

No. 71951-3-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

ZHAOYUN XIA, et al.

Appellant,

vs.

PROBUILDERS SPECIALITY INSURANCE COMPANY RRG, et al.,

Respondent.

APPEAL FROM THE SUPERIOR COURT
FOR KING COUNTY
THE HONORABLE CAROL SCHAPIRA

BRIEF OF APPELLANT

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COURT OF APPEALS
STATE OF WASHINGTON

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I. INTRODUCTION

The developer of single family zero lot line fee simple homes gave its liability insurer prompt notice of a claim by a home purchaser who suffered severe carbon monoxide poisoning when the new home's gas hot water heater was not connected to an exterior vent. With little investigation, the insurer summarily and definitively rejected coverage and refused to defend, relying on the policy's exclusion for completed work at a "condominium or townhouse" (terms that were not defined by the policy), and on the policy's "pollution" exclusion. The purchaser's lawyer sent the insurer the complaint filed against the insured developer, and then, two years later, at the direction of the developer's own retained counsel, notified the insurer that unless it provided a defense to its insured within 30 days, the developer would finalize a settlement agreeing to a stipulated covenant judgment and assigning its claims against the insurer to the purchaser. Rather than defending under a reservation of rights, the insurer on both occasions reiterated its position that the condominium/townhouse and pollution exclusions categorically excluded the claims from coverage.

Thereafter, the purchaser and developer finalized their settlement; the reasonableness of the \$2 million consent judgment

was confirmed at a hearing in which the insurer declined to participate. In defending the assigned bad faith claim, the insurer for the first time claimed it had no duty to defend because the developer had never formally tendered the claim. The trial court dismissed the bad faith claim on summary judgment, citing the “selective tender” rule and the condominium/townhouse exclusion.

The trial court erred because an insurer that receives notice of a claim and lawsuit must prove prejudice before it can rely on its insured’s alleged failure to formally tender. Washington courts have never applied the “selective tender” rule to an insurer that has previously rejected coverage of a tendered claim. The condominium/townhouse exclusion did not apply because the purchaser’s single family residence, owned in fee, did not share a common wall with the neighboring residence and had no elements of common ownership. The pollution exclusion was also inapplicable because the injury was caused not by a pollutant, but by the negligent installation of a hot water heater.

Because the insurer denied a defense outright when coverage was plausible, it is estopped to deny coverage and is liable for its insured’s reasonable settlement. This Court should reverse and direct entry of judgment against the insurer respondent ProBuilders

Specialty Insurance Co., RRG, and in favor of appellant Zhaoyun “Julia” Xia, assignee of the insured Issaquah Highlands 48, LLC.

II. ASSIGNMENT OF ERROR

The trial court erred in entering its Order Granting Defendant ProBuilders Specialty Insurance Company RRG’s Motion for Summary Judgment and in denying Plaintiff’s Motion for Summary Judgment. (CP 1297-1300) (Appendix A)

III. ISSUES RELATED TO ASSIGNMENT OF ERROR

A. A liability insurer unequivocally rejected coverage and a defense after its insured sought its assistance by providing notice of a claim, again denied coverage and refused to defend when the insurer received a copy of the summons and complaint against its insured, and refused a third opportunity to defend before its insured settled with the injured claimant. Did the trial court err in holding the insurer did not breach its duty to defend on the ground that the insured did not formally request a defense?

B. Does a liability policy’s exclusion for bodily injury arising from work on a “condominium or townhouse” (terms that are undefined in the policy) allow an insurer to refuse to defend a developer sued for negligent installation of a hot water heater in a

single family residence, owned in fee, unattached to the adjoining residence by common or shared walls, and having no other elements of common ownership?

C. Does a liability policy's exclusion for bodily injury caused by the "discharge . . . , release or escape of pollutants" excuse the insurer's failure to defend a developer sued for negligent installation of a hot water heater resulting in plaintiff's carbon monoxide poisoning?

D. Did the insurer breach its good faith duty to defend by denying coverage on the basis of exclusions that do not clearly bar coverage with only a perfunctory factual investigation and without any attempt to determine whether Washington law supported its interpretation of the policy?

IV. STATEMENT OF THE CASE

A. ProBuilders insured Issaquah Highlands for its construction of zero lot line single family fee simple homes.

In June 2004, Issaquah Highlands 48, LLC obtained a building permit for construction of a single family residence at 2558 NE Magnolia St. in Issaquah. (CP 339) Two years later, in May 2006, appellant Zhaoyun "Julia" Xia purchased this residence, part of Issaquah Highland's development of 50 single family zero lot line

fee homes. (CP 278, 660) In its building permit and related documents, the City described the residence as single family attached (“SFA”) (CP 339) or “single-family, zero lot line” (CP 983), as well as “Single family attached (fee simple).” (CP 341) Issaquah Highlands described the Villagio development as “fee simple attached affordable townhouse units.” (CP 343)

Issaquah Highlands had previously developed attached residences as condominiums, but after it was sued on five developments by homeowners’ associations alleging construction defects, its president Wes Giesbrecht chose to build only zero lot line single family fee homes, rather than condominiums. (CP 896-97) Zero lot line fee homes do not have the elements of common ownership that define a “condominium” under Washington’s Condominium Act, RCW ch. 64.34. (CP 176-77) The homeowner owns the underlying land, the structure and the sky above it in fee simple. (CP 177)

Zero lot line fee homes also have significant physical differences from condominiums or townhomes, as a zero lot line home does not share a common wall with an adjoining residence. (CP 176-77) Instead, zero lot line fee homes have adjacent side walls separated by a narrow air gap through which the lot line runs.

(CP 176-77) While such homes can appear to be a single building, they are attached only with continuous siding and roofing, and are structurally and fully self contained, with a one-inch space between the walls. (CP 323 (“you could tear one down without affecting the other”); 330-31, 864).

