss doctrine issue on account of the waiver of subrogation provision. (*See* AB at 41-53.) That too is a notion raised for the first time in Crown Corr's Proposed Supplemental Brief, and it is waived by omission from the Answering Brief. *United States v. McEnry*, 659 F.3d 893, 902 (9th Cir. 2011). Crown Corr cannot save the erroneous dismissal of Travelers' negligence claim by pretending that its Answering Brief contract arguments requested affirmance on this alternative basis.

Even if Crown Corr had made such arguments, they would not save the dismissal. First, as detailed extensively in Travelers' Opening and Reply Briefs, the waiver of subrogation here concerns insurance supplied by the general contractor and subcontractors prior to Substantial Completion, in order to prevent disruption to the ongoing project, and it has nothing to do with property insurers like Travelers who step in years later. (OB at 14-38; RB at 4-19.)

Even if that were not plain on the face of the contract, the issue is merely whether the Design/Build Agreement is reasonably susceptible to Travelers' proffered interpretation. *Taylor v. State Farm Mut. Auto. Ins. Co.*, 175 Ariz. 148, 154, 854 P.2d 1134, 1140 (1993). Crown Corr must pass an extraordinary threshold to prevail on its argument; it must affirmatively convince this Court that Travelers' interpretation is "clearly contradicting and wholly unpersuasive" and akin to offering "testimony that white is black and that a dollar is fifty cents." *Id.* at 153-54, 854 P.2d at 1139-40 (quoting 3 CORBIN ON CONTRACTS §579 at 420 (Supp. 1992)). It cannot carry that load, especially here, where even the district court did not buy such a theory as to the negligence claim.

And second, Crown Corr's new citation does not even remotely establish that all subrogation waivers inherently apply to negligence and other types of non-contractual claims. *Fire Ins. Exch. v. Thunderbird Masonry, Inc.*, 177 Ariz. 365, 369-70, 868 P.2d 948, 952-53 (App. 1993), concerned equitable subrogation rather

than conventional subrogation, and it simply involved the scope of waiver among various parties under the particular documents at issue in that case. Crown Corr's failure to develop any actual argument on this point about the documents here is yet another issue it has waived.

B. Crown Corr Waived its New Argument About Substantive Tort Rights by Not Raising it Below

Crown Corr's main argument in the new brief is that Travelers supposedly has no substantive right to proceed in tort. Crown Corr appears to admit that it failed to raise this argument below,[2] which waives it. *Blaisdell v. Frappiea*, 729 F.3d 1237, 1242 (9th Cir. 2013); *G & S Holdings LLC v. Cont'l Cas. Co.*, 697 F.3d 534, 538 (7th Cir. 2012); *see also Medina-Morales v. Ashcroft*, 371 F.3d 520, 527 n.6 (9th Cir. 2004) (denying motion for supplemental briefing regarding argument raised for the first time in the appellee's Rule 28(j) letter, since the argument was untimely and thus waived).

[2] Crown Corr has not always been consistent in its position on this. Crown Corr's Rule 28(j) Letter argued that there were "new grounds for the dismissal." (Dkt. # 36 at 1.) Crown Corr's subsequent Motion for Supplemental Briefing, however, stated that the grounds for its new argument were "argued in the district court." (Dkt. # 41 at 2.) Travelers' Response refuted that (Dkt. # 47 at 4-5), so Crown Corr's Reply went back to arguing that the issue "could not have been raised in the district court." (Dkt. # 49-1 at 2). Should Crown Corr flip-flop back to arguing that it did raise this argument below, that would of course confirm that its argument is untimely, since Crown Corr would have had no possible excuse for failing to include the argument in its Answering Brief.

Crown Corr's excuse for not raising this issue below is to argue that *Sullivan v. Pulte Home Corp.*, 232 Ariz. 344, 306 P.3d 1 (2013), changed Arizona's law regarding the substantive right to proceed in tort. *Sullivan* did nothing of the sort, and Crown Corr cannot raise this argument so late in the day.

1. *Sullivan* Announced No "New Rule" on Substantive Tort Rights

Crown Corr argues that "*Sullivan* suggests for the first time in Arizona" that Arizona courts would "preclude tort liability for certain types of relationships involving claims of economic harm." (PSB at 6.) Whatever it had to say about the economic loss doctrine, *Sullivan* did not purport even to analyze, much less to change, Arizona's substantive law of torts.

Arizona has always required a substantive right to proceed in tort for liability to be imposed, and its caselaw has long given notice that parties can argue about whether there is substantive tort liability given the relationship between the parties. In ¶14, *Sullivan* cites the *Flagstaff Affordable Housing* case, for example, as recognizing that very rule: "whether a non-contracting party may recover economic losses for a defendant's negligent misrepresentation should depend on whether the elements of that tort are satisfied, *including whether the plaintiff is within the limited class of persons to whom the defendant owes a duty*." *Flagstaff Affordable Hous. Ltd. P'ship v. Design Alliance, Inc.*, 223 Ariz. 320, 327-28, ¶39, 223 P.3d 664, 671-72 (2010).

In fact, the Arizona Supreme Court has long recognized the need to inquire "whether the applicable substantive law allows liability in the particular context." *Id.* at 328, ¶39, 223 P.3d 672 (citing *Donnelly Constr. Co. v. Oberg/Hunt/Gilleland*, 139 Ariz. 184, 189, 677 P.2d 1292, 1297 (1984)[3]). The notion that Crown Corr could not have argued before *Sullivan* about "whether the applicable substantive law allows liability," or "whether the plaintiff is within the limited class of persons to whom the defendant owes a duty," is not credible.[4]

In reality, *Sullivan* accepted review of an appeal that had nothing to do with announcing new or different substantive tort rights: "We granted review to answer a recurring question of statewide importance and *to clarify the application of Arizona's economic loss doctrine*." *Sullivan*, 232 Ariz. at 345, ¶6, 306 P.3d at 2. Some courts applying *Flagstaff Affordable Housing* (like the district court here) had failed to give effect to the court's admonitions in that case that the doctrine requires "a contract between the plaintiff and defendant" and is "not implicated

[3] *Disagreed with on other grounds by Gipson v. Kasey*, 214 Ariz. 141, 144, ¶¶14-15, 150 P.3d 228, 231 (2007).

[4] In order to try to excuse its exclusive focus below on the economic loss rule, Crown Corr erroneously states that prior to *Sullivan*, Arizona "primarily" analyzed tort claims through the economic loss rule. (PSB at 3.) To the contrary, prior to *Sullivan* the *Flagstaff Affordable Housing* decision (itself citing other prior authority) expressly provided that in cases like this, with no contractual privity, parties should *not* look to the economic loss rule. *Flagstaff Affordable Hous.*, 223 Ariz. at 327, ¶39, 223 P.3d at 671 ("Rather than rely on the economic loss doctrine to preclude tort claims by non-contracting parties, courts should instead focus on whether the applicable substantive law allows liability in the particular context.").

when the plaintiff lacks privity." 223 Ariz. at 323, 327, ¶¶11, 38, 223 P.3d at 667, 671. Thus, *Sullivan* granted review to affirm that "if the homeowner does not have a contract with the homebuilder . . . the economic loss doctrine does not bar the homeowner's negligence claims." *Sullivan*, 232 Ariz. at 346, ¶1, 306 P.3d at 2.

Sullivan based this holding principally on verbatim quotes from *Flagstaff Affordable Housing*, a case cited at length in the existing briefs in this case. In its 15 short paragraphs, *Sullivan* cites *Flagstaff Affordable Housing* no fewer than 9 times, most often as direct quotes and a series of "*id.*" citations. *See id.* ¶¶7-10.

None of this has anything to do with changing (or even discussing) the substantive tort rights of parties. Indeed, the only thing in *Sullivan* to which Crown Corr points regarding substantive tort rights is its ¶14, which makes the utterly unremarkable statement that "Our holding that the economic loss doctrine does not bar the Sullivans' tort claims does not, of course, imply that those claims will ultimately succeed." *Sullivan*, 232 Ariz. at 347, ¶14, 306 P.3d at 4.

How could a sentence expressly disclaiming any intent to "imply" something, much less issue a holding on it, constitute a new principle of law? Just the opposite; as *Sullivan* itself highlights with the unmistakable use of the words "of course," it was not saying something novel. There is irony in Crown Corr's reliance on *Sullivan* because, unlike Crown Corr, the defendant in *Sullivan* had "made other arguments challenging the legal sufficiency of the tort claims," which

the supreme court did not reach and remanded to the trial court. *Id.* The defendant in *Sullivan* clearly knew that it could make such other arguments, and Crown Corr undoubtedly knew so as well.

