IN THE SUPREME COURT OF THE STATE OF MONTANA
DA 21-0273

R.S. AND D.S.,

Plaintiffs and Appellants,

v.

UNITED STATES AUTOMOBILE ASSOCIATION,

Defendant and Appellee.

BRIEF OF APPELLANTS

On Appeal from the Thirteenth Judicial District Court, Yellowstone County,
The Honorable Jessica Fehr, Presiding.

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STATEMENT OF ISSUES

1. Did the District Court err in finding USAA owed no duty to defend because the act of hiding a camera in a shower to surreptitiously record a minor was not an "occurrence" under a homeowners insurance policy?
2. Did the District Court err in finding USAA owed no duty to defend because of an exclusion for claims "arising out of" sexual misconduct?

STATEMENT OF THE CASE

Underlying Case

In August 2018, United States Automobile Association ("USAA") customer Shawn Conrad ("Conrad") hid cameras in the shower at his insured home to surreptitiously record R.S., a minor, while bathing. R.S. found the hidden cameras and notified her mother, D.S., who alerted the police. Law enforcement searched Conrad's computer and located child pornography.

Conrad was indicted in federal court for child sexual exploitation and possession of child pornography. In May 2019, Conrad pleaded guilty *only* to possession of child pornography. The pornographic images on Conrad's computer were *not* of R.S. showering, but "selfie images of various girls" he downloaded from the internet. Conrad was sentenced to federal prison.

In May 2019, R.S. sued Conrad for invading her privacy and negligent or intentional infliction of emotional distress. In August 2019, two days after

receiving the *Complaint*, USAA refused to defend Conrad, citing to his guilty plea for possession of child pornography and his intentional act of hiding cameras in his shower.

In October 2019, R.S. amended her complaint to include new, independent claims from D.S. alleging her own emotional distress. The *Amended Complaint* also explicitly alleged Conrad did not intend for R.S. to find the hidden cameras and did not expect or intend to cause her harm. Conrad sent USAA the *Amended Complaint* and again requested a defense. Seven days after receiving the *Amended Complaint*, USAA advised Conrad its position remained unchanged and again refused to defend him.

In June 2020, Conrad confessed judgment to R.S. and D.S. for $500,000 and assigned them his rights against USAA.

This Action

On June 9, 2020, R.S. and D.S. sued USAA, seeking a declaration that USAA breached its duty to defend Conrad in the underlying case and contractual damages. Plaintiffs sought summary judgment in September 2020, which USAA resisted under M.R.Civ.P. 56(f) by claiming it needed to conduct discovery because it "cannot present all facts it believes are essential" to justify its opposition to the summary judgment motion. The Court denied USAA's motion in January 2021 and USAA cross-moved for summary judgment in February 2021. No

hearing on the cross-motions was held. On May 28, 2021, the District Court granted USAA summary judgment, finding R.S. and D.S. failed to allege an "occurrence" as defined under the USAA policy, and ruling an exclusion for injuries "arising out of" sexual misconduct was "unambiguous and a clear exclusion from coverage." Plaintiffs timely appealed.

STATEMENT OF FACTS

In August 2018, Shawn Conrad placed hidden cameras in his bathroom and encouraged R.S., a minor, to take a shower, secretly recording her while doing so. *Order, p. 2*. (hereinafter "*Appendix 1").* R.S. discovered the cameras, confronted Conrad and told her mother, D.S., who made a complaint to police. *Id*. Law enforcement obtained a subpoena and searched Conrad's computer. *Id*.

Conrad was indicted in January 2019 on federal criminal charges of child sexual exploitation and possession of child pornography. *Id*. In May 2019, Conrad pled guilty only to possession of child pornography. *Id*. He did not plead guilty to child sexual exploitation. *Id*. In his colloquy at his change of plea hearing, he explained the child pornography on his computer was downloaded from the internet and consisted of "selfie images of various girls." *Appendix 8, p. 24*. His conviction was *not* related to the surreptitious filming of R.S. *Id*.

At Conrad's sentencing hearing, D.S. testified that, "I think it is important to speak to the charge that the defendant is not pleading guilty to, because that is the crime that has hurt my daughter and our family the most." *Appendix 7, p. 34.*

On May 31, 2019, R.S. sued Conrad in Yellowstone County District Court. *Appendix 2*. Her *Complaint* alleged Conrad hid cameras in his bathroom and secretly recorded her naked. *Id., ¶ 2*. Conrad admitted this in his *Answer*. *Appendix 3*, ¶ 1.

R.S. also alleged that when police searched, they "located naked images of R.S. as well as other child pornography on Conrad's computer." *Appendix 2, ¶ 3*. Conrad *denied* this in his Answer. *Appendix 3, ¶ 2*.

Conrad also admitted he was indicted in federal court for possession of child pornography and child sexual exploitation but that he pleaded guilty only to possession of child pornography. *Appendix 2, ¶¶ 4-5; Appendix 3, ¶ 1*.

Conrad *denied* that he invaded R.S.'s privacy. *Appendix 2, ¶ 6; Appendix 3, ¶3*. Conrad also *denied* that he negligently or intentionally inflicted severe and permanent emotional distress on R.S. *Appendix 2, ¶ 7; Appendix 3, ¶3*.

At the time Conrad hid cameras in his shower, USAA insured him under a homeowners policy, which promised him a defense and up to $300,000 of indemnity for his personal liability. *Appendix 1, p. 2*. Conrad tendered the defense of R.S. and D.S.'s lawsuit to USAA. *Id*. The insurer received Conrad's request for

a defense and a copy of the *Complaint* on August 12, 2019. *USAA's Statement of Undisputed Facts*, *Doc. 23*[1]*, Exhibit A-2, ¶ 8*. USAA received a copy of Conrad's *Answer* on August 13, 2019. *Id*. ¶ 14.

The next day, August 14, 2019, USAA sent its Coverage and Defense Denial letter to Conrad. *Appendix 4*. In refusing to defend Conrad, USAA provided the following rationale:

> We have completed our investigation and coverage review. It is our understanding in August, 2018 it is alleged your client, our insured, Mr. Shawn Conrad, had installed video cameras in his bathroom located at 3140 N Morning Glory Dr. Billings, Montana, Yellowstone County. Mr. Conrad encouraged the plaintiff, age 12, and referred to as R.S. in the complaint to take a shower and thus secretly recorded R.S. naked. R.S. found the cameras.
>
> It is noted in your answer Mr. Conrad admits to the allegations in paragraphs 1, 2, 4 and 5. Allegation 4, states Mr. Conrad was indicted in Federal court for possession of child pornography and child sexual exploitation. Allegation 5 states in May, 2019, Mr. Conrad pled guilty to possession of child pornography and is awaiting sentencing.
>
> …
>
> As you can see, the allegations in the Complaint do not meet the definition of an Occurrence as defined in your policy as your actions were not accidental. In addition, the Plaintiff is alleging Emotional Distress, which does not meet the definition of Bodily Injury as defined in your policy.
>
> In addition your Homeowners policy has the following exclusions which specifically applies to your actions of intentionally installing a

[1] Documents not included in the *Appendix of Appellants* are referenced by their Document Number in the District Court Clerk's Case Register Report.