Issaquah Highlands’ president Giesbrecht also was very familiar with the tight insurance market for condominium builders when he sought liability insurance for the project in 2004. (CP 896-97) Mr. Giesbrecht consulted with insurance agent Treacy Duerfeldt, a wholesale surplus line agent, regarding his company’s insurance needs for the Villagio project. (CP 328, 897) Mr. Duerfeldt assisted Issaquah Highlands in filling out an insurance application in which Issaquah Highlands disclosed the five previous lawsuits brought by condominium homeowners’ associations. (CP 369)

Joseph Sacotte, a principal of the developer, then sought coverage and quotes on behalf of Issaquah Highlands from multiple carriers and agents. (CP 328) Respondent ProBuilders Specialty Insurance Company RRG is a liability insurer for the construction industry. ProBuilders and its president Peter Foley were aware of the differences between fee simple zero lot line residences and

townhome or condominium residences with shared ownership, which ProBuilders would only insure on a project by project basis. (CP 860)

Mr. Sacotte talked directly to Mr. Duerfelt, to Dave Lambin, a partner in ProBuilders, and to a representative in ProBuilders' underwriting department. (CP 328) Mr. Sacotte ultimately agreed to coverage with ProBuilders. (CP 328) Mr. Duerfeldt advised Mr. Giesbrecht that the zero lot line homes were correctly classified as single family homes and that ProBuilders would provide liability coverage for the project. (CP 330, 897)

Effective July 7, 2005, ProBuilders issued a Commercial General Liability policy with coverage of \$1 million per occurrence and an aggregate limit of \$2 million. (CP 347) Issaquah Highlands paid ProBuilders a significant annual premium that increased from \$35,806 in 2005 to \$70,565 in 2006 and that was adjustable upwards based on Issaquah Highlands' gross receipts. (CP 347, 569) ProBuilders or its risk management contractor NBIS inspected the Issaquah Highlands building site shortly after issuing its 2005 policy and annually thereafter. (CP 326, 860)

B. Julia Xia was severely disabled by carbon monoxide poisoning from an improperly vented hot water heater in her Issaquah Highlands home.

Julia Xia, then age 34, purchased a newly completed Issaquah Highlands home at Villagio in May 2006. (CP 393-94, 660) Ms. Xia, an American citizen with an MBA and a Masters in Electrical Engineering, worked as a software engineer making more than \$100,000 a year. (CP 661) By September 2006, however, Ms. Xia began suffering headaches, chronic fatigue and chest pain. (CP 660-61) As her symptoms worsened, she complained of cognitive and verbal impairment, depression, insomnia and heart palpitations. (CP 660-61)

Ms. Xia was eventually diagnosed with carbon monoxide poisoning. (CP 661) In December 2006, Puget Sound Energy discovered the problem: the gas hot water heater placed inside her Issaquah Highlands home was not connected to the external exhaust vent when it was installed by subcontractor Extreme Heating, working under Issaquah Highland's direct supervision and control. (CP 191, 195 (photos), 661) The carbon monoxide level in Ms. Xia's home exceeded the maximum exposure set by OSHA and was sufficient to cause severe health problems. (CP 198-201)

Carbon monoxide poisoning destroyed Ms. Xia's professional and personal life. She could not perform as a high functioning professional because her verbal and processing impairment rendered her unable to multitask or comprehend instructions unless they were broken down and repeated. (CP 683-84, 990) She could no longer enjoy recreational pursuits such as swimming and yoga. (CP 661) Ms. Xia's physician deemed her injuries irreversible, and in 2009, the Social Security Administration adjudicated Ms. Xia disabled from a cognitive disorder due to carbon monoxide poisoning. (CP 990, 683-85) Ms. Xia was forced to abandon her life and work in the United States and return to her native China to live with her parents. (CP 662)

C. Issaquah Highlands tendered Ms. Xia's damage claim to ProBuilders, which summarily denied the claim and refused to defend.

On June 26, 2007, Ms. Xia gave written notice to Issaquah Highlands of her personal injury claim, attaching her medical records, and asking Issaquah Highlands to forward "the documents to your liability insurance company." (CP 487) Issaquah Highlands' president Giesbrecht sent the claim to agent Duerfeldt, who on behalf of Issaquah Highlands forwarded the claim to ProBuilders' agent, providing the name of the insured, the

ProBuilders policy number, and referencing Ms. Xia's "Zero Lot Line Home." (CP 485-86, 898) NBIS Claims & Risk Management, ProBuilders' claims administrator, acknowledged receipt of the claim on July 23, 2007. (CP 483-84)

ProBuilders/NBIS made little attempt to investigate Ms. Xia's claim and performed almost no investigation before denying coverage. On September 11, 2007, the adjuster's activity log notes "no contact has been made with insd. or clmt." (CP 256) In the weeks that followed, NBIS sought Ms. Xia's medical records and a list of subcontractors from Issaquah Highlands, but did not undertake any factual investigation of Ms. Xia's carbon monoxide poisoning, how it occurred, or the nature of the zero lot line fee residences built by its insured. (CP 256, 898)

Instead, ProBuilders/NBIS focused its efforts on denying coverage under its policy exclusions. (CP 257-58) On November 28, 2007, the NBIS supervisor overruled its adjuster's recommendation that ProBuilders send a reservation of rights letter and directed the adjuster to send a "tender letter . . . to [Subcontractor Extreme Heating] . . . on behalf of insd. as a courtesy." (CP 257-58) On January 17, 2008, NBIS notified Issaquah Highlands that ProBuilders "will neither defend nor

indemnify Issaquah . . . [from] any judgment or settlement.” (CP 285)

In denying coverage and a defense, NBIS/ProBuilders relied on the policy’s “Pollution Exclusion”¹ and “Condominium or Townhouse Liability Exclusion.”² NBIS/ProBuilders had not determined whether Ms. Xia’s home was constructed with common walls, had done no legal research concerning interpretation of a pollution exclusion under Washington law (CP 213, 899), and the

¹ **Bodily injury, property damage, or personal injury** caused by, resulting from, attributable to, contributed to, or aggravated by the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of **pollutants**, or from the presence of, or exposure to, **pollution** of any form whatsoever, and regardless of the cause of the **pollution** or **pollutants**.

This Exclusion applies regardless of the cause of the **pollution** and whether any other cause of said **bodily injury property damage, or personal injury** acted jointly, concurrently or in any sequence with said **pollutants** or **pollution**. This Exclusion applies whether any other cause of the **bodily injury, property damage, or personal injury** would otherwise, be covered under this insurance.

