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NORTHWEST INSURANCE LAW

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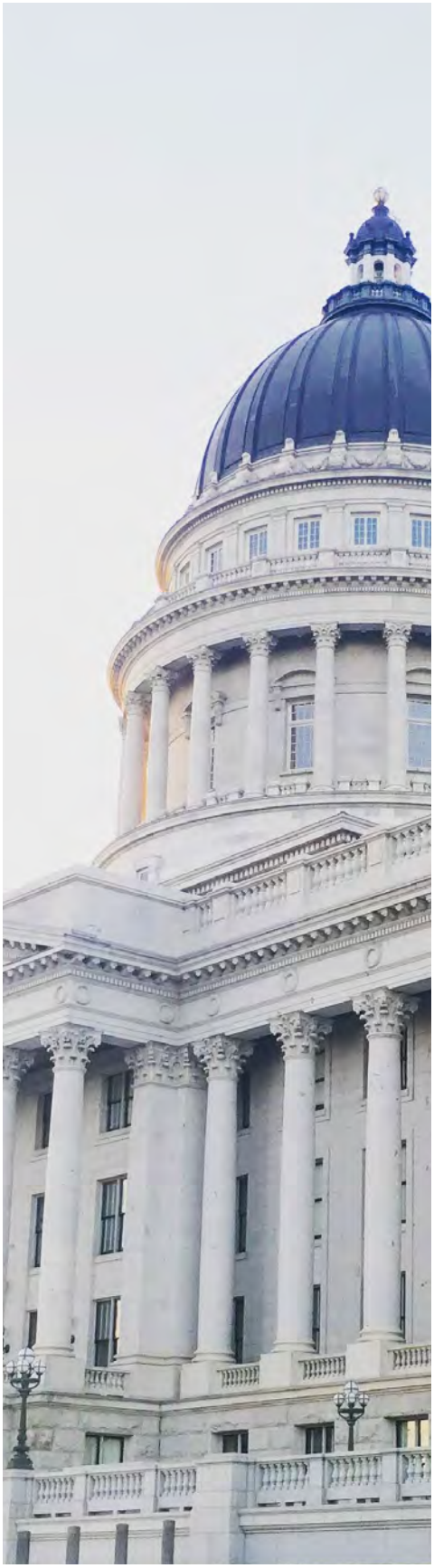


OREGON COURT OF APPEALS RENDERS IMPORTANT DECISION ON VARIOUS COVERAGE ISSUES ARISING OUT OF CONSTRUCTION DEFECT LAWSUIT

by Eliot Harris

In an effort to stem the flood of claims for coverage arising out of construction defect lawsuits, insurers have included various exclusions and endorsements to limit coverage for such claims in their commercial general liability policies issued to construction contractors and subcontractors. One such exclusion, titled the "Multi-Unit New Residential Construction" exclusion, has been included in policies for about the past decade or so. This exclusion generally precludes coverage for loss, related directly or indirectly, to operations, completed operations, products and/or work products involving property intended, in whole or in part, for habitation of more than one single family residence, such as condominiums, town houses/homes, apartments or other developments comprised of more than one single family residence.

Recently, the Oregon Court of Appeals had the opportunity to decide the applicability of this exclusion in *Hunters Ridge Condominium Assoc. v. Sherwood Cross, LLC*. In that case, the insurer issued a policy to a subcontractor, which sought a defense for a construction defect lawsuit brought by a condo association. The project was a mixed-use three-building complex with commercial space on the ground floor and residential units above them. The insurer denied coverage based on a Multi-Unit New Residential Construction exclusion, which defined "multi-unit residential building" as "a condominium, townhouse, apartment or similar structure, each of which was greater than eight units built or used for the purpose of residential occupancy." The insurer argued that the subcontractor's work at the project, which contained more than eight residential units, was subject to the exclusion.

