66636-3

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

LAKE CHELAN SHORES HOMEOWNERS ASSOCIATION,

Appellant,

v.

NORTHERN INSURANCE COMPANY OF NEW YORK,

Defendant,

and

ST. PAUL FIRE & MARINE INSURANCE COMPANY,

Respondent.

REPLY BRIEF OF APPELLANT

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I. INTRODUCTION

The Response submitted by St. Paul underscores the impropriety of the summary judgments in this case. St. Paul dismisses the evidence submitted by LCS and its experts, and insists the summary judgments should have been granted because its evidence was more persuasive, and its experts more believable. In particular, almost all of St. Paul's arguments are based upon the erroneous belief that the trial court could weigh the evidence at summary judgment as if it were a *Frye*[1] hearing to determine admissibility. No authority or persuasive argument has been, or can be, provided to support this position.

Like the trial court, St. Paul simply fails to grasp the purpose of summary judgment. Summary judgments resolve issues upon which there are no disputed facts. Weighing countervailing evidence and judging the credibility of opposing experts is for the trier of fact to determine after a trial, not for the court to determine on summary judgment. Similarly, *Frye* hearing determinations cannot be made at summary judgment based upon conflicting testimony from qualified experts. The summary judgments below should therefore be reversed, and the case remanded for trial.

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[1] Washington follows the standards set forth in *Frye v. United States*, 293 F. 1013 (D.C.Cir.1923) to determine the admissibility of expert testimony relating to new or novel scientific theories.

This case also presents an opportunity for this Court to rein in the abuses of insurance companies which seek to avoid ordinary discovery requirements by assigning adjusting functions to coverage counsel. Inexplicably, the trial court granted access to documents such as claims files and investigation documents from one insurance company, but denied it as to the other. The results were polar opposite outcomes on the merits of the two bad faith claims, and an obvious abuse of discretion by the trial court. This decision should be reversed with instructions on remand to order the production of the withheld documents.

II. REPLY

A. St. Paul failed to demonstrate it was entitled to summary judgment on LCS's contractual insurance coverage claims as a matter of law.

1. St. Paul cannot establish its right to summary judgment by using a legally irrelevant standard of its own making.

ER 702 provides that if "scientific, technical or other specialized knowledge" will assist the trier of fact to determine a fact in issue, "a witness qualified as an expert by knowledge, skill, experience, training, or education" may testify thereto by opinion or otherwise. The legal standard for such opinion testimony is "more probable than not," not 95 percent certainty, or a laboratory standard.[2] By allowing for expert

[2] 5B Teglund Wash. Practice § 702.30; *Torno v. Hayek*, 133 Wn. App. 244, 135 P.3d 536 (2006); *Merriman v. Toothaker*, 9 Wn. App. 810, 515 P.2d 509 (1973).

testimony based upon specialized knowledge gained from practical experience, the rule expressly allows for testimony from qualified individuals based upon field experience, and does not require laboratory precision such as St. Paul arbitrarily specified.

Notwithstanding the breadth of ER 702 and the well-established "more probable than not standard," St. Paul instructed its wood science expert, Dr. Barry Goodell, to render his opinions to a "reasonable scientific certainty," a concept Dr. Goodell interpreted to require 95 percent confidence or the certainty required in a laboratory. CP 1962, 1959, 103-04. Although the Response dedicates several pages to counsel's discussion of "reasonable scientific certainty," not a single case is cited to justify the use of this standard in a court of law. Moreover, whatever "reasonable scientific certainty" might mean, it is undisputed that Dr. Goodell was never asked to determine, and never attempted to determine, if the onset of SSI at Lake Chelan Shores could be estimated on a more probable than not basis. CP 1962, 1958.

When making coverage determinations, insurance companies may not ignore established law, make decisions based upon what they believe the law should be, or create legal standards out of whole cloth. *See American Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 408, 920 P.3d 31 (2010) (any uncertainty in state law must be interpreted in

the light favorable to the insured); *Woo v. Fireman's Fund Insurance*, 161 Wn.2d 43, 60, 164 P.3d 454 (2007) (precluding a carrier from utilizing its own interpretation of equivocal state law). Since Dr. Goodell's opinions are based upon a contrived legal standard, they cannot form a good faith basis for denial of a claim, nor are his opinions capable of establishing the right to summary judgment as a matter of law.