(CP 334) (emphasis in original)

² (1) **Property damage or bodily injury** within the **products-completed operations hazard** arising from, related to or in any way connected with **your work or your product** which is, is part of or is incorporated into or upon a condominium, or townhouse project, or to **personal injury or advertising injury** arising or resulting from **your** operations performed upon, at or for a condominium or townhouse project.

(CP 337) (emphasis in original)

January 2008 letter denying coverage provided no analysis why either of these exclusions applied to Ms. Xia's claim. (CP 281-82) Nor did NBIS' June 2008 notification to ProBuilders' insured and to Ms. Xia, now represented by counsel. (CP 414-19, 898) The letter flatly stated that ProBuilders "will neither defend nor indemnify Issaquah," and directed Ms. Xia's counsel to contact NBIS "if a lawsuit is filed." (CP 414-19)

Her claim having been summarily denied, Ms. Xia filed suit against Issaquah Highlands. As NBIS had requested, Ms. Xia's lawyer sent NBIS a copy of her complaint against Issaquah Highlands on January 27, 2009, informing the insurer that the summons and complaint had been sent out for service and filing in King County Superior Court that day. (CP 112) In February 2009, NBIS reopened its file, noting that ProBuilders' insured Issaquah Highlands was "to be served shortly." (CP 265) NBIS and ProBuilders made no effort to contact its insured.

When Mr. Giesbrecht was served, he immediately gave the summons and complaint to Mr. Duerfeldt to forward to ProBuilders, as he had done with Ms. Xia's initial claim. (CP 898, 901) In light of ProBuilders' unqualified rejection of a defense and coverage, Mr. Giesbrecht also retained attorney Michael Scruggs to

represent Issaquah Highlands in defending Ms. Xia's claim. (CP 898) Mr. Scruggs, cognizant of ProBuilders' position, tendered the complaint to subcontractor Extreme Heating and to its insurer American States. (CP 136, 258, 898) American States also refused to defend Issaquah Highlands. (CP 898)

NBIS/ProBuilders did nothing on the reopened claim for seven months until a new adjuster, noting the lack of activity on the file, asked for authority to run a Westlaw search to "confirm" that Ms. Xia's residence was a "Townhome or Condominium." (CP 266-67) On September 24, 2009, the adjuster spoke with Ms. Xia's counsel, Nik Armitage, and reiterated ProBuilders' denial of coverage for Ms. Xia's claim. (CP 267) The next day, NBIS's search reported that Ms. Xia's residence was listed as a "single family residence – townhouse" in King County Assessor records. (CP 54, 268) On October 19, 2009, an NBIS supervisor logged that Ms. Xia's complaint was excluded because the "matter involves a condo project and our insured is being defended." (CP 269) NBIS closed its claim file for the second time, and ProBuilders gave its insured Issaquah Highlands no reason to believe that it would change its coverage position or provide a defense.

D. Issaquah Highlands agreed to a covenant settlement after giving its insurer one last opportunity to defend. ProBuilders again refused to defend or cover the claim based solely on the condominium/townhouse and pollution exclusions.

Attorney Scruggs appeared and answered Ms. Xia's complaint on behalf of Issaquah Highlands. (CP 899, 905) Ms. Xia's lawyer Armitage approached Mr. Scruggs about a settlement that would involve a covenant not to execute a stipulated judgment and an assignment of Issaquah Highlands' rights against ProBuilders. (CP 905) Issaquah Highlands was amenable to a settlement but, wishing to avoid the adverse consequences of a covenant judgment and the appearance of collusion, insisted on giving ProBuilders one last opportunity to defend and cover the claim. (CP 900, 905-06) On September 21, 2010, Mr. Scruggs sent Mr. Armitage a draft of a letter to ProBuilders demanding that the insurer change its position. (CP 905, 909-10)

Mr. Armitage wrote ProBuilders on December 23, 2010, enclosing a draft settlement agreement in which Issaquah Highlands would consent to a \$2 million stipulated judgment and assign all its claims against ProBuilders to Ms. Xia in exchange for a covenant not to execute. (CP 297-99, 905, 912-14, 941-51) Mr. Armitage gave ProBuilders 30 days to acknowledge coverage and

defend its insured before the parties would finalize the settlement by seeking a judicial determination of the reasonableness of a \$2 million stipulated judgment. (CP 914) On January 12, 2011, an NBIS adjuster called Mr. Armitage and reiterated ProBuilders' unequivocal denial of coverage based on the condominium/townhouse and pollution exclusions. (CP 301, 906) The adjuster did not contend that Issaquah Highlands had failed to tender the lawsuit. (CP 900)

Issaquah Highlands and Ms. Xia gave notice of their reasonableness hearing to NBIS/ProBuilders. (CP 304) ProBuilders did not appear and did not oppose the settlement. (CP 900) Judge Susan Craighead approved the reasonableness of the \$2 million settlement on February 7, 2011. (CP 303-09)

Before filing this action Ms. Xia gave ProBuilders a final chance to indemnify Issaquah Highlands for her damages. In May 2011, Ms. Xia, as assignee of Issaquah Highlands, served notice of intent to sue under the Insurance Fair Conduct Act, giving ProBuilders 20 days to "adjust this claim or face suit for damages." (CP 1414-18) In response, ProBuilders repeated that it had previously made a final determination of no coverage (CP 313), maintaining that "all damages appear to be subject to the pollution

exclusion and certainly the condominium/townhouse exclusion, thus leaving no potential for coverage.” (CP 318) ProBuilders again did not contend that Issaquah Highlands had failed to tender the lawsuit.

E. The trial court dismissed Ms. Xia’s bad faith lawsuit based on failure to tender and the condominium/townhouse exclusion.