After the denial of coverage, the subcontractor failed to appear or answer the complaint, and default judgments were entered. These judgments included attorney's fees and costs for the developer and general contractor on their third-party claims against the subcontractor. The importance of the award of fees is discussed further below. The other parties settled, and the developer and general contractor assigned claims against the subcontractor to the association. A garnishment proceeding followed, during which the association sought the proceeds of the policy. The insurer obtained summary judgment on the application of the Multi-Unit New Residential Construction exclusion, and the association appealed under the argument that this exclusion was ambiguous, and therefore, could not be construed in favor of coverage. The trial court also refused to award attorney's fees and costs to the association as provided for in the judgments.

On appeal, the association argued that the exclusion was ambiguous because it could be read to either include or exclude multi-purpose buildings. The Court of Appeals agreed. Specifically, the Court held that "residential building" could be interpreted as either a multi-use building or one that is purely residential. Using a dictionary to define the terms "condominium," "apartment" and "townhouse," the Court found that "[n]one of these definitions expressly includes mixed-use structures, although one of the meanings of "condominium" is broad enough to include such structures." In light of the ambiguity, the Court reversed the trial court and found coverage because "the relevant dictionary definitions of the listed structures do not render [the association's] construction of the exclusion implausible." Interestingly, the Court noted in a footnote that "or similar structure" in the exclusion was broad enough to also include mixed-use buildings.

The Court also reviewed the trial court's denial of coverage for attorneys' fees and costs as awarded in the underlying judgments. The fees award was based on the contractual indemnity provisions in the subcontracts, which obligated the subcontractor to

indemnify both developer and general contractor. The developer argued that these fees were covered under the insuring language, which provided the insurer with an "obligation to pay damages because of 'property damage' which the insurance applie[d]," and/or the "supplementary payments" provision of the policy that provided coverage for "costs taxed against the insured."