2. St. Paul does not contest that SSI need only exist, not commence, during any one of its policy periods for coverage to be triggered. The trial court's legal analysis is therefore admittedly in error.

The trial court ruled that LCS must prove a collapse occurred "during a specific coverage period as opposed to some other time" and that it was impossible to prove the onset of SSI to a specific, one-year coverage period. CP 1890. This ruling, handwritten into the Order by the trial court,[3] is based upon a legal requirement never argued by St. Paul, is unsupported by the policy language, and is in error.

As St. Paul admitted in its motion for summary judgment on coverage, an insured need only prove "the alleged collapse condition

[3] The entire interlineation added by the trial court reads:
It may be possible to say that if the collapse happened during a coverage period it more probably happened under one policy as compared to another policy based on timing. However, it is not possible to say on a more probable than not basis, even in the light most favorable to Plaintiff, that collapse happened during a specific coverage period as opposed to some other time. CP 1890.

existed while St. Paul insured the property." CP 35 (italics added). Although the trial court's formulation was briefed on appeal by LCS, St. Paul's Response never addresses the issue directly, nor is any attempt made to justify the trial court's rationale. Nonetheless, the Response repeatedly states that LCS need only prove SSI "existed" or was in "existence" during a policy period, thereby tacitly admitting that the trial court's express rationale for ruling in its favor was in error.[4] The error is significant as it is far easier to place the onset of SSI within a 19-year period on a more probable than not basis than it is to make the same determination within a single year.[5] CP 1286.

3. A *Frye* hearing determination cannot be made on contested evidence at summary judgment.

St. Paul's claim that a *Frye* hearing determination can be made at summary judgment is made without citation to controlling authority and is incorrect. First, St. Paul ignores that its motion requested a *Frye* hearing only in the event that its motion for summary judgment was denied. CP 21. Only at oral argument did St. Paul claim that a *Frye* determination could be made at summary judgment. RP (Nov. 20, 2009) 3:17-4:6. This can only occur if the evidence is such that

[4] See Response at 2, 13, 14, 15, 16, 33, 41.

[5] The Response argues it is irrelevant how big the target is if there are no arrows in the quiver. Response at 17. This argument is more clever than real. LCS expert Kevin Flynn testified that the 19-year target and the probability standard employed were both highly relevant to his ability to make a reasonable estimate. CP 1286. This testimony cannot be ignored simply because defense counsel disagrees.

reasonable minds could not differ. The dispute between qualified experts, and the reliance on different standards of proof by each, belies any claim that reasonable minds could not differ or that there was no genuine issue of material fact for the jury to determine.[6]

St. Paul's argument that a dispute among the experts only proves its *Frye* arguments is based upon circular logic. Response at 18-19. According to St. Paul, a dispute among the experts proves the evidence is not generally accepted; therefore, summary judgment is appropriate because the *Frye* standard cannot be met. If this logic were valid, a *Frye* hearing would never be required because the mere existence of a dispute would automatically create a summary judgment issue. The *Frye* procedure recognizes that when a true issue is raised regarding novel scientific theories, it must be resolved at an evidentiary hearing, not at summary judgment. Conversely, CR 56 provides that summary judgment may not be granted when there are material issues of fact.

In this case, there is a dispute between the experts whether a *Frye* issue even exists. According to Mr. Flynn, the underlying science of wood decay is well known and understood. CP 1284-85. Even Dr. Goodell admits this is "old science" and "not a matter of current

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[6] *See Postema v. Pollution Control Hearing Bd.*, 142 Wn.2d 68, 119-20, 11 P.3d 726 (2000); *Larson v. Nelson*, 118 Wn. App. 797, 810, 77 P.3d 671 (2003); *J.N. By and Through Hager v. Bellingham School Dist.*, 74 Wn. App. 49, 60-61, 871 P.2d 1106 (1994).

discussion."[7] CP 1021. Accordingly, we are not dealing with "novel scientific evidence," the threshold issue in *Frye*. Similarly, the methods used to estimate the progression of decay on a more likely than not basis are well established. Mr. Franklin measured the observable amount of decay in each structural member at a known point in time and compared that to the known life of the building. CP 1028. He ascertained the source of water intrusion and determined that rain and melt water began to leak into the structures shortly after the buildings were completed. CP 1030; *see also* CP 1946. Weather records were consulted showing Lake Chelan had been in a similar weather pattern for the life of the buildings. CP 1287. Mr. Franklin then used his knowledge and experience, as well as a mathematical model, to estimate the progression of decay through its well-recognized lag and exponential growth phases. CP 1032. None of this is new or novel.[8] But even if there were new or novel issues, a dispute among the experts must be resolved at a *Frye* hearing, and not at summary judgment.