> video camera for the purposes of creating a pornographic video, for which you have pled guilty.
>
> …
>
> Based on the above policy language and exclusions, we are denying coverage for this loss. There has been no occurrence as defined in your policy. Therefore, there is no duty to defend. If you have additional information you would like us to consider, please send to me for review.

On October 9, 2019, R.S. amended her complaint against Conrad. *Appendix 5*. The *Amended Complaint* asserted separate, independent claims for emotional distress suffered by D.S. upon learning from R.S. what had occurred; alleged physical manifestations of their severe emotional distress and specifically alleged that in hiding the cameras, "Defendant did not intend for R.S., or anyone else, to find the videocameras and consequently did not reasonably expect or intend to cause injury to R.S." *Id., ¶¶, 3, 4, 5, 6, 10*.

On October 31, 2019, Conrad submitted the *Amended Complaint* to USAA and again requested USAA defend him. *Doc. 23, ¶ 38, Exhibit L*. On November 7, 2019, USAA again refused to defend Conrad. *Appendix 6*. In its second Coverage and Tender of Defense Denial, USAA wrote:

> USAA has reviewed the amended complaint, R.S. and D.S. vs. Shawn Thomas Conrad. Our position remains unchanged. USAA has denied coverage and therefore denies Mr. Conrad's request to defend and indemnify him against the claims presented.
>
> I've attached our previous denial letter for your reference.

At no point did USAA file a declaratory judgment action to establish its duties under its contract with Conrad and has affirmatively stated "it was not required [to file a declaratory judgment action] because the policy did not provide coverage." *Doc. 1, ¶ 15; Doc. 7, ¶ 15*.

USAA did not acknowledge the *Amended Complaint*: (1) added a new party asserting independent claims, and (2) specifically alleged Conrad did not intend the cameras to be found and did not expect or intend to harm R.S. *Appendix 5 & 6*.

Left without a defense, on June 8, 2020, Conrad confessed judgment for $500,000 and assigned his claims, including contractual and first-party claims, to R.S. and D.S. *Appendix 1, p. 3*; *Doc. 11, Exhibit 3*.

In June 2020, R.S. and D.S. filed this action seeking to enforce the confessed judgment against USAA. *Doc. 1*. Plaintiffs sought summary judgment on September 11, 2020. *Doc. 10*. USAA sought an opportunity to depose Conrad per M.R.Civ.P. 56(f) which was denied by the District Court in January 2021. *Docs. 13, 18*. USAA cross-moved for summary judgment in February 2021. *Doc. 21*. The District Court did not hold oral argument and granted USAA summary judgment on May 28, 2021. *Appendix 1*.

This appeal was timely taken on June 4, 2021. *Doc. 30*.

USAA POLICY PROVISIONS

Conrad's USAA Homeowner's Policy contains the following provisions relevant to this appeal:

> DEFINITIONS
> …
> 14. "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions, which results, during the policy period in: (a) "Bodily injury"; or (b) "Property damage".
>
> LIABILITY COVERAGES
>
> COVERAGE E – Personal Liability
> If a claim is made or a suit if brought against any "insured" for "damages" because of "bodily injury" or "property damage" caused by an "occurrence" to which this coverage applies, we will:
> …
> 2. Provide a defense at our expense by counsel of our choice, even if the suit is groundless, false or fraudulent.
>
> EXCLUSIONS
>
> Coverage E – Personal Liability and Coverage F – Medical Payments to Others do not apply to "bodily injury" or "property damage":
> …
> q. Arising out of any actual, alleged or threatened:
> (1) Sexual misconduct; or
> (2) Sexual harassment; or
> (3) Sexual molestation.

Doc. 23, Ex. 1.

STANDARD OF REVIEW

This Court reviews *de novo* a district court's rulings on summary judgment, applying the same criteria of M.R.Civ.P. 56. *Pilgeram v. GreenPoint Mort.*

Funding, Inc., 2013 MT 354, ¶ 9, 373 Mont. 1, 313 P.3d 839. The Court reviews a district court's conclusions of law to determine whether they are correct and its findings of fact to determine whether they are clearly erroneous. *Id*. At the summary judgment stage, a district court cannot "make findings of fact, weigh the evidence, choose one disputed fact over another, or assess the credibility of a witness." *Employers Mut. Cas. Co. v. Fisher Builders, Inc*., 2016 MT 91, ¶ 13, 383 Mont. 187, 371 P.3d 375. "All reasonable inferences which may be drawn from the offered proof must be drawn in favor of the party opposing summary judgment." *Watkins Trust v. Lacosta*, 2004 MT 144, ¶ 16, 321 Mont. 432, 92 P.3d 620.

SUMMARY OF ARGUMENT

This is a duty to defend case.

Both USAA and the District Court misapprehend the correct inquiry in a duty to defend case and wrongly engaged in a duty to indemnify analysis. This Court recently directed USAA and district courts that the analysis in a duty to defend case is simple: unless an insurer makes an "unequivocal demonstration" the contested claim does not fall within the policy's scope, the carrier must defend. *Huckins v. USAA*, 2017 MT 143, ¶¶ 14, 27-28, 387 Mont. 514, 396 P.3d 121. *Huckins* was not USAA's first failure to defend a Montana insured. *Lee v. USAA*, 2004 MT 54, ¶ 22, 320 Mont. 174, 86 P.3d 562. This Court has "repeatedly

admonished insurers" facing potential disputes to "defend the insured and file a declaratory judgment action to discern coverage." *State Farm v. Freyer*, 2013 MT 301, ¶ 37, 372 Mont. 191, 312 P.3d 403.

Conrad's conduct was indisputably contemptable. However, USAA may not abandon an insured to whom it is obligated to act in good faith if there is even a chance a claim falls within its policy. Likewise, USAA may not rely upon universal condemnation of an insured's reprehensible conduct to avoid its contractual duty to defend.

The District Court never found USAA "unequivocally demonstrated" the facts alleged in the pleadings, as applied to policy language, fell outside the policy's scope. Instead, it found that R.S.'s emotional harm was the "direct and natural result of Conrad's intentional conduct," and therefore did not meet the definition of an "occurrence." *Appendix 1, p. 9*. This is not Montana law.

The District Court erred by ignoring the allegation in the *Amended Complaint* that Conrad did *not* intend to cause harm to R.S. by hiding cameras in his shower. Instead, the District Court made a series of erroneous factual inferences prejudicial to R.S. and D.S. as the parties opposing USAA's summary judgment motion, including "that [Conrad] knew exactly the type of harm" R.S. would suffer—a finding that is diametrically opposed to the contents of the *Amended Complaint* and wholly absent from the record. *Appendix 1, p. 8*.