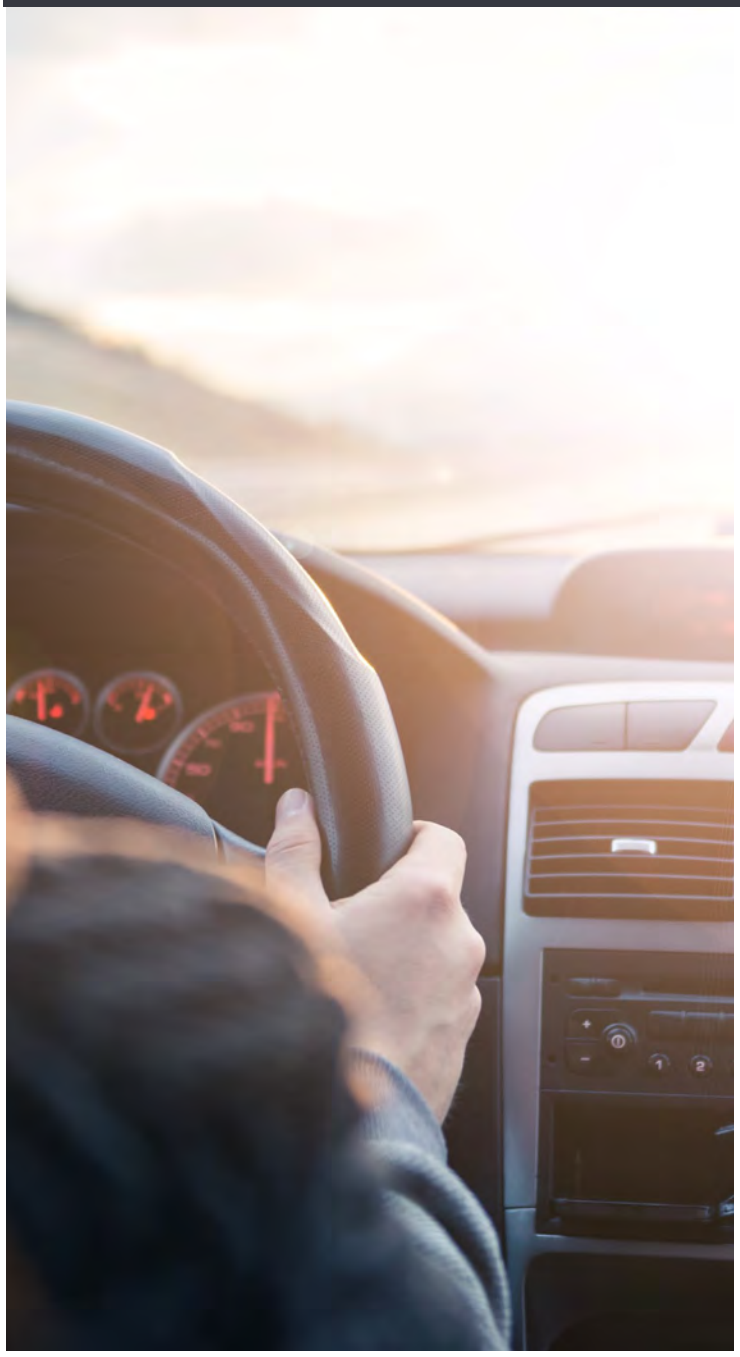
The Court determined that attorney's fees and costs can potentially constitute covered damages under the insuring agreement when claimed as consequential damages because of tortious or wrongful conduct by a defendant that causes a plaintiff to litigate with a third party. By doing so, the Court applied an exception to the standard "American Rule," under which litigants bear their own fees and costs. The Court found that since the claims against the developer and general contractor arose in part from the subcontractor's defective work, the subcontractor was liable for some portion of the fees incurred in defending against the association's claims. The Court further concluded that such fees could qualify as consequential damages recoverable against the subcontractor, even in the absence of a contractual indemnity provision. The Court reasoned that attorney's fees could be considered "damages because of property damage" within the meaning of the policy. However, the Court found that fees incurred by the developer and general contractor in litigating claims directly against the subcontractor would not qualify as such "damages" under the policy, and are not subject to the third-party litigation rule set forth above.

The Court further held that fees incurred by the developer and general contractor in pursuing the insured directly may qualify as "costs" under the "Supplementary Payments" provision. Because "costs" was not defined in the policy, the Court used dictionary definitions to find that "costs" could be construed to either include or exclude attorneys' fees. Therefore, the Court held that the term was ambiguous, and ruled in favor of coverage.

Lastly, the Court of Appeals reviewed the hotly disputed rule regarding an insurer's right to a jury trial in the context of a garnishment proceeding. The Court held that the insurer must be given the right to a jury trial as part of a full opportunity to litigate any coverage issues. Accordingly, the Court held that ORS 18.782 is unconstitutional to the extent it compels parties to a garnishment action to litigate coverage issues to the Court without the ability to elect a jury trial.

These three main issues decided by the Court in *Hunter's Ridge* have a potentially huge impact on coverage disputes arising out of construction defect claims in the future. Given the impact of this decision, it is probable that this case will be reviewed by the Oregon Supreme Court. For now, this decision stands and insurers issuing policies to construction contractors in Oregon should take notice of this ruling as it provides useful guidance on a number of important coverage issues.

OREGON SUPREME COURT REJECTS INSURED'S ATTEMPT TO SEEK ATTORNEY FEES IN UM DISPUTE UNDER ORS 742.061(3)



by Reshvin Sidhu

The Oregon Supreme Court recently interpreted the applicability of the "safe harbor" provision in ORS 742.061(3) which allows an insurer to settle uninsured motorist ("UM") and underinsured ("UIM") claims without payment of attorney's fees. In *Spearman v. Progressive Classic Ins. Co.*, the Court determined that the insured was not entitled to attorney's fees under ORS 742.061(1) because the insurer complied with ORS 742.061(3). Specifically, the court held that the insurer's challenge to the nature and extent of the insured's injuries, as well as the reasonableness and necessity of his medical expenses, did not raise issues that went beyond the "damages due the insured" language of the statute necessary to trigger an award of attorney's fees.