St. Paul's arguments are also flawed because it focused solely upon issues of mathematical modeling and software, ignoring that the

[7] As his basis for believing that others in the wood science community share his opinion, Dr. Goodell cited to general "nods and murmurs" when he expressed his opinions. CP 1018.

[8] Dr. Goodell's analysis never allows for field observations or practical experience as expressly provided for in ER 708. For example, he argues that back dating is impossible "other than if you were to carefully monitor a very very small sample under very tightly controlled conditions . . . ." CP 1021. In other words, under laboratory conditions.

opinions in question were also based upon specialized knowledge gained from practical experience. This experience included inspecting numerous buildings of various ages, and observing the amount of decay which occurred over time. Franklin and Flynn also inspected the 20 buildings at Lake Chelan Shores (in Franklin's case over a 20 month period) and testified that they observed similar amounts of decay in similar construction details, developing over similar periods of time. CP 1287, 1290, 1031. Both testified that these observations demonstrated the decay progressed consistently year to year, and that the variables cited by Dr. Goodell were not in play at Lake Chelan Shores when decay was estimated on an annual basis. CP 1287-88, 1290, 1031. This specialized knowledge, none of which is based upon new or novel scientific theories, is sufficient to justify admission under ER 702 and to defeat summary judgment, irrespective of whether mathematical modeling was used.[9]

4. It was error for the trial court to grant summary judgment over a dispute among qualified experts.

As set forth in LCS's Opening Brief and above, opposing opinions among qualified experts create material issues of fact. Opening Brief at 21. On the issue of timing, LCS presented the testimony of a professional engineer with a Bachelor of Science degree in engineering

[9] Dr. Goodell's opinions never addressed the specific observations made at Lake Chelan Shores by Franklin and Flynn, nor did he dispute that the decay progressed in similar amounts in similar locations over similar periods of time. CP 90-104.

and a Masters degree in architecture, and that of a second expert with a Masters degree in wood science. CP 1026, 1284, 1295. Both have years of professional experience in their fields and both made independent reviews of the evidence.

In opposition, St. Paul presented the testimony of Dr. Goodell. While Dr. Goodell is undoubtedly qualified, unlike Mr. Franklin, he did not spend 20 months inspecting and documenting the progression of decay at Lake Chelan Shores. He did not take any measurements, did not take any samples, and did not perform any laboratory tests, though he expressed his opinions based upon laboratory standards. Accordingly, even if Dr. Goodell's reliance on St. Paul's contrived legal standard is put aside, his testimony at best raises material issues of fact, which should not have been resolved at summary judgment.

St. Paul also takes issue with certain conclusions arrived at by LCS's experts, but it did not present competent evidence to the contrary. For example, LCS's experts were the only witnesses to present opinions based upon a more probable than not standard. Dr. Goodell's opinions, based upon a higher standard of St. Paul's making, do not address whether decay can be dated to the 19-year period relevant to St. Paul's policies on a more probable than not basis. CP 1958. Similarly, LCS's experts concluded wood decay fungi began to grow within a year after

completion of construction based upon the existence of defects in the original design and construction as identified by a professional engineer and an architect. CP 1946, 1029, 1284-85. St. Paul criticized this testimony as speculative, but did not present the testimony of a qualified architect or engineer to rebut it, nor did it present any independent evidence of when water intrusion began at Lake Chelan Shores.

In summary, the trial court improperly resolved factual disputes between the experts at summary judgment, and applied a legal theory of its own making which has never been briefed or supported by St. Paul. There is no legal justification for making a *Frye* hearing determination at summary judgment and it was error for the trial court to do so. The question of whether engineers and wood scientists can make reasonable estimates of when wood decay reached a state of SSI should have been left to a jury to decide by a preponderance of the evidence. The summary judgment dismissing all contract claims asserted by LCS should be reversed and the case remanded for trial.