The District Court further erred by failing to address *all claims* made in the pleadings and focusing only on R.S.'s claims. If the duty to defend is triggered as to a single claim, an insurer must defend against all claims alleged. Here, in addition to R.S.'s claims involving the cameras in Conrad's shower, D.S. asserted her own independent claims including for her emotional distress at learning of her daughter's victimization. USAA cannot and did not unequivocally demonstrate that Conrad intended to cause harm to D.S.—someone who was not recorded in his shower, was not present in his house and whom Conrad affirmatively tried to keep from discovering his odious conduct.

The District Court erred in failing to require USAA to unequivocally demonstrate there was no "occurrence" alleged.

Next, the District Court erred in finding an exclusion for claims "arising out of" sexual misconduct was "unambiguous and a clear exclusion *from coverage*." *Appendix 1, p. 12* (emphasis added). The District Court again erred by deciding the scope of coverage. This is a duty to defend case. If USAA required a determination of coverage, it needed to defend Conrad under a reservation and seek such declaration in a separate action. USAA failed to do so. The correct question to the District Court was whether USAA had "unequivocally demonstrated" the policy excluded all claims raised against its insured.

This Court has twice held the term "arising out of" is ambiguous and has cautioned insurers against relying on policy exclusions to justify refusing to defend an insured. Further, USAA did not define the term "sexual misconduct" in its policy. Insurers including American National and Scottsdale define "sexual misconduct" in their policies and those definitions do not encompass hiding cameras in a shower. This demonstrates there are at least two reasonable interpretations of the term and arguable ambiguity which precludes an unequivocal demonstration by USAA. Third, the District Court again failed to consider all claims brought against Conrad and focused entirely on R.S.'s discovery of hidden cameras in Conrad's shower.

Finally, the District Court erred in finding additional policy exclusions for "mental abuse" and intentional acts "likely" excluded Conrad's conduct. Finding allegations are "likely" excluded means USAA did not "unequivocally demonstrate" those allegations against its insured are outside the policy.

This Court should reverse the District Court, apply settled Montana law, and find USAA breached its duty to defend.

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ARGUMENT

I. The District Court Erred in Failing to Require USAA to Unequivocally Demonstrate the Facts Alleged in the Pleadings Did Not Give Rise to an "Occurrence." The District Court Erred by Making Incorrect Factual Inferences and Applying the Incorrect Law. Had the District Court Applied Montana Law, the Duty to Defend Was Clearly Triggered.

The District Court granted USAA summary judgment by drawing a series of inferences from the pleaded facts that were beneficial to USAA instead of the non-moving party. These include incorrectly linking Conrad's criminal conviction for possessing child pornography to video of R.S. showering and treating that conviction as dispositive of USAA's duty to defend. The District Court erred by ignoring the facts pled in the *Amended Complaint* and determining R.S.'s injuries were not an occurrence because they were the "direct and natural result" of Conrad's intentional act of hiding cameras. The District Court erred by failing to consider the separately alleged claims of D.S.

Applying Montana law, USAA did not and cannot unequivocally demonstrate its duty to defend was not triggered by the allegations in the pleadings. R.S. and D.S. agree Conrad's act of hiding the cameras in his shower was intentional. But USAA and the District Court circularly reached the *ipse dixit* conclusion that Conrad intended to cause R.S.'s injuries because he hid the cameras. *Appendix 1, pp. 8-9*. This conclusion ignores the specific allegation in the *Amended Complaint* that Conrad did *not* intend to cause R.S. harm. Further, it

is illogical: Conrad hid the cameras because he *sought to avoid the consequences* of his actions—if he harmed R.S., his conduct would be discovered.

The District Court failed to liberally construe and consider all allegations in the pleadings, including those made by D.S. Liberally construed, the pleadings accused Conrad of failing to plead guilty to the crime of exploiting R.S. which caused emotional distress. At the sentencing hearing, D.S. described it as follows: "I think it is important to speak to the charge that the defendant is not pleading guilty to, because that is the crime that has hurt my daughter and our family the most." *Appendix 7, p. 34.* The District Court erred in considering only Conrad's actions involving the hidden cameras instead of all the allegations in the pleadings and failing to find USAA had to unequivocally demonstrate that an "occurrence" had not triggered the duty to defend.

A. The District Court Failed to Liberally Construe the Allegations in the Pleadings to Trigger the Duty to Defend and Instead Developed an Incorrect and Prejudicial Set of Factual Inferences that Favor the Party Whose Summary Judgment Motion was Granted.

"When a court compares allegations of liability advanced in a complaint with policy language to determine whether the insurer's obligation to defend was 'triggered,' a court must liberally construe allegations in a complaint so that all doubts about the meaning of the allegations are resolved in favor of finding that the obligation to defend was activated." *Farmers Union Mut. Ins. Co. v. Staples*, 2004 MT 108, ¶ 22, 321 Mont. 99, 90 P.3d 381. The duty to defend is triggered when

allegations in a complaint "potentially implicate[]" coverage. *Tidyman's Mgmt. Svcs. v. Davis*, 2014 MT 205, ¶ 27, 376 Mont. 80, 330 P.3d 1139. In deciding a summary judgment motion, "[a]ll reasonable inferences which may be drawn from the offered proof must be drawn in favor of the party opposing summary judgment." *Watkins Trust*, ¶ 16.

Here, the District Court inferred a series of facts not in the record that benefitted USAA. The District Court inferred, "At the change of plea hearing Conrad *would have been* required to acknowledge, on the record, that he knowingly possessed child pornography." *Appendix 1, p. 2* (emphasis added). "No one *should have been* more aware of the magnitude of his actions and the consequences of surreptitiously recording a child naked and possessing such images on an electronic device than Conrad—a sworn federal law enforcement officer." *Id., p. 8* (emphasis added). "Conrad hid the cameras in hopes to keep his conduct secretive which further stablishes [sic] *that he knew exactly the type of harm* that would result to R.S. if his intentional conduct were discovered." *Id, pp. 8-9* (emphasis added). The District Court also wrote in a footnote it was troubled that R.S. and D.S.'s counsel engaged in "a zealous attempt to obtain coverage for a client"[2] resulting in arguments "that potentially minimize the impact of child

[2] It is USAA's burden to unequivocally demonstrate the duty to defend was not triggered. The question of coverage is irrelevant because an insurer that denies its insured a defense without

pornography on the victims." *Id., p. 8, fn 1*. Finally, the District Court mistakenly linked Conrad's criminal conviction to the hidden cameras, writing "[t]here was nothing accidental about Conrad's actions *or the repercussions for his criminal behavior*." *Id., p. 9* (emphasis added).

The District Court was required to liberally construe the allegation that "Defendant did not intend for R.S., or anyone else, to find the videocameras and consequently did not reasonably expect or intend to cause injury to R.S." Instead, the District Court unilaterally decided the allegation was untrue, finding instead that because Conrad was a federal law enforcement officer that "[n]o one should have been more aware" of the harm that could have been caused. *Id., p. 8*.