ORS 742.061(1) generally provides for an award of attorney fees when an insured brings an action against his or her insurer and recovers more than the amount tendered by the insurer. However, the Oregon legislature developed "safe harbor" provision for both UM/UIM and personal injury protection ("PIP") claims. Specifically, the "safe harbor" provision relating to UM/UIM claims, under ORS 742.061(3):

> An insured is not entitled to attorney fees if, within six months of the filing of a proof of loss, the insurer states in writing that it has accepted coverage, that it agrees to binding arbitration, and that the only remaining issues are the liability of the uninsured motorist and the "*damages due the insured*."

The "safe harbor" statute relating to PIP claims, ORS 742.061(2), is identical except that the only remaining issue is "*the amount of benefits due the insured*." However, unlike PIP claims, whereby the insurer is required to pay out PIP benefits as reimbursement for losses resulting from accidents *without* regard to fault, the focus under UM/UIM claims is to place the injured policyholder in the same position they would be in if they were able to recover directly from the tortfeasor, which is directly predicated the tortfeasor's fault. This was an important factor in the Court's ruling in *Spearman*.

In this case, the insured was injured in an auto accident with an uninsured motorist and filed a proof of loss for UM benefits. Within six months, the insurer sent a letter to the insured stating that it accepted coverage and consented to binding arbitration, and that the only issues are the liability of the uninsured

motorist and damages. After the insurer paid some UM benefits, the parties were unable to resolve their dispute about the extent of the insurer's UM liability. Specifically, the insurer challenged the nature and extent of the insured's injuries, as well as the reasonableness and necessity of his medical expenses. The sole dispute in this case related to whether the insurer had complied with the safe harbor provision in ORS 742.061(3).

The insured argued that by reserving the right to challenge the nature and extent of his injuries, the insurer raised issues that went beyond "damages due the insured." Relying on the Court's decision in *Grisby v. Progressive*, which involved ORS 742.061(2), the insured argued that an insurer must agree that it owes some amount above zero in benefits so that the only remaining issues only concern the particular amount above zero that the insurer owes. In *Grisby*, the court held that the legislature's use of "amount" in ORS 742.061(2) suggested a dispute about a quantity of benefits in excess of zero. The *Grisby* court agreed and found that ORS 742.061(2) did not apply (i.e., the insured could recover attorney's fees when the amount of the claim was disputed). In the present case, the insured argued that the *Grisby* analysis under ORS 742.061(2) should apply to UM/UIM claims under ORS 742.061(3). After the trial court and court of appeals rejected the insured's argument and denied his fee request, the Oregon Supreme Court affirmed.

The Court concluded that *Grisby* was distinguishable in that it construed the safe harbor provision applicable *only* to PIP claims—not UM claims. First the Court looked at the statutory construction of the both statutes and noted that the requirements are different. In the case of claims for PIP benefits, the only issue is "*the amount of benefits due the insured*." In contrast, in the case for UM/UIM benefits, the issues are the liability of the uninsured and the "*damages due the insured*." The Court reasoned that the two provisions are set out separately and with different conditions. Thus, the legislature, in enacting those provisions, found significant differences in the types of coverage offered by PIP and UM claims.

As a result, the Court concluded that the insurer did not raise issues that went beyond "damages due the insured." Accordingly, the safe harbor of ORS 742.061(3) applied. The insurer admitted coverage and that some injury occurred but merely disputed the "nature and extent of plaintiff's alleged injuries," as well as the "reasonableness and necessity of some of plaintiff's accident related expenses." The Court acknowledged that it may be possible that the insurer could have established that it owed the insured nothing, but that does not establish that the insurer raised issues beyond the "damages due the insured." Therefore, the insurer's actions fell within the safe harbor of ORS 742.061(3).