B. LCS provided sufficient evidence to find St. Paul breached its duty of good faith by failing to conduct a reasonable investigation.

St. Paul had a good faith duty to conduct a reasonable investigation of the LCS claim. The investigation is a benefit of the policy conferred upon the insured. *Coventry Associates, L.P. v. American*

States Ins. Co., 136 Wn.2d 269, 279, 961 P.2d 933 (1998); RCW 48.30.015(5). The purpose of the investigation is to explore the facts to determine if a covered claim exists, not to justify St. Paul's predetermined opinions. *Industrial Indemnity Co. of the NW, Inc. v. Kallevig*, 114 Wn.2d 907, 917, 792 P.2d 520 (1990).

1. St. Paul essentially admits it failed to conduct a full and impartial investigation.

In its Statement of Facts, St. Paul admits that it did little more than request documents from LCS and wait to see if LCS could "produce scientifically valid evidence" that SSI conditions existed during its policy periods. Response at 11-13. This highlights the fundamental flaw in St. Paul's approach. The duty to investigate is triggered by notice of a claim. It is the insurer's responsibility to conduct the investigation, not the insured's. Reviewing evidence produced by an insured is not a substitute for a full and fair investigation, and does not absolve the insurer of its obligations. [10]

On this record, summary judgment is appropriate only if St. Paul could show it undertook a fair, impartial and reasonable investigation, and all the evidence indicated there is no possibility of coverage or that

[10] *St. Paul Fire & Marine v. Onvia, Inc.*, 165 Wn.2d 122, 132, 196 P.3d 664 (2008). St. Paul alleges LCS could have demanded an investigation of its loss from an auto insurer under this standard; however, this is an absurd example where there is *no possibility* of coverage. Rationality dictates this was not the circumstance here.

further investigation could not uncover facts leading to coverage. *Capeluoto v. Valley Forge Ins. Co.*, 98 Wn. App. 7, 19, 990 P.2d 414 (1999); *Peterson v. Big Bend Ins. Agency, Inc.*, 150 Wn. App. 504, 522-24, 202 P.3d 372 (2009). St. Paul's actions fail to meet this standard.

2. St. Paul cannot fulfill its duty to investigate by engaging an expert to opine that an investigation is futile.

    a. *The evidence interpreted in the manner most beneficial to LCS indicates St. Paul hired Dr. Goodell as a pretext to avoid the costs of a full investigation.*

St. Paul maintains that an insurer does not commit bad faith if it denies coverage based on meritorious factual contentions or an arguable interpretation of existing law. Response at 35. St. Paul has done neither. St. Paul's factual and legal contentions are based primarily upon a heightened legal standard of its own making and the predetermined opinions of an expert it retained to provide justification for a decision not to investigate made months earlier. Summary judgment may not be affirmed unless there are no genuine issues of material fact regarding the reasonableness of the insurer's actions in light of all the facts and circumstances of the case. *Kallevig*, 114 Wn.2d at 920. Any facts indicating that the insurer was not fair, honest and objective or acted without reasonable justification in handling the claims create a material issue of fact. *Id.*; *Safeco Ins. Co. of Am. v. JMG Restaurants, Inc.*, 37 Wn. App. 1, 14, 680 P.2d 409 (1984).

St. Paul's general adjuster, Dennis Luoma, testified that he retained Mr. Dethlefs of professional engineering firm WJE six weeks after receiving notice of the claim. CP 1596-97. However, after receiving Tatley Grund's cost estimate a short time later, Luoma decided not to authorize an investigation by WJE because he believed collapse conditions could not be traced back to St. Paul's coverage period. CP 1597-98, 1666, 1964. Accordingly, as early as August 2007, St. Paul decided not to conduct a true investigation, but to rely upon an expert it had yet to hire to opine that it was impossible to back date decay.