The District Court made factual findings about both Conrad's intent and subjective knowledge that were not alleged in and directly conflicted with the allegations in the *Amended Complaint*. In doing so, the District Court failed to liberally construe the allegations contained in the pleadings in favor of finding the duty to defend was triggered. *Staples*, ¶ 22.

The District Court's *Order* reasonably and correctly inferred there was a colloquy in which Conrad admitted his guilt. However, the District Court unreasonably and incorrectly assumed that colloquy contained admissions to a

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making the requisite "unequivocal demonstration" is estopped from denying coverage. *Scentry Biologicals, Inc. v. Mid-Continent Cas. Co.*, 2014 MT 39, ¶ 46, 374 Mont. 18, 319 P.3d 1260.

crime related to the allegations in R.S. and D.S.'s *Amended Complaint*, which, in fact, is wrong.

R.S. and D.S. do not seek to expand the record—the change of plea hearing transcript was not presented below, nor was it necessary because the pleadings controlled the issues before the Court—but merely illustrate how far afield the District Court went in making unreasonable factual inferences beneficial to USAA and detrimental to them.

The District Court relied on two documents to infer "[a]t the change of plea hearing Conrad would have been required to acknowledge, on the record, that he knowingly possessed child pornography." *Id., p. 2*. First, the District Court cited to "Exhibit C, ¶ 1" of *USAA's Statement of Undisputed Facts*. (*Doc. 23*). This is Conrad's *Answer (Appendix 3)*, which in ¶ 2 contains his denial of possessing both "naked images of R.S." as well as "other child pornography" on his computer. *Appendix 3, ¶ 2*. The second document the District Court cites is a U.S. Department of Justice press release[3] that neither party presented to the Court and the District Court sought out *sua sponte*. The press release also does not support Conrad's conviction was related to video of R.S in his shower.

[3] https://www.justice.gov/usao-mt/pr/ex-us-fish-and-wildlife-service-employee-sentenced-child-porn-case

At his change of plea hearing on May 7, 2019, the following colloquy occurred between the Hon. Susan P. Waters and Conrad:

> THE COURT: Tell me in your own words, what is it that you did that makes you plead guilty to the charge in Count II of the indictment.
>
> THE DEFENDANT: I don't recall how long ago it was, but I downloaded a file from a file hosting site that contained selfie images of various girls in a folder. And after I reviewed them, I realized that some of the girls may have been underage, and I deleted them. I take full responsibility.
>
> THE COURT: So you agree that when you downloaded these images that you did possess them on your computer?
>
> THE DEFENDANT: Yes, Your Honor.
>
> *Appendix 8, p. 24*.

As the above colloquy transcript shows, Conrad's conviction for child pornography was related to "selfie images of various girls" he downloaded from the internet—not the surreptitious video of R.S. in his shower. In the pleadings, which is the proper focus of a duty to defend case, Conrad affirmatively denied that he possessed naked images of R.S. or child pornography. *Appendix 3, ¶ 2*. The District Court failed to give this any consideration, and incorrectly focused entirely on his guilty plea to a separate crime.

The District Court failed to "liberally construe allegations in a complaint so that all doubts about the meaning of the allegations are resolved in favor of finding

that the obligation to defend was activated" and made unreasonable factual inferences detrimental to the parties against whom summary judgment was entered.

B. The District Court Erred in Applying the "Direct, Natural Result" Test from a Federal Court in New Mexico to Find the Allegations in the Amended Complaint were not an "Occurrence."

Most of the District Court's decision on whether R.S. and D.S. had alleged an "occurrence" consists of a partial recitation of the Parties' legal positions without analysis. *Appendix 1, pp. 5-9*. The final two paragraphs are dispositive. In the penultimate paragraph, the District Court considers a 29-year-old case from a federal court in New Mexico that held no defense was required and no occurrence existed, "so long as the act was inherently harmful, it was performed voluntarily and deliberately, and the injury was the direct, natural result." *Sena v. Travelers Ins. Co*., 801 F.Supp. 471 (D.N.M. June 11, 1992)(emphasis added).

The District Court then used the same language from *Sena* to reach its holding in the present case:

> Conrad's actions of secretly recording R.S., a minor, while she took a shower, and then saving the recording to his computer, were intentional and the injuries that resulted were a **direct and natural result** of Conrad's intentional conduct. There was nothing accidental about Conrad's actions or the repercussions for his criminal behavior. Conrad's conduct was therefore not an "Occurrence" for purposes of the USAA policy in question. *Appendix 1, p. 9* (emphasis added).

Montana has not adopted New Mexico's law in this regard. In Montana, "an 'accident' may include intentional acts, but coverage is excluded when the

consequences of those acts are objectively intended or expected from the standpoint of the insured[.]" *Fisher Builders*, ¶ 18. Unlike this case, however, the insurer in *Fisher Builders* "provided a defense in the underlying action under a reservation of rights while filing a declaratory action (the present case), alleging there was no coverage and it had no duty to defend or indemnify [.]" *Id*., ¶ 7, *Huckins*, ¶ 28. USAA elected to take no such precautions here despite this Court providing it a clear roadmap to doing so. *Huckins*, supra.

The District Court further departed from Montana law by relying on Conrad's "criminal behavior" as a basis to deny him a defense. Under Montana law, even if Conrad's guilty plea was related to filming R.S., an insured's "plea of guilty" to a crime "is not conclusive either as to his policy coverage or the duty of [an insurer] to defend him in a tort action." *Northwestern Cas. Co. v. Phalen*, 182 Mont. 448, 461, 597 P.2d 720 (1979). In another case, this Court held an intoxicated insured was entitled to a defense when she shot a woman dining with her husband in a road-grader. *Safeco v. Liss*, 2000 MT 380, 303 Mont. 519, 16 P.3d 399. The insured in *Liss* pleaded guilty to aggravated assault but was still owed a defense. *Liss*, ¶ 9. Even the insured in *Fisher Builders* pled guilty to misdemeanor charges related to violating zoning regulations and lakeshore protection laws, but was still owed a defense. *Fisher Builders*, fn 2. Unlike each of these cases, Conrad's guilty plea to possessing child pornography was not

related to the allegations in the pleadings and therefore and has even less to do with a duty to defend analysis.

The District Court erred in applying the "direct and natural result" standard from New Mexico instead of the "unequivocal demonstration" test used by this Court to evaluate duty to defend claims.

C. USAA Was Required to "Unequivocally Demonstrate" All Claims Fell Outside the Policy's Scope. USAA Did Not and Cannot Unequivocally Demonstrate there was No Duty to Defend.

"Unless there exists 'an unequivocal demonstration that the claim against an insured does not fall within the insurance policy's coverage, an insurer has a duty to defend.'" *Huckins*, ¶ 27.

Had the District Court correctly held USAA to the "unequivocal demonstration" standard, it should have found the pleadings alleged an "occurrence," triggering the duty to defend. Under the USAA policy, "occurrence" means accident.