This decision is important because an insurer may still reap the benefits of the safe harbor provision in ORS 742.061(3) even if it disputes the damages owed to its insured from both a liability and damages standpoint. The *Spearman Court* also narrowed the holding of *Grisby* to PIP claims and refused to extend this holding to UM/UIM claims.

WASHINGTON APPELLATE COURT FINDS INSURER NOT COLLATERALLY ESTOPPED FROM CONTESTING LIABILITY ISSUES IN DECLARATORY JUDGMENT ACTION

by Eliot Harris

In Washington, insurers can be subject to collateral estoppel, which bars litigation of the same issue in a subsequent declaratory judgment action, when that issue was actually litigated in the underlying proceeding. The circumstances that allow collateral estoppel to apply vary on a case-by-case basis, but generally turn on whether the insurer had an actual opportunity to litigate the merits of liability in the underlying case. Also, if the court in the underlying case ruled on issues that substantially resolved liability, even if not to finality, the insurer may be bound by those rulings in a subsequent coverage action. However, an insurer will not be bound to findings and conclusions concerning liability if the insurer attempted to challenge the liability findings and the trial court in the underlying action failed to adjudicate the merits of the substantive claims.

While various courts in Washington have articulated the potential applicability of collateral estoppel on insurers in subsequent declaratory judgment actions, the Washington Court of Appeals recently entered a significant ruling in *State Farm Fire & Casualty Co. v. Justus*, in which the Court found that the insurer was not collaterally estopped by the trial court's findings at a reasonableness hearing following a covenant judgment settlement. In *Justus*, the insured was a homeowner that lived in a rural area. After finding the claimants allegedly removing large metal pipes from his property, the claimant threatened to fire a gun to prevent the alleged theft. While the claimants were driving away with the pipe in their truck, the insured fired nine shots at the car, one of which struck the driver causing the car to hit a tree. The insured held the passenger of the truck at gunpoint until the police arrived. Over two years after the incident, the passenger filed suit against the insured for negligent wrongful detention, as well as other intentional tort claims. Washington has a two year statute of limitations for intentional tort claims and a three year statute of limitations for negligence-based claims.

The insurer agreed to provide defense coverage under reservation of rights. Both the insured and the claimant moved for summary judgment on the wrongful detention claim, which was denied by the trial court. Eventually, the insured and the claimant entered into a covenant judgment settlement that involved a stipulated judgment against the insured and an assignment of the insured's claims against the insurer to the claimant. The claimant moved for a determination that the settlement was reasonable under Washington law and the insurer intervened to oppose the settlement. One of the issues at the reasonableness hearing was whether the alleged claim of wrongful detention was an intentional-based or negligence-based claim, the latter of which would not be subject to the statute of limitations. By this time, the insurer had also filed a separate declaratory judgment action regarding coverage for the incident.

In approving the reasonableness of the covenant judgment settlement, the trial court recognized that it was not making any findings as to whether the insured's actions were negligent or intentional, but did rule that the claimant would not be time barred for "any negligence-based claim that is later found to have arisen out of the incident." The court's ruling approving the reasonableness of the settlement was affirmed on appeal on the basis that the trial court was not required to decide if the alleged actions were based on negligent or intentional conduct in order to approve the reasonableness of the settlement agreement.

In the separate declaratory judgment action, the court held a bench trial and ruled that the insurer was not required to indemnify the insured because the alleged actions could only constitute intentional acts of false arrest and false imprisonment, each of which would be time barred under the applicable statute of limitations. The insured appealed and argued that the insurer was collaterally estopped by the trial court's ruling in the underlying case from determining the underlying liability, i.e. whether the insured's actions were negligent or intentional.