In fact, Crown Corr's new brief even admits that it was on notice, conceding that "*Flagstaff Affordable Housing* acknowledged that the initial inquiry is 'whether the applicable substantive law allows liability in the particular context,' 223 P.3d at 672 ¶39." (PSB at 7.) Its proffered excuse for not having raised the issue below or in the Answering Brief is that "prior to *Sullivan*, an Arizona owner seeking tort damages against its subcontractor could have been precluded by the economic loss rule." (*Id.*) In other words, Crown Corr thought it would win on its economic loss argument, so it chose not to raise any argument about substantive tort rights, despite being on notice that it could do so.

That kind of tactical decision is not without consequences. Parties are obligated to raise and preserve alternative arguments should they wish to rely on them later. *See Beverati v. Smith*, 120 F.3d 500, 503 (4th Cir. 1997) (appellate court will consider "all *properly preserved* alternative bases for affirmance advanced by the appellee"); *see, e.g.*, *United States v. Almazan-Becerra*, 482 F.3d 1085, 1090 (9th Cir. 2007) (waiver of alternative argument for affirmance that was not raised in the district court or in the answering brief); *United States v. King*, 244 F.3d 736, 740 n.2 (9th Cir. 2001) (same); *Untied States v. Prigmore*, 243 F.3d 1,

14 n.1 (1st Cir. 2001) ("Whatever merits this alternative argument might have, we disregard it for present purposes because defendants did not sufficiently develop and preserve it as a defense theory in the district court.").

In reversing the dismissal under the economic loss doctrine, *Sullivan* expressly declined to reach any substantive tort issues. Because they had been preserved below (unlike here), it allowed the trial court to "consider those arguments in the first instance on remand." *Sullivan*, 232 Ariz. at 347, ¶14, 306 P.3d at 4. *Sullivan* provides no support for Crown Corr's notion that there has been a change to the law of substantive tort rights such that a wholly new argument, never raised below, could be entertained at this late hour on appeal.

2. Restatements *Restate* the Law, They do Not Create New Law

Crown Corr also seeks justification for not having raised this issue below because it says the current tentative draft of the Restatement (Third) of Torts: Liability for Economic Harm, Tentative Draft No. 1, "was first published in April 2012, after the district court's ruling in December 2011." (PSB at 3.) But the notion that publication of a Restatement of *existing law* creates "new grounds" on which to raise a new argument on appeal is incorrect. Crown Corr conflates the existence of a new authority with a change in the law.

As its very name provides, a Restatement *restates* the law; it does not make new law. From its inception, "[t]he object of the Institute in preparing the

Restatement is to present an orderly statement of the general common law of the United States." RESTATEMENT (FIRST) OF TORTS, INTRODUCTION (1934).

Thus, "[t]he Restatement is not a legislative enactment of new law. It is merely what it professes to be, a restatement of existing principles which were adhered to at common law long before the restatement assembled and restated them." *Johnson v. Canadian Transport Co.*, 127 Cal.Rptr. 72, 79 (Cal. App. 1976); *see also Cannon v. Dunn*, 145 Ariz. 115, 116, 700 P.2d 502, 503 (App. 1985) ("the Restatement is supposed to represent the general law on the subject in the United States"); *Brezenski v. World Truck Transfer, Inc.*, 755 A.2d 36, 42 (Pa. Super. 2000) (involving Restatement of Torts: "Restatement sections do no more than to restate the existing tort law") (citation omitted).

A restatement of the existing law does not justify the failure to raise an issue based on that already existing law. "The courts of [Arizona] look to the Restatement for guidance, not as a law to be followed blindly." *Smith v. Lucia*, 173 Ariz. 290, 298, 842 P.2d 1303, 1311 (App. 1992). And this Court does not entertain supplemental arguments based on new authorities that do not change the law — even if they clarify or expound on it. *See, e.g.*, *Pearson v. Muntz*, 639 F.3d 1185, 1191 n.5 (9th Cir. 2011) (improper to consider new argument after appeal briefing, even though it followed a Supreme Court case clarifying the law, since the underlying argument could have been made before; "As this argument comes

too late, the issue is not properly before us."); *United States v. Diaz*, 637 F.3d 592, 604 n.1 (5th Cir. 2011) (refusing to consider new argument based on supposedly "intervening" opinion because the underlying legal principle was not first announced in that opinion).

Sullivan's "*Cf.*" citation to Section 6, Comment c, hardly evidences Arizona's "new" legal analysis adopting a different Comment, b, that Crown Corr could not have articulated before. *Sullivan*'s "*Cf.*" citation to Comment c appears in the same string citation as the quote from *Flagstaff Affordable Housing* discussed above, which amply preceded the inception of this action. *Sullivan*, 232 Ariz. at 347, ¶14, 306 P.3d at 4. In fact, the project draft for Section 6, on which Crown Corr now relies, cites various other cases for support, ***all of which*** were decided before this lawsuit was even filed. *See* Section 6, Rptr. Note, cmt. b.

Neither *Sullivan*, nor anything it cites, excuses Crown Corr for having failed to raise its argument about "whether the plaintiff is within the limited class of persons to whom the defendant owes a duty" and "whether the applicable substantive law allows liability in the particular context." *Flagstaff Affordable Hous.*, 223 Ariz. at 327-28, ¶39, 223 P.3d at 671-72 (citing *Donnelly*, 139 Ariz. at 189, 677 P.2d at 1297). It cannot raise this issue for the first time on appeal.

C. It Would be Imprudent to Rule Based on This New Argument

Even if there were some excuse for having failed to raise this issue below, it would be unwise for this Court reach the issue now. Crown Corr argues that this Court can affirm despite legal errors by the district court (PSB at 9), but that has nothing to do with affirming based on a wholly *new* argument that has never been raised or argued before. This Court is not in that business. *Proctor v. Vishay Intertechnology*, 584 F.3d 1208, 1226 (9th Cir. 2009) ("we may affirm the district court's holding on any ground *raised below* and fairly supported by the record").

Indeed, "parties cannot properly raise new issues at supplemental briefing, *even if* the issues arise based on the intervening decisions or new developments cited in the supplemental authority." *United States v. Nealy*, 232 F.3d 825, 830 (11th Cir. 2000); *see also United States v. Britt*, 437 F.3d 1103, 1104 (11th Cir. 2006) (court may consider new authority "regarding issues already properly raised in the initial briefs," but not on "new issues . . . even if the issues arise based on the intervening decisions or new developments").

Likewise, this Court will "decline to reframe this appeal to review what would be (in effect) a different case than the one the district court decided below." *Robb v. Bethel Sch. Dist. #403*, 308 F.3d 1047, 1054 n.4 (9th Cir. 2002), *overruled in part on other grounds by Payne v. Peninsula Sch. Dist.*, 653 F.3d 863 (9th Cir. 2011); *see also Myers v. Merrill Lynch & Co.*, 249 F.3d 1087, 1088-89 (9th Cir.

2001) (declining to consider even an argument that was raised below but was then framed on appeal in a way that the district court had not considered). To make the Ninth Circuit the place for new theories (of state law, no less) to be raised in the first instance, in supplemental briefing just before oral argument, would invite an eruption of belated arguments that this Court would doubtless regret.[5]

The thrust of Crown Corr's prudential argument for considering its new contentions is that the existence of a duty is a question of law, and thus the district court supposedly would be superfluous. (PSB at 8.) To the contrary, "[t]he benefits which result from a system in which issues of law are resolved first by a district court and then by the Courts of Appeals are well known particularly to the judges on the Courts of Appeals." *Central Hudson Gas & Elec. Corp. v. U.S.*

[5] This supplemental briefing has been particularly irregular. Originally, after *Sullivan* was decided, Crown Corr made no attempt to seek supplemental briefing. Rather, Crown Corr simply filed a Rule 28(j) Letter (Dkt. # 36), and Travelers filed a Rule 28(j) Response (Dkt. # 38). Crown Corr ruminated on Travelers' Response for a month, apparently concluded that it did not like the Rule 28(j) results, and proceeded to file a Motion for Supplemental Briefing. (Dkt. # 41.) Travelers filed an Opposition. (Dkt. # 47.) Then, 77 days after *Sullivan* and 54 days after receiving our Rule 28(j) Response, Crown Corr unilaterally filed its Proposed Supplemental Brief (Dkt. # 49-2) with its Reply (Dkt. # 49-1). The Clerk ordered that the Proposed Supplemental Brief be "lodged for any consideration the panel that considers the merits of the case deems necessary" and ordered that Travelers file its Response to the Proposed Supplemental Brief within just 14 days. (Dkt. # 51.) To date, there has been no order even authorizing supplemental briefs, much less providing a briefing schedule or other procedural parameters. It also bears noting that Crown Corr has repeatedly re-styled arguments throughout this process. *See, e.g.*, *supra* n.2; *compare* Dkt. ## 36, 41, 49.

E.P.A., 587 F.2d 549, 557 (2d Cir. 1978); *accord Estate of Bleck ex rel. Churchill v. City of Alamosa, Colo.*, --- F. App'x ----, 2013 WL 5878802, at *10 (10th Cir. Nov. 4, 2013) ("even as to a purely legal question, we benefit in many instances from giving the district court the opportunity to consider it first"). No "judicial economy" will be served by deciding the issue in this appeal. The only reason there is briefing before this Court right now is because Crown Corr is *asking* to have briefing before this Court, not because the Court has already taken it up.