Ms. Xia, as assignee of Issaquah Highlands, sued ProBuilders for bad faith, negligence, breach of contract, and violation of the CPA and IFCA in King County Superior Court on June 8, 2011. (CP 1-20) The parties filed cross-motions for summary judgment, argued before Judge Carol Schapira (“the trial court”) on November 2, 2012 and December 20, 2013. (CP 1297) ProBuilders sought dismissal on three grounds, arguing that the condominium/ townhouse and pollution exclusions each precluded coverage as a matter of law and that “Issaquah Highlands never disputed [ProBuilders'] declination of coverage nor did they make a tender of defense” (CP 24)

On April 16, 2014, the trial court dismissed the lawsuit with prejudice on the ground that “the townhouse exclusion properly applied and excluded all coverage” so that ProBuilders’ initial denial of coverage and defense in January 2008 was correct, and

that “there was no request for a defense of the suit from or on behalf of the insureds to Defendant ProBuilders.” (CP 1299)

Ms. Xia appeals both the order granting ProBuilders summary judgment and the denial of her own motion for summary judgment. (CP 1301-06)

V. ARGUMENT

A. This Court reviews de novo the trial court’s decision, narrowly construing exclusions and imposing a duty to defend any claims that conceivably fall within the scope of ProBuilders’ policy.

This Court reviews de novo the trial court’s summary judgment that ProBuilders had no duty to defend as a matter of law. *Smith v. Safeco Ins. Co.*, 150 Wn.2d 478, 483, 78 P.3d 1274 (2003). This Court interprets de novo insurance policy provisions. *American Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 404, ¶ 5, 229 P.3d 693 (2010).

The duty to defend is broad, and the insurer’s ability to rely on exclusions or conditions precedent to coverage is narrow. The right to a defense is one of the “principal benefits” of liability insurance, and is often “of greater benefit” than the right to indemnity. *Alea*, 168 Wn.2d at 405, ¶ 6; *Woo v. Firemen’s Fund Ins. Co.*, 161 Wn.2d 43, 54, ¶ 16, 164 P.3d 454 (2007). The duty to

defend is especially crucial to small businesses that rely on their liability insurer for protection from claims that may “expose[] its insured to business failure and bankruptcy.” *Truck Ins. Exch. v. Vanport Homes, Inc.*, 147 Wn.2d 751, 765, 58 P.3d 276 (2002). The duty to defend “arises when a complaint against the insured, construed liberally alleges facts which could, if proven, impose liability upon the insured within the policy’s coverage.” *Alea*, 168 Wn.2d at 404, ¶ 6.

The duty to defend must be determined from the “four corners of the complaint and the four corners of the insurance policy.” *Expedia, Inc. v. Steadfast Ins. Co.*, 180 Wn.2d 793, 806, ¶ 24, 329 P.3d 59 (2014). An insurer may not deny a defense on the basis of ambiguous policy language or in the face of unclear precedent; if there is “any reasonable interpretation of the facts or the law that could result in coverage, the insurer must defend.” *Alea*, 168 Wn.2d at 405, ¶ 7. In denying coverage and a defense ProBuilders relied upon its policy’s condominium/townhouse and pollution exclusions, which are construed “strictly against the insurer” because they are “contrary to the fundamental protective purpose of insurance.” *Vision One, LLC v. Philadelphia Indemn. Ins. Co.*, 174 Wn.2d 501, 512, ¶ 20, 276 P.3d 300 (2012) (internal

quotation omitted); *Lynott v. National Union Fire Ins. Co. of Pittsburgh, Pa*, 123 Wn.2d 678, 690, 871 P.2d 146 (1994).

An insurer with any question regarding coverage may protect itself by defending under a reservation of rights while seeking a judicial determination that it has no duty to defend. An insurer that breaches its good faith duty to defend is estopped to deny coverage. *National Sur. Corp. v. Immunex Corp.*, 176 Wn.2d 872, 879-80, ¶ 12, 297 P.3d 688 (2013); *Alea*, 168 Wn.2d at 405, ¶ 7; *Truck Ins.*, 147 Wn.2d at 759.

B. The trial court erred in holding that ProBuilders had no duty to defend on the ground that Issaquah Highlands did not make a formal tender.

Issaquah Highlands tendered Ms. Xia's claim to ProBuilders. (CP 483-86) ProBuilders then received notice of the lawsuit against its insured, and notice that Issaquah Highlands would be forced to consent to a judgment if it did not receive a defense. (CP 914) At each stage ProBuilders denied coverage and a defense based on policy exclusions. An insurer that receives notice of the claim and notice of the lawsuit may not rely on its insured's failure to formally request a defense as a basis for denying a defense or coverage.

An insurer may rely on its insured's failure to provide notice of a claim only where it can establish actual and substantial

prejudice – prejudice notably absent here because ProBuilders had already categorically rejected coverage on a different basis. Washington courts have never applied the “selective tender” rule, relied upon below, to allow an insurer that had already denied coverage and any defense to evade its duty to defend.

- 1. An insurer may not rely on formal tender as a condition precedent to its obligations unless it establishes that the failure to provide notice prejudices its ability to defend.**

ProBuilders’ policy, like most other liability insurance policies, did not require a formal tender but required the insured to “notify” ProBuilders of a claim or lawsuit. (CP 384) The purpose of this notice provision is to give the insurer a reasonable opportunity to investigate, to prepare a defense, and to control the litigation. *Kidwell v. Chuck Olson Oldsmobile, Inc.*, 4 Wn. App. 471, 474, 481 P.2d 908, *rev. denied*, 79 Wn.2d 1005 (1971). Thus, “[t]he question as to who gives the notice to the insurer is obviously of minor importance as long as notice is actually given of the occurrence of the accident or the pendency of the suit.” *Kidwell*, 4 Wn. App. at 474 (quotation omitted). “An insurer should not be held liable without reasonable opportunity to investigate and to properly defend; but when given such opportunity the insurer should not be

allowed to escape liability because the notice which furnished the opportunity came from someone other than the insured.” *Lee v. Travelers Ins. Co.*, 184 A.2d 636, 639 (D.C. 1962).

In the absence of prejudice, our Supreme Court has refused to allow insurers to rely on strict interpretations of conditions precedent to coverage to gain “a questionable windfall at the expense of the public.” *Staples v. Allstate Ins. Co.*, 176 Wn.2d 404, 417, ¶ 39, 295 P.3d 201 (2013); *Oregon Auto. Ins. Co. v. Salzberg*, 85 Wn.2d 372, 375–76, 535 P.2d 816 (1975). “As in other contexts involving breach of policy provisions by the insured, the insurer must show that late notice actually and substantially prejudiced its interests before performance of its duties will be excused.” *National Sur. v. Immunex*, 176 Wn.2d at 890, ¶ 38.