The Court of Appeals in *Justus* refused to apply collateral estoppel in this case because the court in the underlying tort case specifically indicated that it would not make findings as to whether or not the insured's actions were intentional or negligent. Rather, the trial court in the underlying case recognized that the insurer had already filed a separate declaratory judgment action and left this issue open to be decided by the court in that action rather than at the reasonableness hearing in the underlying action.

This is an important decision for a number of reasons. Insurer are often faced with the difficult situation of defending an insured under reservation of rights when some, if not all, of the claims are either not covered or legally insufficient, such as barred by the applicable statute of limitations. In this case, it was significant that the insurer had a pending declaratory judgment action at the time of the reasonableness hearing in the underlying action, which allowed the court in the underlying case to defer certain rulings that would impact coverage to allow the court in the declaratory judgment action to rule on those issues. Thus, this case provides a valuable lesson to insurers regarding intervening at a reasonableness hearing to avoid collateral estoppel in the future. This case also serves as a cautionary tale for insurers that are hesitant to file declaratory judgment actions for coverage issues in Washington as it shows that a failure to do so can have a dramatic impact on the insurer's ability to litigate certain factual issues in a coverage action versus at a reasonableness hearing in the underlying action.

WASHINGTON COURT FINDS THAT THIRD PARTY ADMINISTRATORS AND CLAIMS ADJUSTERS CAN BE LIABLE FOR INSURANCE BAD FAITH

by Naazaneen Hodjat

The Washington Court of Appeals, Division III recently held that third party administrators and insurance adjusters can be held liable for bad faith claims, in addition to several other claims, that have generally applied only to insurers in the past.

In *Merriman v. American Guarantee and Liability Insurance Company*, 198 Wn. App. 594 (2017), William and Colleen Merriman sued Bernd Moving Systems ("Bernd") after a fire started by a Bernd employee destroyed over $300,000 worth of the Merrimans' property in storage with Bernd. Prior to storing their property with Bernd, the Merrimans had been told that their property would be fully insured. Shortly after the fire, however, the Merrimans were informed that any coverage for their property would likely have to be through their own homeowner's insurance policy. The Merrimans brought a negligence cause of action against Bernd.

Bernd was insured by American Guarantee & Liability Insurance Company ("American Guarantee"). However, it was only after bringing suit against Bernd that the Merrimans discovered that the American Guarantee policy covered their loss. This information had never been disclosed by American Guarantee, its adjuster, or the adjuster's local agent. Rather, shortly following the fire, American Guarantee contracted with York Risk Services Group ("York") to serve as the claims adjuster for the Bernd warehouse fire. Under a preexisting third party administrator agreement, York was engaged to administer the entire review, adjustment, settlement, and payment process for American Guarantee. York subsequently engaged Partners Claim Services, Inc. ("Partners") to serve as its local agent for the administration of the Bernd warehouse fire claims. All communication to the Merrimans (and all other insurance claimants) was handled by Partners' representatives.

The Merrimans moved to amend their complaint to include claims against Bernd's insurer, its adjuster, and the adjuster's local agent, and successfully moved for a certification of a class action. Although settlements were reached with all other parties, no

settlement was reached with York. The trial court subsequently decertified the class and granted the adjuster's motion for summary judgment thereby dismissing the Merrimans' claims against it. The Merrimans appealed the trial court's decision.

Bernd's policy provided coverage for the "[p]ersonal property of others in [Bernd's] care, custody and control" and provided that American Guarantee's "payment for loss of or damage to personal property of others will only be for the account of the owner of the property." Although York agreed that Bernd's customer property stored within the warehouse was covered under the policy, it did not provide a copy of the policy to Partners. Rather, it instructed Partners to tell claimants that it did not know whether Bernd's policy would apply to their loss and that the property owners should file a claim under their own homeowner's insurance in order to expedite their recovery.

The Court of Appeals first determined that the Merrimans were "insureds" under Bernd's policy. The Court rejected York's argument that Bernd's customers were third party claimants, and therefore, could not make claims for their own losses. Rather, the Court found that the language of the policy unambiguously included Bernd's customers' property that was in its care, custody and control at the time of the covered loss.