More importantly, the question of whether there is a substantive tort duty in Arizona is not some slapdash issue the Court could quickly proclaim, as Crown Corr suggests. The merits of this issue are addressed further below, but the Arizona Supreme Court has cautioned that the issue is "whether the applicable substantive law allows liability *in the particular context*." *Flagstaff Affordable Hous.*, 223 Ariz. at 327, ¶39, 223 P.3d at 671. Duty is a context-specific analysis that, were it really an issue, would benefit from a more searching inquiry.

Finally, this is a question of state law, which this Court is reluctant to reach if it can be avoided. *Certain Underwriters at Lloyds v. Inlet Fisheries Inc.*, 518 F.3d 645, 650 (9th Cir. 2008) ("We are reluctant, however, to construe [the forum's] state law unnecessarily[.]"). Here, Crown Corr is asking this Court, in the first instance, on supplemental briefing, to be the first to proclaim that Arizona

would follow Crown Corr's (erroneous) construction of an as-yet unapproved section of a Tentative Draft of a Restatement. It should decline that invitation.

II. Crown Corr's Argument is Substantively Wrong

Not only are the Proposed Supplemental Brief arguments untimely and waived, but Crown Corr's contention that the Court should interpret Arizona law based on the draft Section 6 is deeply flawed.

A. Arguments Based on Section 6 Are Premature and Overreach

The premise of Crown Corr's entire argument is that Arizona would follow a portion of "a subsequent section of the Draft Restatement – Section 6" that was not mentioned, even by a "*Cf.*", in *Sullivan*. (PSB at 4.) While the Section 6 to which Crown Corr refers may be available for perusal on Westlaw, it is not a section of the Draft Restatement and remains unapproved by the ALI.

For ongoing projects to be included as part of citable Restatements, including Tentative Drafts, they must be taken up for debate, amendment, and approval at an ALI Annual Meeting. Until then, they are not approved, not part of the Draft Restatement, and as such not citable. *See* ALI, Can I Cite ALI Project Drafts?, http://www.ali.org/index.cfm?fuseaction=publications.faq ("*Once it is approved by the Council and by the membership at an Annual Meeting*, a Tentative Draft or a Proposed Final Draft represents the most current statement of ALI's position on the subject and may be cited in opinions or briefs . . . .").

While Sections 1-5 of this Restatement (Third) project were taken up, amended, and approved (as modified) at the ALI's 2012 Annual Meeting, Section 6 was not even discussed, much less amended and approved. *See* ALI, Proceedings of the 89th Annual Meeting, at vi (2012) ("the membership approved §§ 1-5 of the Tentative Draft on Torts; there was insufficient time to consider § 6") [excerpts attached hereto as Exhibit 1].[6] On its face, the unapproved draft of Section 6 that is publicly available is even mistaken, duplicating Sections 6(1) and 6(2) with subsections that do not flow. (*See* Dkt. # 36 (attachment to Crown Corr's Rule 28(j) Letter).)

Accordingly, the ALI itself does not acknowledge Section 6 as part of the current draft Restatement and forbids citation as if it were. *See* ALI, Publication of the Restatement (Third) of Torts: Liability for Economic Harm Tentative Draft No. 1, http://www.ali.org/index.cfm?fuseaction=publications.ppage&node_id=137 (only "Sections 1 through 5 of Chapter 1 were approved," and "*with regard to these sections*, T.D. No. 1 may be cited as representing the Institute's position").

Thus, Crown Corr is asking this Court to proclaim that Arizona will follow a comment in an *unedited* and *unapproved* initial project draft of something that *might* one day become part of a first Tentative Draft *in some modified form*

[6] The Restatement (Third) of Torts: Liability for Economic Harm was not on the agenda for the 2013 Annual Meeting. *See* http://2013am.ali.org/agenda.cfm.

because *Sullivan* cited ***different*** provisions in the Tentative Draft. That is an extraordinary and untenable position.

Indeed, *Sullivan* merely noted that its decision "align[ed] with the most recent draft" on the fact that, in the absence of a contract, there can be no economic loss objection to a tort claim. 232 Ariz. at 346, ¶10, 306 P.3d at 3 (citing Tentative Draft Section 3, Comment a). *Sullivan's* only reference to Section 6 (in the "*Cf.*" citation in ¶14) did ***not*** cite or refer to Comment b, on which Crown Corr's argument is based, and said nothing about Section 6 implicating the existence of substantive tort duties from contractors to owners. Rather, *Sullivan* cited Section 6 Comment c on liability to "subsequent purchasers of property," which addressed an issue raised below in *Sullivan* but indisputably has no application here.[7]

Nor, contrary to Crown Corr's representation, did the *Sullivan* court opine, even on this unrelated issue, about whether such arguments "likely" would succeed on remand. (PSB at 4.) Certainly this Court has enough respect for the Arizona Supreme Court to know that it does not prejudge the issues it remands. In reality, *Sullivan* simply noted that other issues had been raised below, that there was a

[7] The *Sullivan* defendant had alternatively argued below that dismissal of the negligence claims could be affirmed, even if the economic loss doctrine did not apply, because as subsequent purchasers "Pulte did not deal with plaintiffs in any fashion" and thus the plaintiffs could not have relied on its representations. *See* Answering Brief, *Sullivan v. Pulte Home Corp.*, No. 1 CA-CV 10-0754, *available at* 2011 WL 862092, at *32 n.9. Here, the Authority was not a subsequent purchaser and Crown Corr knew the Authority would be relying on its work.

"division of authority," that its decision "does not, of course, imply" any views about the merits of the other arguments, and that the trial court "may consider those arguments in the first instance." 232 Ariz. at 347, ¶14, 306 P.3d at 4.

B. Adopting the Rule Crown Corr Advances Would Change Arizona Law

Crown Corr's enormously broad assertion that "Arizona law would prohibit construction-project owners from suing subcontractors in tort" (PSB at 8-9), based on a snippet of a comment to the unapproved draft Section 6 ***not*** cited by *Sullivan*, is unsupportable.

1. Arizona Has Long Recognized a Substantive Tort Duty

While the Arizona caselaw prior to *Flagstaff Affordable Housing* reflected inconsistencies about when and how to apply the economic loss doctrine, it has never been inconsistent on the existence of a substantive tort duty of care in circumstances like those at issue here.

Instead, Arizona has long recognized the existence of tort duties owed by contractors to property owners. *Flagstaff Affordable Housing* recognized that a homeowner may sue a builder/contractor both in contract for breach of an implied warranty "and in tort for the builder's breach of the common law duty of care." 223 Ariz. at 324, ¶20, 223 P.3d at 668 (citing *Woodward v. Chirco Constr. Co.*, 141 Ariz. 514, 515-16, 687 P.2d 1269, 1270-71 (1984) (duty of care recognized)); *see also Chambers v. W. Ariz. CATV*, 130 Ariz. 605, 607, 638 P.2d 219, 221

(1981) (contractor laying and connecting television cables owed duty of care to homeowner, citing RESTATEMENT (SECOND) OF TORTS § 299A (1965)); *St. Joseph's Hosp. & Med. Ctr. v. Reserve Life Ins. Co.*, 154 Ariz. 307, 315, 742 P.2d 808, 816 (1987) ("the *duty which the law recognizes* arises because the defendant has held himself out to be trained in a particular trade or profession") (quoting *Kreisman v. Thomas*, 12 Ariz. App. 215, 220, 469 P.2d 107, 112 (1970)); RESTATEMENT (SECOND) OF TORTS § 299A ("one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities").

Crown Corr is a "licensed professional." A.R.S. §§ 12-2601(3), 32-1101(A)(3). (*See also* ER161 (Crown Corr is a licensed professional with the Arizona Registrar of Contractors).)[8] "As a matter of public policy, attorneys, accountants, and ***other professionals owe special duties to their clients***, and

[8] Not only was Crown Corr a licensed building contractor, it assumed the responsibilities of a design engineer as well. (ER162 §3.1 ("This is a design/build subcontract, therefore the Subcontractor's Work includes the provision of all necessary design services for the proper design of the Subcontractor's work . . . ."); *see also* ER163 §3.3 (scope of work included design and engineering services), ER 204 (scope of work included, among other design obligations, providing "a complete engineered / stamped design for the exterior building enclosure as required to meet all code and wind loading requirements").) The Subcontract specifically provides that "all design services shall be performed by qualified and *licensed architects, engineers and other professionals*." (ER164 §3.4(c).)

breaches of those duties are generally recognized as torts." *Barmat v. John & Jane Doe Partners A-D*, 155 Ariz. 519, 523, 747 P.2d 1218, 1222 (1987).

