No. 45515-3-II

COURT OF APPEALS, DIVISION II
STATE OF WASHINGTON

KUT SUEN LUI and MAY FAR LUI, Plaintiffs-Respondents,

v.

ESSEX INSURANCE COMPANY, Defendant-Appellant.

REPLY BRIEF OF APPELLANT ESSEX INSURANCE COMPANY

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I. THIS CASE IS RIPE FOR FULL RESOLUTION.

This Court's review of the parties' cross-motions for summary judgment is de novo. The facts are undisputed, as conceded by both parties in their cross-motions for summary judgment to the trial court. The law is compelling on the three dispositive issues before this Court: (a) the Essex' policy language without ambiguity partially limits insurance coverage upon the inception of any vacancy or unoccupancy, and also suspends coverage altogether after 60-days of vacancy or unoccupancy; (b) Essex is not estopped from asserting, and has not waived its right to assert, the "vacancy/unoccupancy" provision in the insurance policy; and (c) Essex has not acted in bad faith.

A. Essex' "vacancy" provision is unambiguous and effective.

The Luis offer a flawed argument that there is a "structural ambiguity" in the insurance policy. The Luis vaguely claim that the policy is inconsistent or incoherent in distinguishing between (i) an immediate partial limitation of coverage upon inception of "vacancy" or

"unoccupancy," and (ii) the total suspension of all coverage after 60-days of vacancy or unoccupancy. The Luis' argument is flawed because it violates the rules of insurance policy interpretation.

First, for the Court to find an ambiguity in Essex' "vacancy/unoccupancy" provision, the language in question must be susceptible to two or more reasonable interpretations. See *Quadrant Corp. v. American State Ins. Co.* 154 Wn. 2d 165, 171 (2005). The Luis offer no such reasonable alternative interpretation of the Essex' "vacancy/unoccupancy" provision here. They merely muddy the relevant language, leading to their argument that the language cannot mean what it says.

Yet, the relevant language means exactly what it says: unless the Luis' disclosed the vacancy and unoccupancy of the building to Essex in advance, the insurance policy supplied only limited coverage upon the inception of any vacancy or unoccupancy, and the policy

suspended coverage altogether after 60 days of such vacancy or unoccupancy.[1]

The Luis cannot point to any alternative meaning of these words themselves, so they vaguely argue that the policy language is confusing in its structure, i.e. they claim a structural ambiguity. This defies common sense and the law.

Complexity in an insurance policy does not make it structurally ambiguous. *McDonald v. State Farm*, 119 Wn. 2d 724, 734 (1992). Accord, *Federal Insurance v. Surujon*, et. al. 2008 U.S. Dist. LEXIS 57800 (U.S.D.C. So. Fla. 2008), wherein the court stated: "[S]imply because a provision is complex and requires analysis for application, it is not automatically rendered ambiguous. [citation omitted] . . . Courts should not rewrite contracts . . . [or] add meaning that is not present. *Id.* at *12-13.

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[1]The Court might recall that the Luis knew of the "vacancy" requirement under this surplus lines policy long before this incident took place, when Essex was forced to temporarily suspend the policy altogether years earlier after Essex learned of the property's vacancy. See Essex' opening brief at p. 7; CP 428, CP 432 and CP 232.

The Essex policy defines "vacancy" in spatial terms, e.g. "vacancy" means that less than 31% of square footage is rented or used by the owner. The definition does not include a *temporal* component, nor does it have to define "vacancy" in *temporal* terms: "[t]he property [becomes] vacant upon the happening of that condition." *Heartland Capital Inv. v. Grange Mut. Cas. Co.* 2010 WL 432333 (C.D. Ill. Feb. 2, 2010), at *4.

The Essex policy then applies that "vacancy" definition (along with "unoccupancy") to operate *temporally* in two different ways. First, a 60-day vacancy or unoccupancy automatically suspends all coverage. Second, upon inception of vacancy or unoccupancy, coverage is automatically limited. This is the plain meaning of the Essex policy language. It is not ambiguous, although it does require analysis for its application.

This policy language is a proper expression of the principle that an insurance company –especially a surplus lines insurer such as Essex here[2] – may contractually limit

[2] As explained in Essex' opening brief, this policy was a surplus

its exposure to unknown increases in the risk that are exclusively within the control of the insured to either cure or disclose - such as vacancy and unoccupancy.

1. The Essex policy language cannot be rendered meaningless.

The Luis' argument also ignores the principle that courts must give effect to each and every provision an insurance policy. See *McDonald* at 734.

Under the Luis' interpretation, the different *temporal* effects in the vacancy/unoccupancy provisions are rendered meaningless. More specifically, the phrase "at the inception of any vacancy or unoccupancy" is altogether written out of the policy." "Vacancy" exists upon the happening of the spatial condition. See *Heartland.* "Inception" means "an act, process, or instance of beginning." See *Panorama Village COA v. Allstate*, 144 Wn. 2d 130,139 (2001), citing *Websters' Dictionary* 3d ed.