Next, the Court addressed the Merrimans' claims against York for insurance bad faith. The Court rejected York's contention that the Merrimans could not sue York for insurance bad faith because it was an adjuster, and not an insurer. The Court found that "the duty of good faith has been imposed on the insurance industry" by common law and by statute. Washington's Bad Faith statute [RCW 48.01.030] applies to "all persons" in "the business of insurance." York, although an adjuster, was contracted by American Guarantee to act as its administrator. In fact, York promised American Guarantee that it would administer the entire review, adjustment, settlement, and payment process for American Guarantee. Thus, the Court found that York was a "person" engaged in the "business of insurance" and held that RCW 48.01.030 unambiguously applies to insurance adjusters and administrators.

The Court of Appeals also rejected York's contention that the dismissal of the negligent misrepresentation and negligence claims was warranted. A party to a business transaction has a duty to disclose "facts basic to the transaction, if [the party] knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts." The Court further found that the property owners were the intended beneficiaries of York's third party agreement with American Guarantee and therefore reasonably expected to benefit from York's performance. The Court held that "given the duties undertaken by York in the third party administrator agreement; the intent of that agreement to benefit, in part, American Guarantee's insureds; and the foreseeable harm to the insureds if York's relevant promises were not performed, York owed the insureds a duty of reasonable care to perform those promises."

The Court also addressed the Merrimans' Washington's Consumer Protection Act ("CPA") claim against York. The Court rejected the Merrimans' argument that York's handling of its claims was a per se CPA violation because the regulation only applied to insurers. The Court, however, held that the Merrimans could assert a non per se CPA violation against York for its failure to inform property owners of their available coverage under the policy because a jury could arguably find that it was an unfair or deceptive act that led to harm under the CPA.

The Court of Appeals ultimately reversed the lower court's dismissal of the Merrimans' claims against York for bad faith, negligent misrepresentation, and non per se violations of Washington's Consumer Protection Act.

The Court's ruling is significant because it could substantially increase liability exposure for third party administrators and claims adjusters in coverage litigation. Therefore, third party administrators and adjustors should take note that they may be subject to bad faith liability and exercise reasonable care in performing their duties.

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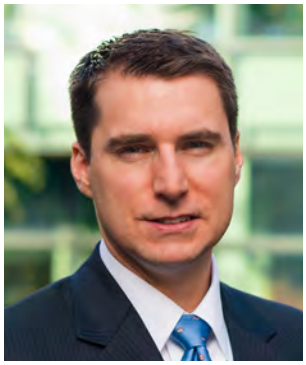
For over eighty years Williams Kastner attorneys have represented clients in the insurance industry, including primary and excess insurers, reinsurers, self-insurers, agents, brokers, and insurance pools. Our attorneys have advised clients on regulatory and claim handling issues, and have assisted insurers in countless claims from the claim investigation through trial on cases involving coverage and bad faith claims. Please feel free to contact us if you have any questions regarding insurance law in Washington, Oregon or Alaska.



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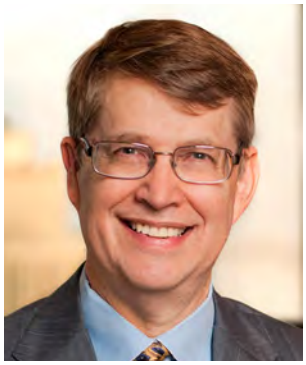

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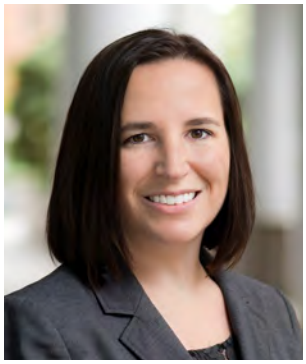

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