Another case recognizing that contractors have a general duty under tort law to owners is *Valley Forge Insurance Co. v. Sam's Plumbing, LLC*, 220 Ariz. 512, 207 P.3d 765 (App. 2009), in which a property owner's insurer brought a negligence claim in subrogation against a plumbing contractor, which had contracted with the tenant that was developing the property. The Arizona Court of Appeals analyzed the economic loss doctrine and concluded that it did not apply, in so doing being 100% clear that there was a substantive tort duty of care: "Sam's Plumbing ***had a general duty under tort law***, separate from any contractually assumed obligation, to exercise reasonable care in any work undertaken." *Id.* at 517, 207 P.3d at 769.

Such authorities establish that in Arizona, construction professionals (like the subcontractor Crown Corr) do indeed owe substantive tort duties, the breach of which will need to be proved at trial on remand. And in Arizona, Travelers may maintain that action despite the absence of privity of contract. *Donnelly*, 139 Ariz. at 187, 677 P.2d at 1295 ("There is no requirement of privity in this state to maintain an action in tort.").

2. Section 6 Also Recognizes a Substantive Tort Duty

Resting on its construction of a portion of Comment b to Section 6, Crown Corr conspicuously makes no effort to engage with the actual Blackletter, which is contrary to Crown Corr's argument. Section 6 sets forth a general rule of liability, not the absence of liability, when the defendant "fails to exercise reasonable care" in performing its service:

> One who, in the course of his business, profession, or employment, or in any other transaction in which he has a pecuniary interest, performs a service for the benefit of others, ***is subject to liability for pecuniary loss caused to them*** by their reliance upon the service, if he fails to exercise reasonable care in performing it.

Section 6(1). By its very terms, this section acknowledges a duty by persons performing services for the benefit of others "to exercise reasonable care in performing" those services. *Id.* The substantive tort duty is recognized.

Draft Section 6(4) sets forth a limitation on the general rule of liability that comports with the economic loss rule applicable to *contracting* parties: "This Section does not recognize liability for negligence in the course of negotiating or performing a contract between the parties." Section 6(4). The comments are clear that this is the exception to liability otherwise imposed under the general rule. *See* Section 6, cmt. a ("Liability under this Section . . . is unavailable when the defendant's negligence occurs in the performance of a contract with the plaintiff.").

The critical language, of course, is "a contract between the parties." Section 6(4). That is the very thing that is absent here and the very reason that economic loss principles cannot bar Travelers' negligence claim.

Comment b to Section 6, on which Crown Corr relies, is an example of the exception to liability stated in subsection (4) of the Blackletter rule. The cases on which Comment b to Section 6 relies (collected in the Reporter's Note to Comment b) are economic loss doctrine cases. They include, for instance, *Indianapolis-Marion County Public Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722 (Ind. 2010). That case actually recognized that "engineers and design professionals (as are the Defendants here) owe such a duty of care" on its way to finding the claim was barred by Indiana's economic loss rule. *Id.* at 734. *Indianapolis* even stated that its law regarding that rule is different than Arizona's. *Id.* at 736 & n.17 (quoting *Flagstaff Affordable Hous.*, 223 Ariz. at 328, ¶39, 223 P.3d 672).

Thus, the draft of Section 6, Comment b does not broadly announce, as Crown Corr claims, that owners can never sue subcontractors in tort where there is no contract between them. It by no means "recommends" such a broad onslaught to the common law of negligence. (PSB at 5.) Rather, the Comment turns on the absence of a negligence claim where the contractor's negligence "is viewed just as a failure in the performance of its obligations to its *contractual* partner," Section 6,

cmt. b, consistent with the Blackletter that there is a general rule of liability, with only an exception for negligence in the course of "performing a *contract between the parties*," Section 6(4). Again, these circumstances are not present here.[9] As Travelers reads this section, it is consistent with Arizona's now-settled rule in *Sullivan* and *Flagstaff Affordable Housing* to allow tort claims for economic losses in the absence of a contract between the parties.

3. Even if Crown Corr's Interpretation of Section 6 were Correct, Arizona Cannot be Predicted to Follow It

Even if Crown Corr were right that Comment b to Section 6 really means that non-contracting owners lack a substantive tort right against professional contractors, the Arizona Supreme Court cannot be predicted by this Court to follow such a rule, having rejected the very same argument in *Sullivan* and *Flagstaff Affordable Housing*.

While it is often said (as Crown Corr does) that Arizona, like many states, "generally" follows the Restatement, *see In re Estate of Zilles*, 219 Ariz. 527, 534, 200 P.3d 1024, 1031 (App. 2008), it is just as often said that Arizona courts "do

[9] Moreover, the justification offered by the comment — avoiding disruption of the relationship between the contractors and those with whom they are working — has no application in the post-construction circumstances at issue here. We are years and years past completion of the stadium, and thus there is no possible disruption by allowing a tort claim. (*Cf.* OB at 36 (discussing authority rejecting the same argument as supposedly defeating a post-completion subrogation claim, as at that point there would be no disruption to the completed project).)

not follow the Restatement blindly" and will come to a contrary conclusion where Arizona law or sound policy counsels otherwise. *Powers v. Taser Int'l, Inc.*, 217 Ariz. 398, 403, 174 P.3d 777, 782 (App. 2007) (citing *Barnes v. Outlaw*, 192 Ariz. 283, 285, 964 P.2d 484, 486 (1998) ("We are not bound by the Restatement" and "we will not [follow it] blindly")); *see also Cook v. Cook*, 209 Ariz. 487, 490, 104 P.3d 857, 860 (App. 2005) ("While Arizona invokes some principles from the Restatement, we do not follow it in certain significant regards.").

Examples of Arizona's departure from the Restatement are numerous. *See, e.g.*, *Grubb v. Do It Best Corp.*, 230 Ariz. 1, 3 n.2, 279 P.3d 626, 628 n.2 (App. 2012) (Arizona statute and common law broader than the Restatement, and thus "we will not follow this portion of the Restatement"); *Villareal v. Ariz. Dep't of Transp.*, 160 Ariz. 474, 479, 774 P.2d 213, 218 (1989) (recognizing a particular tort claim despite Restatement); *Basurto v. Utah Constr. & Min. Co.*, 15 Ariz. App. 35, 39, 485 P.2d 859, 863 (1971) (recognizing third party beneficiary law does not track the Restatement); *W. Coach Corp. v. Vaughn*, 9 Ariz. App. 336, 339, 452 P.2d 117, 120 (1969) ("we do not follow the Restatement view" regarding punitive damages liability of employer for acts of corporate employees).

Arizona law already has several exceptions specifically to the Tentative Draft of the Restatement (Third) of Torts: Liability for Economic Harms. Section 4 of the Tentative Draft, for instance, adopts a particular services exception to the

economic loss rule for contracting parties, while Arizona has disclaimed such an exception. *See Flagstaff Affordable Hous.*, 223 Ariz. at 328, ¶41, 223 P.3d at 672. Another example is Section 3 of the Tentative Draft, which itself recognizes that *Formento v. Encanto Bus. Park*, 154 Ariz. 495, 744 P.2d 22 (App. 1987), is the "leading case for the minority view" rejecting the Restatement's position on applicability of the economic loss rule to cases of inducement to sign a contract by the defendant's negligent misrepresentations. Section 3, cmt. d.

Unlike many states, Arizona has announced a very narrow view of principles that would limit tort recovery of economic damages. "[A]s the Arizona Supreme Court has observed, in Arizona there is no 'blanket disallowance for tort recovery for economic losses.'" *Evans v. Singer*, 518 F. Supp. 2d 1134, 1145 (D. Ariz. 2007) (quoting *Salt River Project Agric. Improvement & Power Dist. v. Westinghouse Elec. Corp.*, 143 Ariz. 368, 379, 694 P.2d 198, 209 (1984)). Yet Crown Corr asks this Court to predict for Arizona the classic "blanket disallowance for tort recovery" that Arizona has emphatically rejected. *See Sullivan*, 232 Ariz. at 345, ¶8, 306 P.3d at 2 ("Although some courts apply the doctrine to generally bar tort recovery of purely pecuniary losses, *Arizona takes a narrower approach*.").

Crown Corr says that "policy goals" that should establish a "prohibition against tort liability by subcontractors to the owners of construction projects" are

"the same as Arizona's justification for the economic loss rule." (PSB at 5-6.) But the policy goals on which Crown Corr relies were held to establish that Arizona's economic loss doctrine does ***not*** apply to bar tort claims of non-contracting parties. *Sullivan*, 232 Ariz. at 346, ¶¶10-11, 306 P.3d at 3 ("Limiting the doctrine to contracting parties supports those policy considerations . . . ."); *Flagstaff Affordable Housing*, 223 Ariz. at 325-26, ¶¶26-29, 223 P.3d at 669-670 (policies favor prohibiting tort liability under the doctrine only between contracting parties, and thus only "a contracting party is limited to its contractual remedies for purely economic loss from construction defects").