2. ProBuilders, which repeatedly denied coverage on other grounds and suffered no prejudice, cannot evade its duty to defend by a post-hoc assertion that its insured failed to formally tender.

ProBuilders received notice of the claim and notice of the suit. This notice was sufficient to trigger ProBuilders’ duty to defend Issaquah Highlands:

In order to trigger an insurer's duty to defend, the insured need only put the insurer on notice of the claim, thereby at least implicitly tendering the defense. A formal demand is not necessary.

Windt, *Insurance Claims & Disputes*, § 4.1 at 4-5 - 4-7 (6th ed. 2013)

Issaquah Highlands tendered Ms. Xia's claim to ProBuilders as soon as it received the claim, in 2007 (CP 483-86, 898) ProBuilders' contention that it never understood that its insured sought a defense is based on its own failure to investigate and communicate with its insured after receiving notice that Issaquah Highlands had been sued, and, in any event, is refuted by the "last chance" letter putting ProBuilders on notice that Issaquah Highlands would consent to judgment unless it received a defense within 30 days. (CP 301, 912-14) Given ProBuilders' repeated denial of coverage, its post-hoc reliance on Issaquah Highlands' claimed failure to formally request a defense gives the insurer a windfall at the expense of both its insured and the public interest. *Staples*, 176 Wn.2d at 417, ¶ 39.

ProBuilders cannot dispute that Issaquah Highlands "implicitly request[ed] coverage by reason of the lawsuit," but even if that argument could be supported on this record, where "the

insurer previously denied coverage . . . it would no longer be necessary for the insured to request a defense.” Windt, *supra*, § 4.1 at 4-7 - 4-9. ProBuilders unconditionally denied any defense for Ms. Xia’s claim in January 2008, closed its file, and thereafter made no attempt to defend or resolve the claim despite notice that its insured had been sued by Ms. Xia in January 2009. (CP 264, 278-86) ProBuilders then reopened its file only to close it again, citing policy exclusions that it claimed unequivocally defeated coverage. (CP 265-69) ProBuilders again unconditionally refused to defend Issaquah Highlands when notified in December 2010 that its insured would consent to a judgment and assign its rights to Ms. Xia unless ProBuilders agreed to “provide coverage *and defend*.” (CP 301, 906, 914) (emphasis added)

In repeatedly denying any obligation to indemnify or defend, ProBuilders never cited Issaquah Highlands’ failure to formally tender the complaint, and never expressed confusion regarding whether its insured wanted ProBuilders’ help in defending or settling the suit – confusion that could have been easily resolved had its adjusters investigated and communicated. All ProBuilders had to do was pick up the phone and talk to Issaquah Highlands or its retained counsel Scruggs. (CP 899-900, 967)

Principles of good faith and equitable estoppel preclude an insurer from providing a post-hoc rationalization for its refusal to defend. See WAC 284-30-380 (“insurer must not deny a claim on the grounds of a specific policy provision, condition, or exclusion unless reference . . . is included in the denial”); WAC 284-30-330(13) (insure must promptly provide “a reasonable explanation” for its denial of a claim). Issaquah Highlands is undoubtedly prejudiced by ProBuilders’ refusal to promptly inform its insured that it would not defend in the absence of its insured’s formal tender. (CP 900) See *Hayden v. Mutual of Enumclaw Ins. Co.*, 141 Wn.2d 55, 63, 1 P.3d 1167 (2000) (insurer may be estopped from denying coverage if insured suffers prejudice from insurer’s failure to explain all reasons in its initial denial letter.)

By contrast, ProBuilders suffered no prejudice whatsoever by its insured’s failure to formally tender the lawsuit after it unconditionally rejected Issaquah Highlands’ tender of Ms Xia’s claim one year earlier. “The fundamental defect in [ProBuilders’] position here is that it has at no time suggested that, in the event that a timely tender of the defense . . . had been made, it would have undertaken the defense.” *Clemmer v. Hartford Insurance Co.*,

22 Cal. 3d 865, 883, 151 Cal. Rptr. 285, 587 P.2d 1098 (1978) (insurer that has denied coverage on another basis cannot not prove that it was prejudiced by insured’s failure to tender). As a matter of law, ProBuilders suffered no prejudice from Issaquah Highlands’ failure to formally provide notice of suit.

3. The “selective tender” rule is inapplicable.

That Issaquah Highlands’ counsel made a formal tender to American States – its subcontractor Extreme Heating’s insurer – *after* ProBuilders had unconditionally denied coverage and refused to defend does not establish a “selective tender” that would absolve the insurer of its duty to defend. The selective tender rule recognizes that the insured has the right to make an informed decision in choosing whether it wants one or another insurer to provide a defense. *See Mutual of Enumclaw Ins. Co. v. USF Ins. Co.*, 164 Wn.2d 411, 421-22, ¶¶ 16-17, 191 P.3d 866 (2008). It has no application here.

In *Mutual of Enumclaw*, the insured condominium developer tendered a condo board’s claim for construction defects to multiple insurers, including MOE, but on advice of counsel deliberately decided not to tender the claim to USF. 164 Wn.2d at 416, ¶ 5. Recognizing an insured’s right to make a knowing and

intelligent selective tender to a specific insurer, the Court rejected MOE's attempt to claim equitable contribution from USF after MOE funded a settlement of the underlying litigation:

An insured may choose not to tender a claim to its insurer for a variety of reasons. Like a driver involved in a minor accident, an insured may choose not to tender in order to avoid a premium increase. The insured may also want to preserve its policy limits for other claims, or simply to safeguard its relationship with its insurer. Whatever its reasons, an insured has the prerogative not to tender to a particular insurer.

164 Wn.2d at 421-22, ¶ 17. "It was the insured's intentional choice not to tender to a particular insurer that gave meaning to the *Mutual of Enumclaw* court's discussion of 'selective tender.'" *Axis Surplus Ins. Co. v. James River Ins. Co.*, 635 F. Supp. 2d 1214, 1220 n.3 (W.D. Wash. 2009).