USAA failed to make an unequivocal demonstration that when hiding the cameras (a concededly intentional act) Conrad expected or intended to cause harm to R.S. and D.S. The *Amended Complaint* specifically alleges Conrad did not intend to cause them harm. Squalid as his actions were, Conrad sought to secretly make a video of R.S. showering; Conrad did not intend to lose his job or go to prison by harming R.S. and thereby putting her on notice of his conduct. By

hiding the cameras, he affirmatively sought to *avoid* any consequences of his intentional actions. Conrad's desire that R.S. not suffer harm was based in ignobility; it was his intent because it was in his self-interest not to get caught. Nevertheless, the District Court ignored the factual allegations in the pleadings, and instead ruled Conrad "knew exactly the type of harm that would result to R.S. if his intentional conduct were discovered." *Appendix 1, pp. 8-9*.

The District Court's rationale eliminates insurance coverage on a vast scale. A rushing motorist may accelerate through a changing traffic light, hoping to avoid delay but also knowing she risked a wreck causing injury or death to others. Under the District Court's rationale, if the motorist "knew exactly the type of harm that" racing through a yellow or red light would cause, then there is no "occurrence" and an insurer need not even defend when a crash occurs. That is not the law, even in a duty to indemnify case. *Fisher Builders*, ¶ 18.

In *Huckins*, this Court advised Montana judges considering duty to defend claims that "nuanced arguments about intent make it impossible to conclude that there was 'an unequivocal demonstration' that [a party's] claims fell outside the [policy]." *Huckins*, ¶ 28. Here, the District Court was required to decide if the claims alleged in the pleadings, if proven true, triggered the duty to defend. Instead, the District Court ignored the express allegations in the pleadings and instead inferred Conrad's likely mental state to find his actions were not covered

under a decades-old New Mexico case. As set forth above, not only was the District Court's inference logically flawed, but wholly absent from the allegations in the pleadings that should have been the focus of her inquiry. The District Court departed from Montana's duty to defend law.

Next, the District Court only considered Conrad's conduct pertaining to hiding cameras in the shower and the harm it caused R.S. The District Court was directed to liberally construe the allegations in the pleading in favor of triggering the duty to defend. *Staples*, ¶ 22. Applying liberal construction here, the *Amended Complaint* alleged D.S. suffered independent emotional harm when told by her minor child what had happened, and that Conrad's refusal to admit his guilt or plead guilty to the crime of exploiting R.S. caused both plaintiffs "severe and permanent emotional distress." *Appendix 5, ¶¶ 6-8, 10*.

"Montana follows what is known as the mixed-action rule, which requires an insurer to defend all counts in a complaint so long as one count triggers coverage, even if the remaining counts do not trigger coverage." *Fire Ins. Exch. v. Weitzel*, 2016 MT 113, ¶ 14, 383 Mont. 364, 371 P.3d 457.

Thus, even if the District Court correctly ruled USAA had no obligation to defend Conrad against R.S.'s claims for hiding cameras in his shower, it erred by finding no duty to defend in light of the other claims. The District Court excused USAA's failure to defend because emotional harm to R.S. was the "direct and

natural result" of Conrad's intentional conduct and therefore not an "occurrence." *Appendix 1, p. 9*. Even under the District Court's flawed rationale, it does not follow that it was *also* Conrad's intent to harm R.S.'s mother. D.S. was not filmed in the shower. D.S. was not present in Conrad's home when any of the alleged acts occurred. She suffered emotional harm when she learned R.S. had been victimized by the person to whom she had entrusted her daughter and when Conrad refused to admit his guilt and plead guilty to the crime of exploiting R.S.

USAA did not unequivocally demonstrate Conrad intended to cause harm to D.S. The District Court erred by failing to require USAA to do so, and by failing to analyze the issue at all.

Separately, the District Court erred in failing to consider persuasive cases involving similar alleged conduct in which courts found the duty to defend (though not necessarily to indemnify) had been triggered. See, *Foti v. USAA*, 2014 WL 3906863 (Conn. July 2, 2014) and *AIG Prop. and Cas. Co. v. Anenberg*, 2020 U.S. Dist. LEXIS 143485 (D. Haw. Aug. 11, 2020). Judges in other jurisdictions applying similar rules to Montana make it nearly impossible for USAA to make an "unequivocal demonstration" the claims fell outside the policy sufficiently for it to avoid its duty to defend.

For example, in *Foti*, USAA was held to have breached its duty to defend an insured therapist who pleaded guilty to three counts of sexually assaulting a

patient. Like here, USAA claimed the intentional conduct was not an "occurrence" and that its exclusion for "sexual misconduct; sexual harassment; sexual molestation, or physical or mental abuse" eliminated its obligation to defend its insured. *Foti*, *12-13. Like Montana, Connecticut views the duty to defend more broadly than the duty to indemnify and looks to the allegations of the complaint to see if the duty to defend has been triggered. *Id.,* *14. The third count of the sexual assault victim's complaint alleged negligent infliction of emotional distress. *Id*., *16. The *Foti* court noted "[t]here are no allegations that Thorsen expected or intended injury. In that absence the court holds there was not enough information available within the complaint to justify USAA's decision that no occurrence took place and no duty to defend existed. Both of these issues required further investigation by USAA." *Id*. at *26-27. As a result, USAA was contractually liable for a $750,000 stipulated judgment. *Id*.

Here, R.S. and D.S. both alleged negligent infliction of emotional distress claims and the *Amended Complaint* expressly alleged Conrad did *not* expect or intend to injure R.S. Further, in his *Answer*, Conrad denied some of the allegations against him, including that he possessed images of R.S. or that unrelated child pornography was located on his computer. *Appendix 3, ¶ 2*. Based on the pleadings, USAA was obligated to defend.

Next, in *Anenberg*, a man was accused of using his smartphone to take video of a woman in the dressing room of a Hawaiian store. Unlike the present case and *Foti*, the insured was provided a defense by AIG under a reservation of rights. *Anenberg* at *10. A federal declaratory judgment action was brought after discovery in the underlying case had progressed to the point where AIG's exclusion-based arguments could be considered. Importantly, the insurer in *Anenberg* did not even contest that its insured's conduct constituted an occurrence. *Id*. at *13-14. The Court ultimately found a duty to defend was owed but postponed deciding whether exclusions eliminated a duty to indemnify because material facts remained unresolved. *Id*. at *24. The insurer in *Anenberg* knew an occurrence had occurred and prudently defended under a reservation of rights and pursued a declaratory judgment action. *Anenberg* evokes this Court's discussion in *Huckins* about nuanced arguments being appropriate to cases in which a defense is provided under a reservation of rights and its finding that "USAA had a duty to defend [its insured], at least until a ruling was obtained declaring there was no coverage." *Huckins*, ¶ 28.

Finally, two months after the District Court granted USAA summary judgment, United States District Judge for the District of Montana Donald W. Molloy held State Farm responsible for a $1.1 million consent judgment for failing to defend an insured accused of multiple sexual assaults. *Wigton v. State Farm*

Mut. Auto Ins. Co., ___ F.Supp.3d___, 2021 U.S. Dist. LEXIS 140974, 2021 WL 3185965 (July 28, 2021). In *Wigton*, Judge Molloy observed that "[w]here the duty to defend is triggered, the carrier must defend until relieved of that duty by court determination in a legal proceeding. It is a rare proceeding indeed where that duty is not implicated." *Wigton*, *20 (emphasis added).