If the very same policies do not justify barring tort claims of non-contracting parties under the economic loss rule, they cannot justify barring the tort claims of non-contracting parties under a theory with a different name. It would be a thoroughly absurd outcome to apply the very same policy, yet reach a different result. *See Patches v. Indus. Comm'n of Ariz.*, 220 Ariz. 179, 182, ¶10, 204 P.3d 437, 440 (App. 2009) (courts applying Arizona law avoid absurd results). And there is no policy that would justify barring tort recovery here, for the same reasons as discussed in the prior briefing. (OB at 46-49.)

III. The "Other Property" Exception Would Still Apply Anyway

Finally, even if Crown Corr's new argument could jump every other hurdle, it still would not avoid the "other property" problem that has already been briefed

and which calls for reversal. There can be no doubt that there is a substantive right to recover in tort for physical injuries caused to a person or to other property, regardless of the ability to pursue tort damages for property subject to a contract. *Flagstaff Affordable Hous.*, 223 Ariz. at 328, ¶42, 223 P.3d at 672 (Arizona "*allows tort recovery* if there is also physical injury to persons or other property").

For whatever else it purports to do, Section 6 is clear that damage to "other property" is excepted from the rule it posits. Section 6's Illustration 6, for instance, provides that a subsequent purchaser has no claim against the builder of a house purchased from the seller, *but only* where "[t]he defects cause no personal injuries and no damage to other property." Section 6, illus. 6.

As explained in Travelers' Opening and Reply Briefs, some of the property damaged by Crown Corr's defective design and construction of the stadium exterior was not the property that was the subject of Crown Corr's subcontract, but rather other property (e.g., the stadium roof and speaker systems). (OB at 49-58; RB at 25-30.) Because Crown Corr's negligence caused damage to other property, Crown Corr can (and should) be held accountable for that negligence.

CONCLUSION

The district court's dismissal of Travelers' negligence claim has been conceded to be error. Crown Corr's new argument in its proposed supplemental briefing was available long ago, was never asserted, and is therefore waived. It

also is wrong on the substance. This Court should reverse dismissal of the negligence claim, and it also should reverse dismissal of the contract claim based on the district court's erroneous subrogation waiver ruling, for the reasons set forth in the Opening and Reply Briefs, so that Travelers' suit may be resolved on the merits.

RESPECTFULLY SUBMITTED this 12th day of November, 2013.

LEWIS ROCA ROTHGERBER LLP

By /s/ Susan M. Freeman
Susan M. Freeman
William G. Voit
40 North Central Avenue, Suite 1900
Phoenix, Arizona 85004-4429

and

THE LAW OFFICE OF JAMES K. LAROE, P.C.
James K. LaRoe
5910 North Central Expressway, Suite 700
Dallas, Texas 75201
Attorneys for Plaintiff-Appellant
The Travelers Indemnity Company

CERTIFICATE OF SERVICE

I hereby certify that on this 12th day of November, 2013, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF System.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

s/ Jeff A. Siatta

CERTIFICATE OF COMPLIANCE

The undersigned certifies that the attached Response to Proposed Supplemental Brief is proportionally spaced Times New Roman, has typeface of 14 or more points, and contains 6,693 words.

s/ Jeff A. Siatta

EXHIBIT 1

EXHIBIT 1

89th
Annual Meeting
The American Law Institute
Proceedings 2012

Executive Office
The American Law Institute
4025 Chestnut Street
Philadelphia, PA 19104-3099
telephone: (215) 243-1600
fax: (215) 243-1636
e-mail: ali@ali.org
website: http://www.ali.org

7. Employee Privacy and Autonomy (§§ 7.01-7.07). Appendix: Black Letter of Tentative Draft No. 5];

• Report to ALI of Legal and Economic Principles of World Trade Law [Preface; The Genesis of the GATT Summary; Why the WTO? An Introduction to the Economics of Trade Agreements; Border Instruments; National Treatment];

• Discussion Draft of Principles of the Law of Liability Insurance [Chapter 1. Basic Liability Insurance Contract Principles. Appendix: Black Letter of Discussion Draft];

• Report to ALI of Principles of Election Law: Resolution of Election Disputes [Model Calendar for the Resolution of Disputed Elections (8/9-week version); Reporter's Notes on Model Calendar for the Resolution of Disputed Elections (8/9-week version); Model Calendar for the Resolution of Disputed Presidential Elections (5-week version); Reporter's Notes on Model Calendar for the Resolution of Disputed Presidential Elections (5-week version); Expedited Procedures for an Unresolved Presidential Election; The Resolution of Ballot-Counting Disputes; *How Fair Can Be Faster: The Lessons of* Coleman v. Franken (page proofs); Non-Precinct Voting. Appendix: *Lessons from Minnesota 2008 and Beyond: Reforming the Absentee Voting Process*];

• Report to ALI of Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases [Global Principles for Cooperation in International Insolvency Cases [Full text without Commentary]; Global Guidelines for Court-to-Court Communications in International Insolvency Cases [Full text without Commentary]; Section I. Introduction and Overview; Section II. Global Principles for Cooperation in International Insolvency Cases; Section III. Global Guidelines for Court-to-Court Communications in International Insolvency Cases. Appendix: Glossary of Terms and Descriptions; Annex: Global Rules on Conflict-of-Laws Matters in International Insolvency Cases].

Subject to the discussion at the Meeting and to editorial prerogative, the membership approved §§ 1-5 of the Tentative Draft on Torts; there was insufficient time to consider § 6 (see pages 46-47). It also approved Chapter 1 and §§ 4-1 through 4-25 of Chapter 4 of the draft on International Commercial Arbitration; there was insufficient time to consider the remaining Sections of Chapter 4 (see page 184). The draft on Employment Law was approved in its entirety (see page 239). The proposed amendment to U.C.C. § 4A-108 was likewise approved by the membership (see pages 277-278).

The Discussion Drafts on Sentencing and Liability Insurance were extensively discussed, but as planned, no votes were taken.

In addition, during the Tuesday morning special session on ALI's membership process, President Ramo and Judge Paul Friedman, chair of the ad hoc committee on membership process, led a discussion during which members made many suggestions, all of which will be given serious consideration. Also

whose conduct, plaintiff or defendant, caused the harm the plaintiff claims, and I think courts have regularly and routinely been using the same elements of causes of action after the adoption of comparative responsibility as they did before.

My question is this: Are there cases that have changed the elements of underlying causes of action or torts as a result of the adoption of comparative responsibility, and if so, should we discuss those, and if not, should we leave the common law, the elements of the torts, as they are stated?

Professor Farnsworth: I think that if you read the cases, what you find is courts treat these like ordinary negligence cases that happen to involve negligent misrepresentations as the kind of negligence at stake, and they don't regard justifiable reliance as a threshold showing that the plaintiff loses for not putting forward; they treat it as a matter for comparative responsibility. So I think the way that it is written here reflects what courts are actually doing.

If you are asking, are there courts that have explicitly said, "Let us now revisit this cause of action," I am not sure about that. There probably are, there are dozens of courts that have gotten into this issue, and most of them have ended up resolving it in favor of comparative responsibility. I don't know if they have spoken of it, though, in the way that you describe.

Vice President Black: And finally, the last member at microphone 6 for one minute.

Mr. H. Mark Stichel (Md.): My question also involves subsection (4), and that is, how would you treat cases coming from states such as Maryland that still have contributory negligence as a complete bar to recovery? Justifiable reliance seems to at least give you some wiggle room, whereas a pure contributory negligence rule gives you no wiggle room at all.

Professor Farnsworth: Well, of course, the Institute does not endorse the all-or-nothing approach to begin with, so I don't want to spend a lot of time in the Restatement advising about how to go about using this in that jurisdiction. But I would be happy to make a comment in the Reporter's Note that we don't mean to create an all-or-nothing regime by omission of justifiable reliance.

Mr. Stichel: I appreciate that, because the way it is written now, I think one could interpret the black-letter law as saying that in contributory-negligence states.

Professor Farnsworth: Okay. I will be happy to make an addition about that.

Vice President Black: Mr. Boskey-Wagner, please.

Mr. Bill Wagner (Fla.): In the temporary absence of Mr. Boskey but on his behalf, I am happy to move that the Institute's membership approve

this Tentative Draft, subject to the usual editorial prerogatives and subject to the discussion at this Annual Meeting.

Vice President Black: Up through § 5. Is there a second to that motion?

Unidentified Speaker: Second.

Vice President Black: Any discussion?

All in favor.

(*There was a chorus of ayes.*)

Opposed.

The ayes clearly have it.

Director Liebman: Now let's thank almost-Dean Farnsworth.

Vice President Black: We need to do two things. Thank the Reporter. (*Applause*)

And I need to give you a stern lecture to be back in your seats by 1:45. That means that even with all the straggling in and so forth and so on, you will be here by 2:00 and in your seats when Justice Stevens arrives.