Where, as here, the insurer had already rejected the tendered claim and there is no evidence that the insured deliberately chose not to make a formal tender of the subsequent suit, the underpinnings of the "selective tender" rule vanish. *See Axis Surplus*, 635 F. Supp. 2d at 1220 n.3. That an insured may have hypothetical reasons not to tender a suit does not give an insurer a free pass to do nothing once it is apprised of a lawsuit against its insured. The good faith duty to defend attaches "at the point a

complaint was filed,” and not upon tender, *National Sur. Corp. v. Immunex Corp.*, 162 Wn. App. 762, 775, ¶ 25, 256 P.3d 439 (2011), *aff’d*, 176 Wn.2d 872, 297 P.3d 688 (2013) and imposes upon insurers the “duty to act promptly, in both communication and investigation, in response to a claim or tender.” *St. Paul Fire and Marine Ins. Co. v. Onvia, Inc.*, 165 Wn.2d 122, 132, ¶ 22, 196 P.3d 664 (2008). Thus, an insurer that knows a complaint has been filed has, at a minimum, a duty to determine whether its insured wishes it to provide a defense – the primary benefit of its liability policy.

No Washington court has applied the selective tender rule to absolve an insurer of its duty to defend or indemnify where the insurer had already told its insured that it would not provide coverage or a defense. Instead, courts in Washington continue to require an insurer to show that it suffered “actual and substantial prejudice” from its insured’s untimely notice even where there is no

contractual basis for a duty to defend under the policy. *National Sur.*, 176 Wn.2d at 875, ¶ 1.³

Thus, in *Mutual of Enumclaw*, while the Court held on equitable grounds that the insured's informed decision not to tender to USF precluded MOE from an equitable recovery against USF on a claim for equitable contribution, it nonetheless allowed MOE to pursue the same claim on the basis of subrogation; MOE could assert its insured's right to a defense because MOE stood in the shoes of its insured. Even though USF did not receive any notice of the claim until four years after its insured was sued and two years after the settlement of the litigation, the Court refused to find that the insured had forfeited its right to a defense. USF was not prejudiced in the absence of any evidence that the delay "specifically deprived it of the ability to put forth defenses to

³ Accord, *Terhune Homes, Inc. v. Nationwide Mut. Ins. Co.*, ___ F. Supp. 2d ___, 2014 WL 1998528 (W.D. Wash. 2014) (insurer breached duty to defend although it was not notified of lawsuit for two years after court entered judgment); *S & K Motors, Inc. v. Harco Nat. Ins. Co.*, 151 Wn. App. 633, 213 P.3d 630 (2009). In *Unigard Ins. Co. v. Leven*, 97 Wn. App. 417, 431, 983 P.2d 1155 (1999), *rev. denied*, 140 Wn.2d 1009 (2000), this Court relieved an insurer of its duty to defend the individual owner of a company who failed to tender after he was sued for the expense of removing hazardous waste, holding that the insurer's inability to "argue that [the individual] should not personally have incurred MTCA liability . . . resulted in prejudice" to the insurer.

coverage or to contest the value of the damages” 164 Wn.2d at 431, ¶ 37.

This Court should reverse the trial court’s summary judgment because the selective tender rule is inapplicable. In the absence of prejudice to ProBuilders, Issaquah Highlands’ failure to make a formal tender of a suit brought after its insurer categorically denied a defense cannot absolve ProBuilders of its duty to defend.

C. Ms. Xia’s “zero lot line” home, owned in fee and with no elements of common ownership, does not fall within the policy’s “condominium/townhouse” exclusion.

The trial court also erred in concluding that Ms. Xia’s zero lot line home was a “condominium” or “townhouse” within the meaning of the policy exclusion. Those terms, which were not defined in the liability policy, are commonly understood to require structural and legal elements of common ownership that are lacking here. To the extent the undefined “townhouse” term is ambiguous, the exclusion must be narrowly construed in favor of coverage.

The condominium/townhouse exclusion excluded coverage for **“bodily injury within the products-completed operations hazard** arising from, related to or in any way connected with **your work** or **your product** which is, is part of or is incorporated into

or upon a condominium, or townhouse project” (CP 337) The policy did not define the unbolded terms “condominium or townhouse project.” This Court should apply any of several principles of interpretation to reverse the trial court’s expansive definition of these undefined terms in the policy exclusion.

First, undefined terms must be given their “plain, ordinary, and popular meaning,” referencing standard English language dictionaries. *Kitsap County v. Allstate Ins. Co.*, 136 Wn.2d 567, 576, 964 P.2d 1173 (1998) (quotation omitted). Second, because the terms are part of an exclusion to coverage, they will not be interpreted “beyond their clear and unequivocal meaning.” *American Star Ins. Co. v. Grice*, 121 Wn.2d 869, 875, 854 P.2d 622 (1993) (internal quotation omitted). Third, the meaning of words in a contract may be controlled by those terms with which the word is associated, and may be informed by surrounding provisions. *Ball v. Stokely Foods*, 37 Wn.2d 79, 87-88, 221 P.2d 832 (1950) (applying doctrine of *noscitur a sociis* to interpret contract terms). Fourth, to the extent that the undefined terms are ambiguous or susceptible to two meanings, they must be construed against the insurer, particularly where contained in a policy exclusion. *American Star Ins. Co. v. Grice*, 121 Wn.2d at 875.

Each of these principles separately defeats the application of the condominium/townhouse exclusion to Ms. Xia's claim. ProBuilders does not argue that Ms. Xia's residence was a "condominium." (CP 37) A condominium has a clear statutory definition as real property in which portions are owned individually and the other portions are designated for joint ownership with the other individual owners and controlled by an association of those owners. *See, e.g.*, RCW 64.34.020(10). The residence is clearly not part of a condominium.