St. Paul also claims it is not possible to breach the duty to investigate if an investigation is not scientifically feasible. Response at 31. However, there is ample evidence from which a jury could conclude that St. Paul simply used this, and Dr. Goodell's supporting opinion, as a pretext to deny coverage. St. Paul knew Dr. Goodell believed it was impossible to back date decay before he was hired because he had been retained by St. Paul's defense attorney to testify to the same opinion in two prior cases. CP 1955-56. This raises an inference that Dr. Goodell was retained precisely because he would testify an investigation was futile. CP 1962, 1955-56. Other jurisdictions have held the practice of selecting experts to support a preconceived result is bad faith. *See, e.g., State Farm Lloyd's v. Nicolou,* 951 S.W.2d 444, 448-50 (Texas S. Ct.

1997) (hiring an expert as a pretext is bad faith); *Chateau Chamberay Homeowners Assoc. v. Associated Int'l Ins. Co.*, 90 Cal. App. 4th 335, 348-49, 108 Cal. Rptr. 2d 776 (2001) (insurer's reliance on expert does not insulate it from bad faith if insurer failed to conduct thorough investigation or insurer dishonestly selected its expert); *Columbia Universal Life Ins. Co. v. Miles,* 923 S.W.2d 803, 810 (Tex. App.-El Paso 1996) (bad faith claim supported if evidence indicates investigation conducted solely to justify pre-conceived result). The overarching theme of these decisions is that an insurer cannot justify its failure to fully and fairly investigate a claim by hiring an expert to validate its preconceived position, as St. Paul has done here. Washington law is in accord with the public policy expressed in these cases. *See Smith v. Safeco Ins. Co.*, 150 Wn.2d 478, 486, 78 P.3d 1274 (2003) (insured may present evidence that alleged reason for the insurer's action was a pretext, or that other factors outweighed it).

Interpreting the evidence in favor of LCS as the nonmoving party, a reasonable juror could conclude St. Paul decided it would deny the claim shortly after tender, and hired Dr. Goodell to support its "no coverage" opinion, knowing his opinions in advance. This inference is further supported by St. Paul's refusal to approve an independent investigation by WJE in April 2008, after eight buildings had been

stripped at LCS's expense, and its subsequent refusal to investigate SSI at the Clubhouse. CP 952-57, 970-75, 1919, 1597; CP 2044-45. These incidents raise material issues of fact which should have precluded summary judgment in St. Paul's favor.

b. St. Paul's requirement of proof to a standard of its own making was used to deny LCS the benefits of a reasonable investigation.

As discussed in Section II(A)(1) above, St. Paul's argument that there must be reasonable scientific certainty before an expert's opinion is relevant to coverage is an illusory requirement of St. Paul's manufacture. St. Paul also required LCS, as its insured, to prove its claim to this standard and refused to conduct an investigation until this had been done to its satisfaction. CP 2044-45. This arbitrary action, taken without justification in the insurance policy or in law, is bad faith. *Kallevig*, 114 Wn.2d at 920; *JMG Restaurants,* 37 Wn. App. at 14.

The duty to investigate is an obligation owed by an insurer to its insured. It is triggered by notice of a claim, not by proof adequate to meet an arbitrary standard set by the insurer. *Onvia*, 165 Wn.2d at 132. By imposing a false standard upon LCS, St. Paul effectively required LCS to conduct and pay for its own investigation, causing harm to LCS and denying it a benefit of its insurance. *Coventry*, 135 Wn.2d at 282.

3. St. Paul's proximate cause arguments are not supported by applicable law and raise material issues of fact which cannot be decided on summary judgment.

St. Paul claims the costs LCS incurred in removing and replacing siding were not proximately caused by bad faith breach of the duty to investigate. This argument ignores both the facts and Washington law.

First, there is a question whether the doctrine of proximate cause applies. Washington bad faith law either presumes harm, as in *Kirk v. Mt. Airy Ins. Co.,* 134 Wn.2d 558, 951 P.2d 1124 (1998) ("Once the insurer breaches an important benefit of the insurance contract, harm is assumed . . ."), or requires the insured to prove its actual damages, as in *Onvia,* 165 Wn.2d at 133, and *Coventry,* 136 Wn.2d 269 at 284-85. *Onvia* and *Coventry* determined that the damages for WAC violations and breach of the duty to investigate first party claims are not presumed, as in *Kirk*; instead, the insured must prove actual harm because the underlying harm has already occurred. As stated by the Court in *Onvia*:

> As in *Coventry,* [the insured] must prove actual harm and its "damages are limited to the amounts it has incurred as a result of the bad faith... as well as general tort damages."