(*At 12:30 p.m., a lunch recess was taken until 1:58 p.m. the same day.*)

WO

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

The Travelers Indemnity Company, as subrogee of Tourism and Sports Authority d/b/a Arizona Sports & Tourism Authority, Plaintiff, vs. Crown Corr, Inc., Defendant.	No. CV 11-0965-PHX-JAT **AMENDED JUNE 29, 2012 ORDER**

Pending before the Court is Crown Corr's Motion for Award of Attorneys' Fees and Non-Taxable Expenses (Doc. 39).

I. BACKGROUND[1]

This Court previously granted Crown Corr's Motion to Dismiss Plaintiff's Complaint. In its Complaint, Travelers sought to recover roughly $1.4 million in damages that it paid on behalf of its insured, Tourism and Sports Authority ("TSA"). TSA is the owner of the University of Phoenix Stadium (the "Facility"). Hunt Construction ("Hunt") entered into a "Design/Build Agreement" (the "DBA") with TSA for the construction of the Facility. Hunt then entered into a subcontract (the "Subcontract") with Defendant Crown Corr for services

[1] A more in-depth background regarding the contracts and parties discussed herein can be found in the Court's December 27, 2011 Order. *See Travelers Indem. Co. v. Crown Corr, Inc.*, No. CV 11-0965-PHX-JAT, 2011 WL 6780885 (D. Ariz. Dec. 27, 2011).

relating to the construction of the Facility. Travelers' Complaint was dismissed with prejudice. Crown Corr now moves, pursuant to Federal Rules of Civil Procedure 54(d)(2), for an award of attorneys' fees and non-taxable expenses and argues that it is entitled to such fees pursuant to contractual authority and statutory authority. Travelers disputes Crown Corr's entitlement to attorneys' fees.

A. Whether There is Contractual Authority for an Award of Attorneys' Fees

Crown Corr claims to be entitled to an award of attorneys' fees pursuant to paragraph 14.6 of the Agreement for Design/Build Services ("DBA") (Doc. 22-2 at 90), which states:

> The prevailing party in any litigation shall be entitled to recover from the other party its reasonable attorneys' fees, costs, and consultants' fees and other expenses incurred by the prevailing party in connection with such litigation.

(Doc. 22-2 at 90). Crown Corr admits that it is not a party to the DBA, but instead claims that, because the DBA was incorporated into the Subcontract between Hunt and itself, this provision should apply to allow it to recover attorneys' fees. (Doc 48 at 2). Crown Corr also argues that paragraph 14.6 should be dispositive because Travelers cited this provision "as part of its claim against Crown Corr." *Id.* In response, Travelers argues that Crown Corr was neither a party nor a third-party beneficiary of this provision of the DBA and thus Travelers is not bound by paragraph 14.6 because Travelers was not a party to the Subcontract. (Doc. 51 at 2-3).

The Court agrees that Crown Corr is not entitled to fees under paragraph 14.6 of the DBA. Although the Subcontract incorporates the DBA, it does not make Crown Corr a third-party beneficiary to all of the provisions of the DBA. Crown Corr fails to point to any language in the DBA making it a third-party beneficiary of the attorneys' fees provision of the DBA. Accordingly, Crown Corr is not entitled to attorneys' fees based on paragraph 14.6 of the DBA.

B. Whether There is Statutory Authority for an Award of Attorneys' Fees

Crown Corr next argues that it is entitled to attorneys' fees under A.R.S. section 12-

341.01. (Doc. 39 at 2). That provision allows a Court to award attorneys' fees to the successful party in any dispute "arising out of" a contract dispute. A.R.S. § 12-341.01. Travelers contends that the provisions of the Subcontract are "incompatible with an award to [Crown Corr]." (Doc. 51 at 5). Travelers further asserts that the Subcontract's terms expressly exclude an award of this nature and that Arizona law precludes considering section 12-341.01 where a contract seeks to control the award of attorneys' fees. *Id.* at 6. Travelers also argues, in the alternative, that Crown Corr should not be awarded attorneys' fees because it did not comply with LRCiv. 54.2. *Id.* at 7. Finally, Travelers argues that, even if section 12-341.01 does apply, it should not be applied based on the *Warner* factors.[2] *Id.* The Court will now examine these issues.

1. Whether 12-341.01 Applies

Travelers argues that where "contractual terms are inconsistent with an award of fees, a court *cannot* award them under a statute." (Doc. 51 at 5). Travelers claims that paragraph 33.6 of the Subcontract contains a "specific, express provision limiting the recoverable fees and expenses to those incurred by the general contractor . . .". *Id*. Travelers reads this provision to 'expressly [provide] that the ***only*** 'attorneys' fees, disbursements or costs' that may be awarded under the Subcontract are those 'incurred by Hunt or for which Hunt is liable to others under the [Contracts] or applicable law.'" *Id.* (emphasis added). Travelers cites to *Jordan v. Burgbacher*, 883 P.2d 458 (Ariz. Ct. App. 1994) to support its argument. *Id.* There, the Court held that section 12-341.01 was inapplicable when a contract governed the recovery of attorneys' fees. *Jordan*, 883 P.2d 458.

Paragraph 33.6 of the Subcontract states:

> Whenever reasonable attorneys' fees, disbursements or costs *are referred to in this Subcontract*, ***such terms include***, ***without***

---

[2] In *Associated Indem. Corp. v. Warner*, 694 P.2d 1181 (Ariz. 1985), the Court identified six factors that should be used in determining whether an award of attorneys' fees is appropriate under A.R.S. 12-341.01.

> ***limitation***, the following expenses paid or incurred by Hunt or for which Hunt is liable to others.

(Doc. 22-3 at 39) (emphasis added). Travelers argues that this definitional provision somehow limits recoverable attorneys' fees to Hunt and parties to which Hunt is liable. However, paragraph 33.6 attempts to further *define* the terms "attorneys' fees, disbursement, or costs," but it does not limit them. *Id*. The terms "include" and "without limitation" mean that Hunt was to recover fees when they were referred to in the Subcontract. However, this definition does not, on its face, limit recovery of fees to Hunt. *See Black's Law Dictionary*, (9th ed. 2009), include. The phrase "without limitation" means that the terms listed are not the only terms included. Any reading of this provision as creating a unilateral contract solely in favor of Hunt is untenable on the plain language of paragraph 33.6. Travelers has not pointed to any other part of the Subcontract that purports to limit the recovery of attorneys' fees to Hunt.

Even if this provision purported to limit fees to Hunt, Arizona courts "will not infer a prohibition against the recovery of attorneys' fees to one party under [section] 12-341.01 simply because a contract contains a unilateral attorneys' fee provision favorable to another party." *Pioneer Roofing Co. v. Mardian Constr. Co.*, 733 P.2d 652, 668 (Ariz. Ct. App. 1986); *see McDowell Mountain Ranch Cmty. Ass'n v. Simons*, 165 P.3d 667, 669 n.1 (Ariz. Ct. App. 2007).

Accordingly, as Travelers has pointed to no specific provision in the contracts limiting Crown Corr's ability to pursue attorneys' fees, section 12-341.01 applies to a fee award in this case.

2. Whether Crown Corr Complied with Local Rules

Travelers argues that Crown Corr is not entitled to fees because it did not comply with Local Rule 54.2. (Doc. 51 at 8). Local Rule 54.2(d) requires a party moving for attorneys' fees to provide supporting documentation, which must include a statement of consultation, a fee agreement, an itemized statement of fees, and an affidavit. LRCiv 54.2(d). That

affidavit must contain statements regarding the background of each attorney involved in the litigation and the reasonableness of the rate and time spent. *Id.* Within the attorneys' statement on reasonableness, the Local Rules indicate the moving party must discuss whether or not the client has paid their attorneys' bills and if so, to what extent. *Id.*

The moving attorneys must also demonstrate that they have exercised billing judgment in these affidavits. *Id.* Noncompliance with any of these rules can justify a Court in entirely rejecting an application for fees, as they are "not advisory, but are mandatory to support an award of attorneys' fees." *Societe Civile Succession Richard Guiono v. Beseder, Inc.*, No. CV 03-1310-PHX-MHM, 2007 WL 3238703, at *7 (D. Ariz. Oct. 31, 2007). In some cases, however, a Court may overlook mere "procedural irregularity" and award fees in the face of a violation of Local Rule 54.2. *Schrum v. Burlington N. Santa Fe Ry. Co.*, CV 04-0619-PHX-RCB, 2008 WL 2278137, at *3 (D. Ariz. May 30, 2008).

Travelers first argues that Crown Corr has not demonstrated exercise of billing judgment. (Doc. 51 at 8). Crown Corr contends that it has made a showing of billing judgment in Doc. 48-1. (Doc. 52 at 8). The Court agrees. Doc. 48-1 is an affidavit signed by James L. Blair in which he asserts personal knowledge of the background and reasonableness of fees. The Court can find no violation of Local Rule 54.2 for failure to exercise billing judgment. (Doc. 48-1).