In *Wigton*, a woman alleged her landlord had sexually assaulted her twice and harassed her on multiple occasions. State Farm refused to defend, alleging there had not been an "occurrence" and relying on exclusions for intentional acts, sexual harassment or molestation and personal injury when the insured acts with the intent to cause harm. *Id*. *16. Judge Molloy dismissed State Farm's argument that it was objectively unreasonable for its insured to believe his sexual assault victim consented to the assault. *Id*. *12. Instead, Judge Molloy looked to the facts pleaded in the complaint, the fact State Farm's insured had pled not guilty to criminal charges before pleading no contest and "[c]onstru[ed] the underlying complaint to resolve all doubt in favor of finding coverage," to decide the duty to defend had been triggered. *Id*. *12-13.

Here, the District Court did the opposite, resulting in inconsistent application of settled Montana law.

Unsavory though Conrad's conduct was, USAA owed its insured a defense, pending the outcome of a declaratory judgment action. Having failed to provide Conrad a defense, USAA breached its duty to defend.

II. The District Court Erred by Not Requiring USAA to Unequivocally Demonstrate All of R.S. and D.S.'s Claims Were Excluded by its Sexual Misconduct Exclusion. Under this Court's Jurisprudence, An Exclusion for Claims "Arising out of … Sexual Misconduct" is Ambiguous. The District Court Finding Other Exclusions "Likely" Applied Fails to Unequivocally Demonstrate USAA Did Not Owe a Duty to Defend.

USAA did not "unequivocally demonstrate" its exclusion for claims "arising out of … sexual misconduct" applied to all claims asserted against Conrad. The undefined exclusion is ambiguous and when other homeowners policies define the term "sexual misconduct," the definitions do not encompass hiding cameras in showers. The District Court's finding other exclusions "likely" applied fails to unequivocally demonstrate USAA did not have a duty to defend.

This Court has warned insurers that the use of policy exclusions as a basis to refuse insureds a defense is problematic as "exclusions 'are frequently subject to challenge for ambiguity and inconsistency,' and as a result 'the mere existence of the exclusions in [a policy] does not establish an unequivocal determination that the claim does not fall within the insurance policy's coverage.'" *Dowson v. Scottsdale Ins. Co*., 645 F.Appx. 532, 533 (9th Cir. 2016), quoting *Newman v. Scottsdale Ins. Co.*, 2013 MT 125, ¶ 35, 370 Mont. 133, 301 P.3d 348 (2012).

"Sexual misconduct" is at least potentially ambiguous because when the term is defined by other insurers, it does not include the conduct alleged against Conrad. This Court has twice held the term 'arising out of' is ambiguous; the District Court failed to recognize D.S.'s claims did not arise from Conrad's acts but from learning of R.S.'s experience. Finally, the District Court erred in finding other exclusions "likely" exclude Conrad's conduct because "likely" means USAA failed to meet the "unequivocal determination" standard in a duty to defend case.

A. USAA Cannot Unequivocally Demonstrate its "Sexual Misconduct" Exclusion is Applies to All Claims Brought By R.S. and D.S.

The USAA policy excludes "'bodily injury' or 'property damage' … **arising out of** any actual, alleged or threatened: (1) **Sexual misconduct**; or (2) Sexual harassment; or (3) Sexual molestation." (emphasis added). Without analysis, the District Court simply held this provision unambiguous and excluded R.S.'s claims. *Appendix 1, p. 12*.

Neither "arising out of" nor "sexual misconduct" are defined in USAA's policy.

1. 'Sexual Misconduct' is Vague and Ambiguous and Must Be Narrowly Construed Against USAA. When Other Insurers Define 'Sexual Misconduct' it does not Include Conrad's Acts.

While "sexual misconduct" generally encompasses sexual assaults, the staggering breadth of human sexuality and human conduct renders the exclusion akin to an insurer announcing it does not cover "bad acts" or "improper conduct."

The undefined term is so broad as to lose meaning. Other that its conclusory determination that "The Court finds this exclusion unambiguous and a clear exclusion from coverage," the District Court failed to analyze the term. *Appendix 1, p. 12*. USAA simply argued it is "common sense" that hiding cameras in showers constitutes "sexual misconduct." *Doc. 22, p. 8*.

USAA's argument fails when the full scope of the exclusion is considered. USAA specifically *and separately* excludes coverage for "sexual misconduct," "sexual harassment" and "sexual molestation." In interpreting policies, "we will read the insurance policy as a whole, and will if possible, reconcile its various parts to give each meaning and effect." *Farmers Alliance v. Holeman*, 1998 MT 155, ¶ 25, 961 P.2d 114.

To give each part "meaning and effect" requires the recognition that USAA believed "sexual misconduct" does *not* include "sexual molestation," because it affirmatively needed to separately exclude sexual molestation claims. USAA thus argues that hiding a camera in a shower is always sexual misconduct, but affirmatively molesting someone in a shower is not sexual misconduct. If "sexual misconduct" does not extend to the sexual molestation of someone in a shower, necessitating a separate exclusion, it is not "common sense" to argue that the undefined exclusion "unequivocally" extends to surreptitious filming someone in a shower where no physical or sexual contact occurred.

USAA left a critical policy term undefined. USAA failed to defend its insured under a reservation and seek a judicial declaration as to its obligations under its own undefined term. USAA did this because it relied on universal disapprobation of Conrad's conduct to absolve it of its duties instead of an unequivocal showing under its policy.

Insurance companies that actually define "sexual misconduct" offer definitions that do *not* include hiding cameras in a shower. This fact alone demonstrates there are at least two reasonable meanings to the undefined term and that "sexual misconduct" is ambiguous.

American National Property & Casualty Co. excludes from its homeowners policy claims resulting from "sexual misconduct." That insurer's policy defines 'sexual misconduct' as:

> d. … Sexual misconduct means physical or mental harassment or assault of a sexual nature against any person.

Am. Nat'l Prop & Cas. Co. v. Rosenschein, 2020 U.S. Dist. LEXIS 112776, *5 (D. N.M. 2020).

As defined by American National, 'sexual misconduct' would not include the surreptitious recording of R.S. in a shower because there was no physical contact alleged and the cameras were hidden to avoid discovery or "harassment." Here, applying an actual definition of "sexual misconduct" as authored by an insurance company, Conrad's conduct is not excluded. At a minimum, it

establishes that USAA cannot "unequivocally demonstrate" Conrad's conduct falls within its policy's undefined exclusion.