Essex' words and phrases have meaning and they have a purpose in setting forth two different temporal

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lines policy issued to a higher risk property, consistent with RCW 48.15.040. See e.g. *Saunders v. Lloyds*, 113 Wn. 2d 330. n. 1 (1989).

standards for application of the "vacancy" and "unoccupancy" conditions. To reiterate, a surplus lines insurer is entitled to reduce its exposure to unknown increases in the risk (such as vacancy and unoccupancy) that are exclusively within the control of the insured to either cure or disclose.

2. The word "unoccupancy" has an effective independent meaning within the insurance policy.

Also under the Luis' interpretation, the word "unoccupancy" is non-existent within the insurance policy. Yet, the word "unoccupancy" is there. The policy provision calls for limited suspension of coverage upon the inception of vacancy or unoccupancy. As Essex briefed in the cross-motions below, "vacancy" and "unoccupancy" have different meanings and different purposeful effects.

The Nebraska case of *Rojas v. Scottsdale Ins. Co.*[3] is explicitly on-point wherein the court noted that the "construction/renovation" exception to "vacancy" does not apply to "unoccupancy." The *Rojas* insurance policy was

[3] 678 N.W. 2d 527 (Neb. 2004).

virtually identical to the Essex policy here in all material respects, i.e. the policy contained an exclusion that suspended coverage in the event of "vacancy or unoccupancy." The policy also included a "construction" exception to "vacancy" alone, i.e. a building "under construction is not considered vacant." *Id.* at 529.

The insureds evicted their tenant, and thereafter began a series of repairs and improvements to their property that lasted throughout the vacancy period.[4] No one lived in or occupied the building. A fire damaged the property 3 months after the eviction. The insureds tried to exploit the "construction" exception to the "vacancy" exclusion based on their renovation work. The court rejected that approach, declaring that the "unoccupancy" exclusion stood alone from "vacancy," and was independent of the "construction" exception.

> [T]he occupancy endorsement provides in the disjunctive that Scottsdale is not liable if the property is either "vacant, or unoccupied." Because of this, if the property

[4] In this respect, the Rojas case differs from the Luis, who have admitted that they had undertaken no work on their building during its period of vacancy and unoccupancy.

was either vacant or unoccupied, there would be no coverage. See *Alcock v. Farmers Mut. Fire Ins. Co.*, 591 S.W.2d 126, 128 (Mo.App.1979) ('vacant' and 'unoccupied' " language in policy "is clearly in the disjunctive, indicating that either a condition of vacancy or unoccupancy . . . constitutes a defense to a policyholder claim"). . . .

The terms "vacant" and "unoccupied" are not defined in the policy. The terms are not synonymous. 6 Lee R. Russ & Thomas F. Segalla, *Couch on Insurance 3d* § 94:135 (1997). . . [T]he U.S. Court of Appeals for the Seventh Circuit . . . stated that the terms "vacant" and "unoccupied" are not synonymous and noted that "vacant" focuses on the lack of animate or inanimate objects, while "unoccupied" focuses on the lack of animate objects. *Myers v. Merrimack Mut. Fire Ins. Co.*, 788 F.2d 468, 471 (7th Cir.1986). The Court of Appeals of Oregon recently noted that "a house may be unoccupied, and yet not be vacant ... a dwelling is 'unoccupied' when it has ceased to be a customary place of habitation or abode." *Schmidt v. Underwriters at Lloyds of London,* 191 Or.App. 340, 345, 82 P.3d 649, 652 (2004) (quoting *Schoeneman v. Hartford Fire Ins. Co.*, 125 Or. 571, 267 P. 815 (1928)). . . .

The Rojases argue that because the property was undergoing renovation, it was "under construction" and was not vacant . . . and should similarly not be considered vacant under the occupancy endorsement. This argument is unavailing for several reasons, the most important being that coverage was

> properly controlled and denied under the occupancy endorsement, and, based on the evidence, the trial court properly found as a matter of fact that the property was unoccupied. Under the controlling disjunctive language of the occupancy endorsement, denial of coverage was proper where the property was unoccupied, regardless of whether or not it was vacant. . .

Id. at 532.

Here, it is undisputed that the Luis' building was unoccupied when the sprinkler pipe broke. No one lived in the building after December 3rd, 2010. The Luis provided no contrary evidence in cross-motions below, and they point to no evidence within the record to this Court now. The Luis do not meet their burden with unproven, unsubstantiated allegations about negotiations with potential future tenants. The building was unoccupied.