Travelers next alleges that Crown Corr has failed to attach fee agreements or to describe which fees have been paid in its motion for attorneys' fees. In response, Crown Corr contends that it has attached these agreements and included descriptions in Doc. 48-1 and Doc. 52-1. (Doc. 52 at 9). Doc. 52-1 contains affidavits dealing with fee agreements and Crown Corr's payment history. (Doc. 52-1). Accordingly, Doc. 48-1 and Doc. 52-1 contain the information necessary to satisfy the fee agreements and descriptions requirement.

3. Whether Crown Corr Is Entitled to an Award

Under Arizona law, "[i]n any contested action arising out of a contract, express or implied, the court may award the successful party reasonable attorney fees." A.R.S. § 12-

341.01(a). Therefore, in order to award attorneys' fees to Crown Corr under this statute, the Court must find that Crown Corr is the "successful party," that the action arose out of a contract, that the award of attorneys' fees is appropriate, and that the fees are reasonable.

a. Whether Crown Corr is a Successful Party

Crown Corr is the "successful party" under A.R.S. section 12-341.01(a). Under Arizona law, to determine whether a party is a successful party, the Court considers the "totality of the litigation." *All Am. Distrib. Co., Inc. v. Miller Brewing Co.*, 736 F.2d 530, 532 (9th Cir. 1984); *see Nataros v. Fine Arts Gallery of Scottsdale*, 612 P.2d 500, 505 (Ariz. Ct. App. 1980). "[T]he fact that a party does not recover the full measure of relief it requests does not mean it is not the successful party." *Sanborn v. Booker & Wake Prop. Mgmt., Inc.*, 874 P.2d 982, 987 (Ariz. Ct. App. 1994).

In the present case, the Court granted a motion to dismiss with prejudice in favor of Crown Corr and judgment was entered in favor of Crown Corr. Travelers contends that Crown Corr had a number of motions denied,[3] however these motions were immaterial to the ultimate disposition of the case, as Crown Corr's motion to dismiss was granted. *See e.g.* Doc. 37 at 1-4. Therefore, Crown Corr is a "successful party" within the meaning of A.R.S. § 12-341.01(a).

b. Whether the Action Arises Out of Contract

This case arises out of a contract. When determining whether an action arises "out of a contract," a court must consider the "essence of the action." *ASH, Inc. v. Mesa Unified Sch. Dist. No. 4*, 673 P.2d 934, 937 (Ariz. Ct. App. 1983). If "a contract was a factor in causing the dispute," the action arose out of the contract. *Id.* at 937.

Neither party disputes that this action arose from contracts related to the construction of the Facility. Accordingly, the contracts were "factor[s] in causing the dispute" and,

[3] The Court denied Defendant's Motion for Summary Disposition of the Motion to Dismiss Third Amended Complaint with Supporting Affidavit and granted Plaintiff's Motion for Extension of Time to Answer.

therefore, this action arose from a contract within the meaning of section 12-341.01(a).

c. Whether the Award is Appropriate

An award of attorneys' fees is appropriate. Under A.R.S. § 12-341.01, the Court *may* award reasonable attorneys' fees. There is no presumption in favor of granting attorneys' fees in contract actions; rather, it is a matter within the discretion of the Court. *Warner*, 694 P.2d at 1183-84. The Arizona Supreme Court has enumerated six factors that courts must consider when deciding whether to award attorneys' fees to a prevailing party: (1) the merits of the unsuccessful party's claim or defense; (2) whether litigation could have been avoided or settled; (3) whether assessing fees against the unsuccessful party would cause extreme hardship; (4) whether the successful party prevailed with respect to all relief sought; (5) the novelty of the issues; and (6) whether the award would discourage other parties with tenable claims or defenses from litigating or defending legitimate contract issues for fear of incurring liability for substantial amounts of attorneys' fees. *Id.* at 1184.

Here, Travelers failed to assert a successful claim because its insured waived its subrogation rights. While there may have been some issues that were "open to debate," as Travelers' puts it, these issues were not necessary to the resolution of the case or were ultimately rejected by the Court. Because Travelers failed to make a claim that warranted litigation past dismissal, this factor weighs in favor of awarding attorneys' fees.

Second, the record is generally devoid of any real effort to avoid or settle this lawsuit on the part of Travelers or Crown Corr. Crown Corr claims it contacted Travelers asking for a withdrawal of the claims and Travelers refused. Crown Corr argues that, because Travelers had no subrogation rights, and thus no right to bring a suit, this withdrawal would have been proper. However, asking the other side to withdraw its suit does not fall under the category of negotiation. This Court has been presented with no evidence that either side made significant efforts to negotiate a settlement. Thus, this factor does not favor either party.

Third, Travelers has failed to allege that an award of attorneys' fees would present an "extreme hardship." Travelers has offered no evidence to show any financial circumstances

sufficient to suggest an undue hardship. Therefore, the Court cannot consider Travelers' hardship in determining whether to award fees. *See Rowland v. Great State Ins. Co.*, 20 P.3d 1158, 1168, n. 7 (Ariz. Ct. App. 2001); *Woerth v. City of Flagstaff*, 808 P.2d 297, 305 (Ariz. Ct. App. 1991) (party seeking fees bears burden of proving entitlement to fees, except, on this prong, burden shifts to party opposing fees to come forward with prime facie evidence of financial hardship, and that evidence must be in the form of sworn testimony). Thus, this factor weighs in favor of awarding attorneys' fees.

Fourth, Travelers argues that, because Crown Corr was denied summary disposition and on opposing an extension of time, Crown Corr did not "prevail on all relief sought." Doc. 51 at 12. However, Crown Corr's success was not dependent on those motions and Crown Corr accomplished its goal by having the case dismissed. Doc. 37 at 1-4. Thus, this factor weighs in favor of awarding attorneys' fees.

Fifth, Travelers brought a breach of contract claim against Crown Corr. Although these matters are adjudicated in the courts on a daily basis, this case presented some novel issues. Crown Corr admits "this lawsuit presented a somewhat novel question of law" and then refers specifically to the "issues open to debate" that have been mentioned above. Doc. 48 at 8. Novelty weighs against awarding fees. *Rowland*, 20 P.3d 1158, at 1168. Thus, this factor weighs against awarding attorneys' fees.

As to the last factor, an award of attorneys' fees in this case would not discourage other parties with tenable claims from pursuing such claims. While the fear of incurring liability for substantial amounts of attorneys' fees will generally tend to discourage litigation, the legislature has specifically provided for attorneys' fees in contract disputes. *See* Ariz. Rev. Stat. Ann. §12-341.01. Awarding attorneys' fees in such cases has the effect of dissuading litigants from taking a case to trial when there are clear contractual provisions that prohibit litigation. Because the contract claims in this case were barred by the DBA, an award of attorneys' fees will not have the effect of precluding meritorious claims.

Therefore, the Court finds that the factors-based analysis of the appropriateness of

attorneys' fees tilts sharply, though not entirely, in favor of Crown Corr. Thus, an award of attorneys' fees is appropriate in this case.

d. Whether the Fees and Expenses are Reasonable

The final step in the attorneys' fees analysis is to determine whether the fees sought by Crown Corr are reasonable. *See Schweiger v. China Doll Rest., Inc.*, 673 P.2d 927, 931 (Ariz. Ct. App. 1983). In the original motion, Crown Corr sought an estimated $190,000 in fees. Thereafter, Crown Corr filed a Memorandum in Support of Crown Corr's Motion for Attorneys' Fees, wherein Crown Corr amended its fees. Crown Corr now seeks $189,822.61 in fees and expenses. (Doc. 52 at 11).

The Court may award the successful party in a contract action reasonable attorneys' fees. A.R.S. § 12-341.01(a). Once a party submits an itemized list of fees with sufficient detail and establishes entitlement to fees, the burden then shifts to the party challenging the fees to show that the fees are unreasonable. *See Nolan v. Starlight Pines Homeowners Ass'n*, 167 P.3d 1277, 1286 (Ariz. Ct. App. 2007).

When determining if a fee award is reasonable, the Court must consider the hourly fee and the number of hours worked. *Jordan v. Multnomah Cnty.*, 815 F.2d 1258, 1262 (9th Cir. 1987). In this case, Travelers does not challenge the hourly rates that Crown Corr's attorneys charged, but instead argues that the amount of hours worked was excessive. Thus, the Court will only review the amount of hours worked. (Doc. 51 at 13-17).

In analyzing the reasonableness of hours expended, the Court looks to the amount of hours that would be expended by a "reasonable and prudent lawyer." *China Doll*, 673 P.2d at 932. Further, "[i]n order for the court to make a determination that the hours claimed are justified, the fee application must be in sufficient detail to enable the court to assess the reasonableness of the time incurred." *Id.* An award may also be reduced for hours not "reasonably expended." *Id.* As the United States Supreme Court explained in *Hensley v. Eckerhart*, 461 U.S. 424 (1983),

> Counsel for the prevailing party should make a good faith effort

> to exclude from a fee request hours that are excessive, redundant, or otherwise unnecessary, just as a lawyer in private practice ethically is obligated to exclude such hours from his fees submission.