Onvia, 165 Wn.2d at 133, *quoting Coventry*, 135 Wn.2d at 285.

Neither *Onvia* nor *Coventry* expressly requires a proximate cause analysis. Both decisions require that the bad faith result in harm and actual damages, but do not discuss proximate cause. To the extent proof

of causation is required, LCS need only prove that it was harmed as a result of St. Paul's bad faith, not the amount. Under *Coventry*, this occurs if the insured is forced to conduct an investigation itself, or even if it does nothing at all, since in either case it has not received the full benefit of its policy. *Coventry*, 136 Wn.2d at 282.

In this case, the harm to LCS is amply proven since LCS paid 100 percent of the cost to strip the buildings to inspect the decayed structures beneath. Removal of at least some stucco is required to inspect the structure beneath, and no part of this expense was paid by St. Paul although it took full advantage of it.[11] LCS has therefore suffered damage in an amount to be proven as a result of St. Paul's bad faith.

St. Paul's proximate cause argument also fails because it assumes the decision by the LCS Board to proceed with an investigation of its own was unalterable and irreversible, or that St. Paul had no way to share in the cost, neither of which was the case. LCS did not make a final decision on proceeding with its investigation until approximately March of 2007, and did not sign a contract with its contractor until September 2007. CP 1778, 1919-20. Thereafter, the work proceeded in stages over the next 20 months leaving an ample opportunity for St. Paul

[11] Dennis Luoma admitted that he restricted the investigation he would normally have conducted to take advantage of the demolition performed by LCS's contractor. CP 1597-98.

to investigate or cooperatively join LCS's investigation. CP 1918-29. Insurance expert Kay Thorne also testified that St. Paul should have offered to cover all or part of the costs of investigation, something it never did. CP 1935-38. It is instructive that when WJE proposed a scope of investigation for buildings 9 through 20 to St. Paul, St. Paul failed to authorize the investigation or to disclose the scope to LCS. CP 2022-42. Similarly, when LCS asked St. Paul to investigate the Clubhouse after OAC uncovered preliminary evidence of SSI, St. Paul refused. CP 2044-48. Neither of these investigations was in any way precluded by LCS and the harm incurred cannot be dispensed with on a proximate cause analysis.[12]

Finally, St. Paul's proximate cause argument, as applied to the facts of this case, would set a harmful precedent. Policyholders, as owners, often decide before notifying their insurers that their cars, homes, places of business or other insured property must be repaired. The more emergent the situation, the more quickly this decision is likely to be made. It cannot be inferred that by simply making the decision to

[12] St. Paul quotes *Panag v. Farmers Ins. Co. of Washington*, 166 Wn.2d 27, 64, 204 P.3d 885 (2009), a Consumer Protection Act case, for the proposition that if an investigative expense would have been incurred regardless of whether a violation existed, causation cannot be established. However, in *Panag*, it was determined that this raised an issue of fact, not that it warranted dismissal as a matter of law. Moreover, the testimony of Revelle and Thorne establishes that the full cost of investigation would not have been incurred by LCS if St. Paul had agreed to conduct an investigation. CP 1919-20, 1935-38.

repair, a policyholder has decided to forgo insurance benefits, or to incur the costs of repair and investigation alone. The logical result of St. Paul's argument is that whenever a policyholder decides to repair or investigate, there can be no damages from bad faith because the policyholder would have repaired anyway. This ignores that the policyholder is entitled to receive the full benefit of its insurance, including an investigation of the loss funded by its insurer, irrespective of any decision to repair. *Coventry*, 136 Wn.2d at 282. St. Paul's proximate cause argument should be rejected.

4. St. Paul cannot credibly deny that it load tested the support structures of decks which were not claimed to be in a state of SSI and then used these results to deny coverage.

Perhaps the only independent investigation conducted by St. Paul involved dead and live load testing on the support structures of four decks. St. Paul then used the results to deny coverage and in support of its motion for summary judgment. CP 2162, 1598, 1722-42; 1583. Contrary to St. Paul's Response, the structures tested were not claimed to be in a state of SSI, St. Paul was warned of this, and went forward with the tests anyway. In its Response, St. Paul accuses LCS of bad faith by bringing this discrepancy to the Court's attention; however, the evidence shows St. Paul had no reason to test the decks, and no justification for relying upon the results, but insisted on doing both.