Likewise, Scottsdale Ins. Co. defines 'sexual misconduct' in a professional liability policy as:

> "Sexual misconduct" means **any action or behavior, or any physical contact or touching, which is intended to lead to, or which culminates in a sexual act**, arising out of the professional treatment and care of any client, patient, or any other person whose care has been entrusted to the named insured, whether committed by, caused by or contributed to by a failure of any insured to: (1) properly train, hire or supervise any employees; or (2) properly control, monitor or supervise the treatment and care of any client, patient or any other person whose care has been entrusted to the named insured.

Scottsdale Ins. Co. v. Roumph, 18 F.Supp.2d 730, 732 (E.D. Mich. 1998) (emphasis added). See, also, *Navos v. Mental Health Risk Retention Group*, 2011 U.S. Dist. LEXIS 72474 (W.D. Wash. 2011)(same definition). As defined by the insurers in *Roumph* and *Navos*, 'sexual misconduct' would not include the surreptitious recording of R.S. because there was no allegation Conrad's acts were intended to "culminate[] in a sexual act."

Assuming the meaning of "sexual misconduct" as defined by American National and Scottsdale in their insurance policies is reasonable and assuming the meaning USAA and the District Court gave the term "sexual misconduct" is also reasonable, then the term is ambiguous. At a minimum, the uncertainty prevented USAA from making an unequivocal demonstration in this duty to defend case.

Regardless of ambiguity, however, an exclusion must be narrowly defined. In the absence of a definition authored by USAA, the narrow definition in other policies is appropriate to apply and results in USAA's duty to defend Conrad surviving the policy exclusion.

2. This Court Has Twice Held the Phrase "Arising Out Of" is Ambiguous. Not All Claims Against Conrad "Arose Out Of" Undefined "Sexual Misconduct."

This Court has previously determined that the phrase 'arising out of' is ambiguous. *Wendell v. State Farm Mut. Auto Ins. Co*., 1999 MT 17, ¶ 53, 293 Mont. 140, 974 P.2d 623; *Pablo v. Moore*, 2000 MT 48, ¶ 16, 298 Mont. 393, 995 P.2d 460. The term can be very broad—eliminating coverage for claims even tangentially connected to sexual misconduct; the term can also be very narrow—eliminating coverage only for claims directly caused by an act of 'sexual misconduct.' Both are reasonable, so the term is ambiguous and this Court construes it against insurers in whichever context benefits an insured. Compare, *Wendell*, ¶ 54 (adopting "an expansive, rather than restrictive, interpretation of the phrase" for purposes of finding UM coverage in a general insuring agreement) and *Pablo*, ¶ 18 ("the justification for a broad interpretation of the clause is not present—in fact, here, the plaintiffs benefit from a narrow interpretation of the clause, since it determines the extent to which insurance coverage is excluded.").

In *Wendell*, a group of men were driving around Butte looking to pick fights at random. *Wendell*, ¶ 3. They encountered a State Farm insured on his way to go fishing with friends. When the State Farm insured stopped for the group of men, he got dragged out of his vehicle and beaten. The State Farm insured made a claim for uninsured motorist (UM) benefits which the insurer denied because the injuries were "not caused by an accident **arising out of** the operation, maintenance or use" of the assailant's vehicle. *Id.*, ¶ 7 (emphasis added). This Court found that "arising out of" was ambiguous and resolved the ambiguity in favor of the insured. *Id.*, ¶¶ 53-54. This Court held:

> In cases where the uninsured vehicle is the instrumentality and, therefore, the legal cause of the insured's injuries, we are certain the average UM policyholder would think that his or her injuries arose out of the use of the uninsured vehicle. However, we cannot agree with State Farm that the average UM policyholder would not think his or her injuries arose out of the use of the uninsured vehicle in cases where the uninsured vehicle is not the instrumentality causing the injuries, but is a prime accessory, without which the injury-producing incident or the severity of the injuries would not have occurred. Indeed, we think the opposite.

Id., ¶ 53.

In *Wendell*, the term "arising out of" decided whether coverage was available. Because it benefitted the insured to do so, this Court gave "arising out of" broad meaning so that the assailants' use of a vehicle to drive around Butte picking fights was enough to trigger UM coverage.

One year later, in *Pablo*, this Court again held the term "arising out of" is ambiguous—but because the ambiguous phrase was contained in an exclusion, it benefitted the insured by narrowly applying the ambiguous term. *Pablo*, ¶ 18. In Pablo, a husband and wife were injured when struck by a truck hauling a landscaping tractor. *Id*., ¶¶ 3-4. The commercial general liability policy excluded coverage for claims "arising out of" automobiles and "arising out of" the transportation of "mobile equipment." *Id*., ¶ 7. Pablo sued under a variety of negligence theories, including negligent hiring and supervision of employees. *Id*., ¶ 8. This Court concluded that narrowly construing "arising out of," in the exclusions, the Pablos' claims "are not clearly and unambiguously excluded from coverage under the [] policy." *Id*., ¶ 24.

The ambiguity of the term "arising out of" contained in sexual misconduct exclusions resulted in courts across the country holding insurers had a duty to defend disgraced comedian Bill Cosby in lawsuits brought by his victims. In addition to sexual assault allegations, women accused Cosby of harming them by publicly denying their allegations of abuse. Courts unanimously held the women's claims did not "arise out of" excluded sexual misconduct, but out of statements Cosby and his agents made after the women came forward. See, e.g., *AIG v. Cosby*, 892 F.3d 25 (1st Cir. 2018); *AIG v. Cosby*, 2015 U.S. Dist. LEXIS 174858, 2015 WL 7710145 (C.D. Cal. 2015); *AIG v. Green*, 217 F.Supp. 3d 415 (D.Mass.

2016). Unlike the case before this Court, however, AIG defended Cosby under a reservation of rights and was not estopped from denying Cosby indemnity. "'Where there is a duty to defend, there may be a duty to indemnify,' but there may not be, depending on how the facts develop." *Id*. at 429.

Here, the *Amended Complaint* alleged claims by *both* R.S. and D.S. The District Court only addressed *some* of the claims brought by R.S. Each sued Conrad, alleging he "negligently or intentionally inflicted severe and permanent emotional distress on R.S. and D.S." *Appendix 5, ¶ 10*. Conduct attributed to Conrad in the pleadings was not only hiding cameras in the shower to surreptitiously record R.S., but denying he sexually exploited R.S. in court and not pleading guilty to that crime. *Id., ¶¶ 7-8*. The transcript from Conrad's sentencing hearing includes D.S.'s testimony that "the charge that the defendant is not pleading guilty to … is the crime that has hurt my daughter and our family the most." *Appendix 7, p.34*. His conduct in failing to be accountable and accept responsibility by admitting his guilt has caused R.S. and D.S. emotional harm. These are undisputedly actions that arise out of decisions he made in his criminal prosecution, not out of sexual misconduct. Thus, USAA failed to unequivocally demonstrate all claims raised in the pleadings were outside of the policy.

Next, D.S. alleged she also suffered emotional distress resulting in bodily injury at being told by her daughter about her victimization. *Appendix 5, ¶¶ 5-6*.