Id. at 434.

Travelers has raised a number of objections to the reasonableness of the hours claimed by Crown Corr. Travelers challenges Crown Corr's fee application, in part, because eighteen attorneys worked on the case, which Travelers claims necessarily involves duplication of effort and inefficiencies. (Doc. 51 at 17). Undoubtably, the more timekeepers a firm has working on a case, the higher the likelihood of duplication of effort and wasted time. On the other hand, complicated litigation of a significant magnitude may demand the resources of multiple attorneys and firms. *See Agster v. Maricopa Cnty.*, 486 F.Supp.2d 1005, 1015-16 (D. Ariz. 2007).

Crown Corr defends the number of attorneys that worked on the case by arguing that eight of those attorneys worked two hours or less. (Doc. 52 at 10). While ten attorneys working on one case may seem excessive, the litigation involved potential claimants in three different states and a claim at issue of over one million dollars. After a careful review of the invoices for Crown Corr's three defense firms and their supporting affidavits, the Court is satisfied that the hours billed are not excessive. This Court is unwilling to reduce fees without some kind of supporting evidence that the fees are excessive. Where entries have provided a sufficient amount of information, the Court has found the amount of hours billed on the litigation to be reasonable. The fees will not be reduced for being excessive.

Travelers challenges the pre-complaint investigation and analysis fees on the basis that they were charged before the complaint was filed, and, alternatively, that the investigation is unrelated to the litigation. (Doc 51 at 16). Pre-complaint work is considered part of the process of litigation and can be included in an award for fees. *Pioneer Roofing Co.*, 733 P.2d at 665. While pre-complaint work is important to litigation, this Court cannot find any authority which justifies a presumption of the validity of pre-complaint fees and expenses.

Travelers asserts that the "vast majority of fees incurred by . . . Donovan Hatem and Sullivan Ward . . . actually involve Crown Corr's insurance carriers' post-storm investigations and claims monitoring for *multiple insureds* and *multiple potential claimaints.*" (Doc. 51 at 16). In fact, Travelers contends that Crown Corr has attempted to "pull a 'fast one' on this Court." *Id.*

The Donovan Hatem invoice contains fee entries that do appear to be unrelated to the claim. One entry reads:

> "02/14/11 KRR L120:A104 REVIEW COVERAGE COUNSEL'S PROPOSED AMENDMENT TO JOINT DEFENSE AGREEMENT CLAUSE REGARDING CONFLICT COUNSEL IN CONJUNCTION WITH UNI SYSTEM'S AND WALTER P. MOORE'S REQUESTS REGARDING THE SAME PROVISION TO PREPARE FOR TELEPHONE CONFERENCE WITH LEXINGTON."

(Doc. 48-2 at 85). To support their assertion that these fees are related, Crown Corr has submitted the sworn affidavit of Gwen P. Weisberg. In her affidavit, Ms. Weisberg asserted "The Donovan Hatem invoices cover a fourteen (14) month period, August 2010 through October 2011, and approximately $52,000. The first nine (9) months represent pre-litigation legal services, e.g., analyzing the claims and relevant contracts, negotiating with Travelers, and working with consulting experts (Bliss & Nyitray, Inc., for example), *to understand and attempt to resolve the Travelers claim pre-lawsuit*. (Doc. 52-1 at 6) (emphasis added). Ms. Weisberg also asserts that "[a]ll of the pre-lawsuit investigation and negotiations contributed significantly to the successful resolution of the lawsuit." *Id.* at 7.

Based on this affidavit, the Court can only conclude that any ambiguity in the invoices must be a factor of the brief nature of a fee entry, and not, as Travelers asserts, bad faith.[4]

---

[4] Federal Rule of Civil Procedure 11 indicates:

> By presenting to the court a pleading, written motion, or other paper--whether by signing, filing, submitting, or later advocating it--an attorney or unrepresented party certifies that to the best of the person's knowledge, information, and belief,

However, as a large majority of the pre-complaint litigation does, indeed, appear to be unrelated to the litigation, the Court must exclude the majority of these fees pursuant to Local Rule 54.2(e)(2). That rule indicates that the "party seeking an award of fees must adequately describe the services rendered so that the reasonableness of the charge can be evaluated." LRCiv 54.2(e)(2). The rule also provides that if "the time descriptions are incomplete, or if such descriptions fail to adequately describe the service rendered, the court may reduce the award accordingly." *Id.* So, while the Court does not lend credence to Plaintiff's contention that Defendant's fee award request was made in bad faith, Defendant's invoices have not been kept in a manner that sufficiently describe the services rendered and their relationship to the Crown Corr litigation. After a careful review of these invoices, the Court finds that there is insufficient evidence to justify an award of fees for the Donovan Hatem pre-complaint litigation. Accordingly, the Court has reduced the Donovan Hatem fee award to $9,481. This reduction takes into account a complete exclusion of pre-complaint fees.

Similarly, many of Sullivan Ward's invoice entries are incomplete or too vague to assess. Most notable are those relating to correspondence. The Local Rules provide that telephone conferences must "identify all participants and the reason for the telephone call,"

> formed after an inquiry reasonable under the circumstances: (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation; (2) the claims, defenses, and other legal contentions are warranted by existing law or by a non-frivolous argument for extending, modifying, or reversing existing law or for establishing new law; (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information.

Fed. R. Civ. P. 11. Because both parties to this suit are aware of this Rule, the Court will rely on their briefs and affidavits in the absence of evidence of bad faith.

Id. This requirement also applies to emails and physical correspondence. *See* LRCiv. 54.2(e)(2)(A)-(D)(providing examples of billing entries). Because these entries, and others, are incomplete, the Sullivan Ward fee award will be reduced to $4,275. This reduction takes into account a complete exclusion of fees where the entries do not conform to the Local Rules.

For the preceding reasons, the Court has determined that the requested fee award is reasonable, but that a portion of it is too unclear to assess properly.

e. Whether Crown Corr is Entitled to Expenses

Because Crown Corr is claiming fees pursuant to A.R.S. sections 12-341 and 12-341.01, Arizona law is controlling here. At the outset of any discussion of expenses, it is valuable to draw a distinction between taxable and non-taxable costs. Under Arizona law, taxable costs that can be recovered pursuant to A.R.S. §12-341 are limited, by A.R.S. 12-332, to "expenses incurred for witness fees, deposition expenses, certified copies, surety expenses, and other costs incurred pursuant to an agreement between the parties." *Ahwatukee Custom Estates Mgmt Ass'n, Inc. v. Bach*, 973 P.2d 106, 107 (Ariz. 1999). The court in *Bach* specifically recognized that "section 12-332 does not permit recovery of expenses incurred for photocopying, long distance telephone calls, messenger and delivery charges, and telecopier or fax charges." *Id.* Section 12-332 also contains no provision allowing travel expenses. In order to claim taxable expenses under Local Rule 54.1(a), a claimant must file a Bill of Costs with the Clerk of the Court. LRCiv. 54.1(a).

Further, the Arizona Supreme Court has held that non-taxable costs are not recoverable under 12-341.01. *Bach*, 973 P.2d at 109. Unless provided for by statute, non-taxable costs are generally not recoverable. *Id.* More specifically, expert witness expenses are not allowed under 12.341.01 as they are not activities undertaken by an attorney. *Id.* (indicating that 12-341.01 is limited to "[an attorney's] legal training and knowledge as it relates to the legal services rendered to, or on behalf of, a particular client.").

In the instant case, Crown Corr has not filed a Bill of Costs, and cannot claim taxable

expenses. Even if they could, none of Crown Corr's expenses are of a type that can be claimed as taxable expenses under section 12-332. Because there is no statutory provision allowing the Court to award Crown Corr non-taxable expenses, it is not entitled to these expenses. Therefore, the Court will not award any expenses to Crown Corr and will reduce its request by $30,834.81.

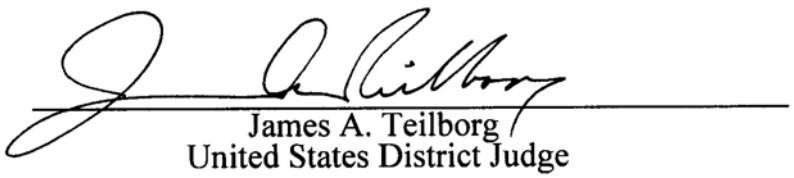
II. CONCLUSION

The Court finds that an award amount of $105,284.10 is reasonable. This award takes into account a reduction of $84,538.51 for incurable ambiguity and a rejection of expenses.

Based on the foregoing,

IT IS ORDERED that Crown Corr's Motion for Award of Attorneys' Fees and Non-Taxable Expenses (Doc. 39) is granted in the amount of $105,284.10.

DATED this 9th day of July, 2012.



James A. Teilborg
United States District Judge