St. Paul first informed LCS that it wanted to load test four decks of its choosing on January 27, 2009. CP 1981-86. According to the email from Mr. Derrig, "These decks have been identified by Olympic Associates as containing conditions of 'substantial impairment of structural integrity.'" CP 1981. Mr. Petrie pointed out the error by return email, "OAC says they have not investigated these decks and do not know yet if the decks or their support systems are in a state of SSI." CP 1987; *see also* CP 1989. Notwithstanding these warnings, St. Paul went forward with the testing. CP 1723. The tests consisted of piling sand bags on the deck floors and measuring the deflection under load. CP 1726. No attempt was made to evaluate the guardwalls, portions of which were removed to accommodate the testing. CP 1724-26, 1738-40. The WJE report concluded that the decks tested could support "code design level live and dead loads without failure." CP 1726.

When OAC issued its SSI analysis, none of the support structures tested were claimed to be in a state of SSI. Mr. Franklin took issue only with the structural integrity of the guardwalls, which were nailed into decayed wood. His description of the problem for the deck at Unit 16-7 is typical of the four decks tested:

> The deck guardwall wall framing and deck rim joist at this location are damaged to the point where they can no longer support nailing required to connect the guardwall framing to the

deck framing.

Mr. Franklin did not claim there was SSI in the support structures; nevertheless, St. Paul relied upon the tests to deny coverage.

> The numbers generated by Mr. Franklin are distorted by the engineering criteria he uses to define when a collapse exists. . . . This was amply demonstrated when St. Paul had an allegedly "SSI" deck tested and the deck held the weight of two Cadillacs without deflecting, much less endangering any potential occupants.

CP 2162. St. Paul also cited the tests as evidence in support of its motion for summary judgment. CP 1598, 1722-42.

St. Paul's stubborn insistence on claiming the deck structures were alleged to be in a state of SSI demonstrates St. Paul's bad faith. Rather than undertake an impartial investigation, St. Paul looked for evidence to support its no coverage position, chose to test decks which were not claimed to be in a state of SSI, and then used the results to deny coverage. This type of contrived and self-serving investigation is the antithesis of a reasonable, unbiased, good faith investigation as required by Washington law. *Kallevig,* 114 Wn.2d at 917 (actions of an insurer taken without reasonable justification are done in bad faith).

C. St. Paul's Response fails to explain how the trial court could grant a motion to compel and a continuance in regard to one insurer, but deny it in regard to another, based upon identical discovery requests served on the same date, without abusing its discretion.

The final issue under review raises significant issues relating to

discovery in a bad faith case when an insurer chooses to delegate its adjusting and investigation functions to defense counsel and then refuses to produce their communications and work product by asserting claims of privilege. Current case law fails to effectively deal with this issue, creating a safe harbor for the bad faith insurer and barriers to justice for the aggrieved insured. The problem lies in the inherent conflict between the ongoing obligations of an insurance company to adjust and investigate a claim in good faith, and the zealous advocacy of defense counsel. St. Paul's Response would have the Court look only to the role of defense counsel after suit has been filed, and the privileges which are typically accorded to its communications and work product. To resolve the conundrum in this manner would abrogate the ongoing duty of good faith owed by the insurer to its insured, as well as raise significant barriers to justice by denying policyholders the effective means to prove bad faith. This approach also fails to recognize that the conflict can be easily avoided, and appropriate privileges preserved, by keeping the roles of adjuster and defense counsel separate. If the insurance company elects to combine these roles, no claim of privilege should attach to adjusting or investigation functions.