Nor is Ms. Xia's residence a "townhouse." (CP 37) Unlike "condominium," the term "townhouse" or "townhome" has no specific legal definition. In ordinary and popular usage, a "townhome" or "townhouse" is "a house that has two or three levels and that is attached to a similar house by a shared wall." Merriam-Webster Online Dictionary.⁴ *See also* Black's Law Dictionary (9th ed. 2009) (defining "townhouse" as "[a] dwelling unit having

⁴ <http://www.merriam-webster.com/dictionary/townhouse>. *See also* American Heritage Dictionary (2nd College Ed. 1982) ("One of a row of houses connected by common side walls").

usu[ally] two or three stories and often connected to a similar structure by a common wall”). The purchasers of these policies in building and real estate industry, often use the term to describe a two level condominium, distinguishing it from a “flat.” (CP 176 – 177)

Land use codes similarly identify the “common wall” that attaches separate units as a distinguishing characteristic of a townhouse. The King County Zoning Code defines a “townhouse” as “a building containing one dwelling unit that occupies space from the ground to the roof, and is attached to one or more other townhouse dwellings by common walls.” KCC 21A.06.370. The Issaquah Municipal Code likewise defines a “dwelling, single family attached (townhouse)” as “[t]wo (2) or more single household dwellings that are attached to one another by common vertical wall(s). . . .” IMC 18.02.060. Ms. Xia’s residence did not have the common wall that is essential to a “townhouse.”

Ms. Xia’s zero lot line fee simple residence is also not a “townhouse” under established contract interpretation rules. The placement of the term “townhouse” next to “condominium” in the policy indicates an intent to apply the exclusion to those residential arrangements having the common ownership attributes of a

condominium, rather than fee ownership. *See Ball*, 37 Wn.2d at 87-88. The extension of the condominium/townhouse exclusion to work performed when the “apartment project or structure . . . has been or is being converted into a condominium or townhouse” (CP 178, 337), further indicates that the term is intended to be defined by the core component of common ownership essential to such conversions. The exclusion, interpreted as a whole, does not encompass single family residences owned in fee.

Ms. Xia’s single family zero lot line fee home does not share a common side wall with the neighboring unit. (CP 176-77) No separate association owns any of the structure or the ground underneath her residence, of which Ms. Xia has complete fee simple ownership. (CP 177) The trial court’s interpretation of the undefined term “townhouse” not only contravened its ordinary meaning, but took an expansive rather than a narrow view of an exclusion to coverage that employed an undefined term. And it interpreted the term “townhouse” in isolation, rather than in conjunction with the surrounding language of the exclusion, all because the term was used repeatedly in describing Issaquah Highlands’ development. (11/2/12 RP 131) The trial court

improperly expanded the narrow exclusion to encompass any structure marketed or referred to as a townhouse.

To the extent the undefined term is ambiguous, the trial court further erred by adopting an interpretation of the exclusion that favored the insurer, rather than the insured. *See Kitsap Cnty.*, 136 Wn.2d at 576 (“If a policy remains ambiguous even after resort to extrinsic evidence, then the ambiguity is construed against the insurer.”). Expert testimony established there was no hard and fast definition of the term “townhouse.” (CP 176) As the term “townhouse” had one or more meanings to average policyholders, the trial court was required to give this exclusionary clause the meaning that favored coverage. This Court should reverse and hold that the condominium or townhome exclusion is inapplicable as a matter of law.

D. Ms. Xia’s claim arose from negligence in failing to vent her hot water heater and not from the “release or escape of pollutants.”

Ms. Xia suffered bodily injury as a result of Issaquah Highlands’ negligent installation of a water heater, and not from “pollution.” ProBuilders wrongfully denied coverage on the basis of the policy’s Pollution Exclusion. The trial court erred in refusing to

grant Ms. Xia summary judgment holding this exclusion inapplicable as a matter of law.

Pollution exclusions “originated from insurers’ efforts to avoid sweeping liability for long-term release of hazardous waste.” *Quadrant Corp v. American States Ins. Co.*, 154 Wn.2d 165, 172, ¶ 12, 110 P.3d 733 (2005). ProBuilders’ policy purported to exclude coverage for bodily injury arising from exposure to pollution or pollutants:

Bodily injury, property damage, or personal injury caused by, resulting from, attributable to, contributed to, or aggravated by the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of **pollutants**, or from the presence of, or exposure to, **pollution** of any form whatsoever, and regardless of the cause of the **pollution** or **pollutants**.

This Exclusion applies regardless of the cause of the **pollution** and whether any other cause of said **bodily injury property damage, or personal injury** acted jointly, concurrently or in any sequence with said **pollutants** or **pollution**. This Exclusion applies whether any other cause of the **bodily injury, property damage, or personal injury** would otherwise, be covered under this insurance.

(CP 334)

The policy defines the term “pollutant” and “pollution:”

Pollutant means any solid, liquid, gaseous or thermal irritants or contaminants, which include but are not limited to smoke, vapor, soot, fumes, acids,

alkalis, chemicals, waste, biological elements and agents, and intangibles such as noise, light and visual esthetics, the presence of any or all of which adversely affects human health or welfare, unfavorably alters ecological balances or degrades the vitality of the environment for esthetic, cultural or historical purposes, whether such substances would be or are deemed or thought to be toxic, and whether such substances are naturally occurring or otherwise.

...

Pollution as used herein means any form of pollutant which forms the basis for liability, whether the pollution is said to cause physical injury or not, which by volume or timing or any other factor is said to give rise to liability.

(CP 335)

When “the underlying injury and cause of action are rooted in negligence, not in environmental harm,” the court “must decide whether the fact a pollutant appears in the causal chain triggers application of the exclusion clause.” *Kent Farms, Inc. v. Zurich Ins. Co.*, 140 Wn.2d 396, 399, 998 P.2d 292 (2000). The court is “required to view the exclusion in light of the whole policy to determine whether, in that context, the exclusion applies.” *Kent Farms*, 140 Wn.2d at 400. This is necessarily a fact-specific inquiry. *Quadrant Corp.*, 154 Wn.2d at 181, ¶ 32 (“An absolute pollution exclusion clause can be ambiguous with regard to the facts of one case but not another.”).