Narrowly construed, D.S.'s claims did not "arise out of" sexual misconduct, but from being *informed* of what her daughter had experienced. It is not "sexual misconduct" for an underage victim to tell her mother she was victimized. D.S. was not surreptitiously filmed nor was she at the insured residence when the claims arose. Narrowly construed, D.S.'s claims did not "arise out of" sexual misconduct.

The District Court erred by focusing *exclusively* on Conrad's act of hiding video cameras in his shower, his pleading guilty to possessing child pornography and some of R.S.'s claims. *Appendix 1, p. 12*.

Under Montana law, USAA cannot unequivocally establish its ambiguous exclusion absolved it of the duty to defend Conrad against the claims asserted by R.S. and D.S.

B. The District Court Declaring that Conrad's Conduct was "Likely" Excluded under the "Expected or Intended" and "Mental Abuse" Exclusions Means USAA Did Not Unequivocally Demonstrate it had no Duty to Defend.

In the final paragraphs of its *Order*, the District Court cites two other exclusions USAA listed in its denial letter, holding without analysis that they "likely exclude[]" Conrad's conduct, but that "the issue of *coverage* is resolved in the issues outlined above." *Appendix 1, pp. 12-13* (emphasis added).

As addressed above, the District Court was charged with a duty to defend analysis, not deciding "the issue of coverage." See, *Huckins*, ¶ 28.

By finding USAA "likely" would prevail, the District Court unintentionally recognized there was not an "unequivocal demonstration" USAA had no duty to defend. 'Likely' is not the same as 'unequivocal.'

To the extent the District Court was expressing no binding opinion on the merits, however, these two exclusions fail to demonstrate USAA's duty to defend was not triggered for many of the same reasons outlined above.

The USAA exclusion for injury "which is reasonably expected or intended," does not unequivocally apply because Conrad hid the cameras in an effort not to cause harm to anyone. As discussed above, Conrad was not noble in intending no harm to R.S.—rather, he was selfish. The pleadings expressly allege that Conrad "did not intend for R.S., or anyone else, to find the videocameras and consequently did not reasonably expect or intend to cause injury to R.S."

Instead of considering whether there would be coverage if those facts were proven true, USAA unilaterally decided the fact alleged in the *Amended Complaint* was untrue and denied Conrad a defense. That is improper.

Next, the exclusion for claims "arising out of any actual, alleged or threatened physical or mental abuse" is utterly unaddressed in USAA's Coverage and Defense Denial letter. The allegations against Conrad did not include any claims of "physical … abuse," so we are left to presume that USAA believes it can unequivocally demonstrate its insured engaged in "mental abuse." Again, USAA

fails to define this dispositive term in its policy. In its briefing, it simply asserted that "predatory tactics" are the same thing as mental abuse. *Doc. 22, p. 18*. Also, the exclusion again uses the term "arising out of" which has twice been declared ambiguous by this Court. Surreptitiously hiding cameras does not qualify as "mental abuse." Moreover, D.S.'s claim for her distress at being told by R.S. about what happened is not "mental abuse." It was a young girl telling her mother the truth about what happened to her. USAA cannot unequivocally demonstrate that all claims against Conrad arose out of mental abuse.

Finally, as to all exclusions, USAA should be bound by its one-sentence explanation of its reasons for denying Conrad a defense contained in its August 14, 2019 Coverage and Defense Denial letter. *Appendix 4*. As set forth in Mont. Code Ann. § 33-18-201(14), an insurer must "promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim…."

That means when denying an insured a defense, insurers must meaningfully explain how they apply the facts and applicable law to the policy terms. This Court relies upon those denial explanations in evaluating a duty to defend. "Reiterating that the case before us is a 'duty to defend' case, we return to [the insurer's] initial denial of coverage letter which precipitated its refusal to defend." *Newman*, ¶ 54.

The entirety of USAA's rationale for asserting a page-long list of policy exclusions was: "In addition, your Homeowners policy has the following exclusions which specifically applies to your actions of intentionally installing a video camera for the purposes of creating a pornographic video, for which you have pled guilty." *Appendix 4, p. 2*. This single sentence statement is not only factually inaccurate, it also fails to "unequivocally demonstrate" Conrad was not owed a defense. It does not explain why USAA believed Conrad mentally abused R.S., much less D.S. It does not explain why R.S. and D.S.'s emotional distress was an expected and intended consequence in light of the allegation that Conrad hid cameras and did not intend to harm R.S. USAA's short Coverage and Defense Denial letter is not a "reasonable explanation" at all—it certainly is not an "unequivocal demonstration."

Should these arguments be insufficient regarding the "expected or intended" and "mental abuse" exclusions, then the Court should remand to the District Court to fully address their inapplicability.

CONCLUSION

In 2004, the Montana Supreme Court "put insurers on notice that 'unless there exists an unequivocal demonstration that the claim against an insured does not fall within the insurance policy's coverage, an insurer has a duty to defend." *Scentry*, ¶ 44. Absent that unequivocal demonstration, the insurer must defend its

insured under a reservation of rights and file a declaratory action to adjudicate the coverage issues. *Id*. An insurer which denies a defense in violation of these rules is estopped from denying indemnity coverage and is liable for defense costs, settlements, and judgments. *Newman*, ¶ 57.

The District Court erred by applying incorrect facts to incorrect law and finding there was no "occurrence" under the policy. Under Montana law, the District Court was obligated to liberally construe the allegations in the pleadings to trigger the duty to defend and determine whether USAA unequivocally demonstrated all claims against its insured fell outside the policy. The District Court inferred facts prejudicial to the non-moving party, applied the incorrect law and engaged in a duty to indemnify analysis. This Court should reverse the District Court and find USAA failed to unequivocally establish that if the allegations in R.S. and D.S.'s pleadings were true there was an "occurrence."

Second, the District Court erred in failing to require USAA to unequivocally demonstrate its policy exclusion for claims "arising out of … sexual misconduct" absolved it of its duty to defend Conrad. As this Court has cautioned insurers, relying on a policy exclusion instead of a defense under a reservation is risky because exclusions are "frequently subject to challenge for ambiguity and inconsistency," as R.S. and D.S. have done here. *Id*., ¶ 35. USAA cannot unequivocally demonstrate its exclusion applies because it fails to define "sexual

misconduct" and when other insurers define it, the exclusion does not extend to hiding cameras in a shower. Thus, there are at least two reasonable interpretations of the exclusion's operative term and it is ambiguous. Further, this Court has twice held "arising out of" ambiguous and at least some of R.S. and D.S.'s claims do not "arise out of" undefined "sexual misconduct."

Because USAA did not carry its burden under a duty to defend analysis, the Court should reverse the District Court and remand for further proceedings.

DATED this 29th day of October, 2021.

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CERTIFICATE OF COMPLIANCE

Pursuant to M.R.App.P. 11(4), I certify this brief is printed with a proportionally spaced Times New Roman typeface of 14 points, is double-spaced except for footnotes and quoted indented material; has margins of 1-inch; and has a word count as calculated by Microsoft Word for Mac of 9,665 words (excluding Tables and Certificates).

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