Shielding the decisions of an insurance company from discovery by using defense counsel as a front-man is a well worn form of

gamesmanship.[13] There is little doubt that insurers control and will opt to secure damning evidence in a manner that avoids discovery[14] or shifts the burden of disclosure to an insured. For example, St. Paul argues that under *Cedell v. Farmers Ins. Co.*, 157 Wn. App. 267, 237 P.3d 309 (2010) LCS was required to show proof of civil fraud to establish the right to an *in camera* review of the documents. In contrast, this Court's holding in *Magana v. Hyundai Motor America*, 167 Wn.2d 570, 220 P.3d 191 (2009) places the burden upon St. Paul as the objecting party to move for a protective order before it can justifiably withhold documents. As set forth in LCS's Opening Brief, *Cedell* expressly exempts communications made when an attorney is serving in the role of an adjuster from any claim of privilege. Accordingly, the civil fraud requirement in *Cedell* only applies to attorney client communications when the attorney is not acting as an adjuster/investigator as did Mr.

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[13] St. Paul's privilege log also asserts the attorney-client privilege over documents that are not between an attorney and the client. CP 1872-1875, 2153-57 [at SPCF000041, SPFC00059, SPCF001273].

[14] As an example of avoidance, St. Paul maintains it was required to produce documents only from St. Paul, not all Travelers' entities, and further that it searched St. Paul's "corporate memory." Response at 40. Neither statement is accurate. On the first page of its discovery requests, LCS specified that it was requesting all information known to St. Paul, St. Paul/Travelers, and/or the Travelers Companies with which St. Paul had merged. CP 1842. The definition of "you" or "St. Paul" was never objected to, nor can St. Paul deny the association, yet it unilaterally limited its responses. St. Paul also failed to search its "corporate memory" however defined. Only Dennis Luoma and James Derrig participated in preparing the responses although six other names of Travelers' personnel were identified in materials produced. CP 1845, 1974. Further, St. Paul unilaterally limited its search to the State of Washington and did not identify at least five cases in which Mr. Derrig himself had earlier participated. CP 1854, 1870.

Derrig. Any other interpretation puts *Cedell* in direct conflict with *Escalante v. Sentry Insurance*, 49 Wn. App. 375, 394, 743 P.2d 832 (1987), *rev. denied*, 109 Wn.2d 1025 (1988) which requires only a showing "adequate to support a good faith belief by a reasonable person that wrongful conduct sufficient to invoke the . . . fraud exception . . . has occurred" to justify an *in camera* inspection, not proof of civil fraud.[15] In any event, the salient point is that insurance companies will take advantage of whatever loopholes exist to protect damaging information from discovery. Policyholders must be allowed reasonable access to this information, or bad faith will be encouraged and protected.

This case provides a stark example of what can occur when access to claims adjusting information is granted or denied. Although LCS served identical discovery requests on its two insurers, St. Paul and Northern, its motion to compel and for a continuance was denied as to St. Paul, but granted as to Northern only a few weeks later. There is no principled way to distinguish between the two motions. Yet, with access to key claim file documents, including documents regarding the retention

[15] Even if the civil fraud standard in *Cedell* is held to apply before an in camera inspection, LCS provided adequate evidence of bad faith and civil fraud by demonstrating that St. Paul decided not to conduct a full investigation before retaining an expert to justify that decision after the fact. St. Paul also ignores that by defending the case by claiming it conducted a reasonable investigation in good faith, it placed the matter of its adjuster's opinions and motivations to deny the claim at issue. *See Lexington Insurance Co. v. Swanson*, 240 F.R.D. 662, 670 (W.D. Wash. 2007) (discussing waiver of privilege over claim related documents in a bad faith lawsuit).

of experts, LCS established that Northern acted in bad faith as a matter of law. Without access to similar documents, its claims against St. Paul were dismissed. This grossly disparate treatment of identical motions involving similarly situated insurers is patently unreasonable, and an abuse of discretion. *Gildon v. Simon Prop. Group, Inc.*, 158 Wn.2d 483, 494, 145 P.3d 1196 (2006). This Court should reverse, hold that claims adjusting functions and investigation of a claim are not within the attorney-client privilege or the work product doctrines, and should remand with instructions that such documents be produced.

III. CONCLUSION

For the above-stated reasons, and those stated in LCS's Opening Brief, the relief requested by LCS in this appeal should be granted.

DATED this 14th day of January, 2011.

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DECLARATION OF SERVICE

I declare that on the 14th day of January, 2011, I caused to be served the foregoing document on counsel for Respondent, as noted, at the following address:

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Dated: January 14, 2011

Place: Seattle, WA

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Attached for filing is the Reply Brief of Appellant.

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Thank you.

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