B. <u>As a matter of law, estoppel and waiver do not prevent operation of the "vacancy" provision.</u>

The trial court below implicitly recognized that this case turns on policy interpretation. This was the reason the trial court certified the partial summary judgment rulings for this Court's discretionary review. The Luis should have

no other argument to prevent full resolution of this case in Essex' favor.

Still, the Luis argue that Essex should be estopped from denying coverage because Essex made payments. Yet, that argument is contrary to law, for as a matter of law, the Luis cannot change the insurance policy language with an estoppel argument. Washington law categorically prohibits coverage by estoppel and waiver. See *Sullivan v. Great American Ins. Co.*[5]

> One may not, by invoking the doctrine of estoppel or waiver, bring into existence a contract not made by the parties and create a liability contrary to the express provisions of the contract the parties did make. **The general rule is that, while an insurer may be estopped, by its conduct or its knowledge or by statute, from insisting upon a forfeiture of a policy, yet, under no conditions, can the coverage or restrictions on the coverage be extended by the doctrine of waiver or estoppel.** *Carew, Shaw & Bernasconi v. General Cas. Co. of America,* 189 Wash. 329, 336, 65 P.2d 689, 692 (1937). In support of this rule, courts have reasoned that an insurance company should not be required by waiver or estoppel to pay for a loss for which it

[5] 23 Wn. App. 242 (1979).

> charged no premium. See Annot., Insurance Coverage Estoppel Waiver, 1 A.L.R.3d 1139, 1144 (1965).

Sullivan, at 247. See also, *Estate of Hall, v. HAPO,* 73 Wn. App. 359 (1994).

While the facts are not material because the aforementioned legal principle alone carries the day, the facts here are not in dispute. The Luis have not produced evidence that Essex misled them, although the Luis were required to produce such evidence at summary judgment below. The Luis have never proved that Essex made a promise on which Essex failed to deliver, although the Luis were required to prove that at summary judgment below. And, the Luis have yet to produce evidence that they detrimentally relied on anything Essex said or did, although they also had that burden at summary judgment below.

The undisputed facts are that Essex properly reserved its rights throughout the claim-handling process. Essex paid the Luis a windfall of nearly $300,000 and did nothing to lure the Luis into believing more would be forthcoming. As

such, the Luis have no basis to claim their own reasonable reliance or to claim Essex' waiver.

Furthermore, the Luis cannot claim harm. Essex gave the Luis a windfall. On this basis also, estoppel does not exist as a matter of law. See *Logan v. NorthWest Ins. Co.*[6] and *Dombrosky v. Farmers Ins. Co.*[7] "[Based on the evidence that] the Dombroskys were overpaid on this claim. . . there is no injury [from estoppel]"; *Id.* at 257.

The estoppel/waiver issue is ripe for this Court's resolution now.

C. <u>As a matter of law, Essex conduct was proper.</u>

The Luis' bad faith allegation is also ripe for this Court's resolution now. The Luis' complaint does not allege bad faith independent of Essex' coverage decision. For instance, the Luis do not allege an independent failure to investigate or discrete independent claim-handling violations. The Luis' only "bad faith" quarrel with Essex is over Essex' coverage decision, and Essex' "mistake" in

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[6] 45 Wn. App. 95 (1986).

[7] 84 Wn. App. 245 (1996).

paying the Luis $300,000 to which the Luis were not entitled. Reasonable minds should not differ about the fairness of Essex' conduct.

II. CONCLUSION

Essex asks this Court to utilize its de novo scope of review of the cross-motions for summary judgment below, and to reverse the trial court's decision. As a matter of law, Essex is entitled to a declaration that its "vacancy" provision exonerated it from coverage based on the undisputed facts. Such a declaration should resolve the case. As a matter of law, estoppel and waiver do not apply to effect a change of the policy language, and reasonable minds should not differ about the fact that Essex refrained from bad faith. This case is ready for resolution in full.

DATED this 7th day of July, 2014.

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By _____
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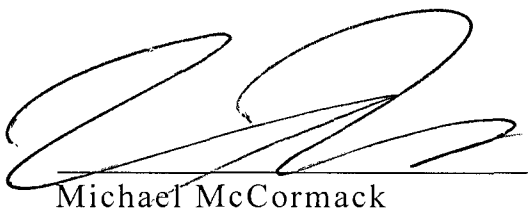
CERTIFICATE OF SERVICE

The undersigned certifies that on this 7th day of July, 2014, I caused the foregoing to be served to the following persons in the manner indicated below:

J. Dino Vasquez
Jacque E. St. Romain
Karr Tuttle Campbell
701 Fifth Avenue, Suite 3300
Seattle, WA 98104

☒ via hand delivery.
☐ via first class mail.
☐ via email.

I declare under penalty of perjury under the laws of the state of Washington this 7th day of July, 2014, at Seattle, Washington.



Michael McCormack

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