In *Kent Farms*, the Supreme Court differentiated between a pollutant acting as a pollutant, which would trigger the exclusion, and “bodily injury caused by negligently maintained or operated equipment,” which falls outside the scope of the exclusion. 140 Wn.2d at 401-02. In *Kent Farms*, the insured’s shutoff valve malfunctioned while plaintiff was delivering diesel fuel. While he was attempting to reattach the delivery hose to prevent a spill, diesel fuel physically engulfed the plaintiff, pouring down his throat and into his lungs and stomach. 140 Wn.2d at 398. The Supreme Court held that because the plaintiff alleged negligence in the maintenance and design of the insured’s fuel storage facility, not environmental harm caused by pollution, a reasonable purchaser of insurance could conclude that the exclusion would not apply to “acute bodily injury caused by negligently maintained or operated equipment.” 140 Wn.2d at 401-02.

In *Quadrant Corp.*, the Court held that a similar absolute pollution exclusion barred coverage for a claim by an apartment tenant who was “overcome by fumes and became ill after a restoration company applied sealant to a nearby deck.” 154 Wn.2d at 167, ¶ 1. The complaint alleged that plaintiff “suffered *bodily injury and property damage* when the deck sealant *fumes* drifted

or *migrated* into her apartment.” 154 Wn.2d at 180, ¶ 31 (emphasis in original). The Court distinguished *Kent Farms* because there, “it was the defect in the shutoff valve, not the toxic character of the fuel, that was central to the injury.” 154 Wn.2d at 176, ¶ 21.

The *Quadrant* Court distinguished *Kent Farms* on another ground – the sealant fumes were toxic even when properly used and applied. The Court held that the *Kent Farms* rule does not apply when “the fumes caused injury and where the pollutant was being used as it was intended,” 154 Wn.2d at 179, ¶ 28 (emphasis in original), and the company hired to apply the sealant, “brought the sealant onto the premises for the purpose of applying it to the deck owned by the insureds.” 154 Wn.2d at 180, ¶ 31. When a “substance whose toxicity could cause injury even when used as intended,” the pollution exclusion precludes coverage. *Quadrant Corp.*, 154 Wn.2d at 179, ¶ 28. *Accord, Cook v. Evanson*, 83 Wn. App. 149, 920 P.2d 1223 (1996) (fumes from concrete sealant applied to building fell within absolute pollution exclusion), *rev. denied*, 131 Wn.2d 1016 (1997).

The facts of this case are analogous to *Kent Farms*, not *Quadrant Corp.* Ms. Xia suffered from carbon monoxide poisoning from a disconnected vent in a negligently installed water heater.

(CP 191, 195, 260, 661) Unlike the sealant in *Quadrant Corp.*, carbon monoxide occurs naturally and is not harmful in small quantities. (CP 198: exposure to CO at less than 35 ppm has no effect in healthy adults) The carbon monoxide was never *used*; it is the natural and intended consequence of combustion. While the deck sealant at issue in *Quadrant* would have been dangerous if inhaled regardless how the sealant was applied, 154 Wn.2d at 180, ¶ 31, toxic levels of carbon monoxide are not an expected result of the installation or use of a water heater in a residence. That is why building codes permit interior gas hot water heaters. Just as the delivery driver in *Kent Farms* would not have been injured if the defective valve had operated as intended, Ms. Xia would not have been injured if the water heater was “used as intended.” 140 Wn.2d at 398. Here, as in *Kent Farms*, Ms. Xia’s injury is “rooted in negligence, not in environmental harm caused by pollution.” 140 Wn.2d at 399.

At a minimum, the language of the pollution exclusion in ProBuilders’ policy was ambiguous because it defined “pollution” as “any form of pollutant which forms the basis for liability” (CP 335) The *Quadrant Corp.* Court held that application of an absolute pollution exclusion will vary depending on the facts and

circumstances of the case. While ProBuilders argued that carbon monoxide, a “gaseous . . . contaminant” formed “the basis for liability,” Ms. Xia’s interpretation is equally reasonable: the negligently installed water heater, and not a pollutant “forms the basis for liability.”

The trial court erred in failing to engage in the fact specific analysis of the pollution exclusion clause required by *Quadrant Corp.* and *Kent Farms* and in refusing on summary judgment to resolve this ambiguity in the pollution exclusion in favor of coverage. This Court should reverse the trial court’s denial of summary judgment and hold that the pollution exclusion clause does not apply to Ms. Xia’s claim.

E. ProBuilders breached its good faith duty to defend and is liable for its insured’s reasonable settlement and for penalties and fees under IFCA and the CPA.

1. ProBuilders breached the duty to defend by summarily concluding that Ms. Xia’s claim was clearly not covered.

Because an insurer may refuse to defend its insured only where a claim is “clearly not covered,” this Court need not determine that the condominium/townhouse and pollution exclusions are inapplicable as a matter of law to hold that ProBuilders breached its duty to defend. *Truck Ins. Exch. v.*

Vanport Homes, Inc., 147 Wn.2d 751, 760, 58 P.3d 276 (2002); *Woo v. Firemen’s Fund Ins. Co.*, 161 Wn.2d 43, 53, ¶ 14, 164 P.3d 454 (2007) (“duty to defend is triggered if the insurance policy conceivably covers the allegations in the complaint”). “[I]f coverage is not clear from the face of the complaint but coverage could exist, the insurer must investigate and give the insured the benefit of the doubt on the duty to defend.” *Expedia, Inc. v. Steadfast Ins. Co.*, 180 Wn.2d 793, 803, ¶ 18, 329 P.3d 59, 65 (2014). Whether an insurer breached the duty to defend depends on its actions at the time the complaint is filed, and not with the benefit of hindsight after adjudicating whether the insurer has the ultimate obligation to indemnify. *American Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 404, ¶ 6, 229 P.3d 693 (2010).

ProBuilders breached its duty of good faith by adopting the most expansive interpretation of the ambiguous and undefined term “townhouse” in its condominium/townhouse exclusion. ProBuilders’ adjuster failed to consult any dictionary definition of this undefined policy term, its usage in local ordinances or within the building industry – the consumers of its policies. Rather than reserving its rights to later deny coverage, the insurer performed only a *pro forma* investigation, closing its file without determining

whether Issaquah Highlands' project had any elements of common ownership or common walls. Despite receiving Mr. Duerfeldt's email indicating the Ms. Xia's claim concerned a "zero lot line home," it did not determine that Ms. Xia's residence was owned in fee. (CP 958) When ProBuilders/NBIS reopened its claims file a year later upon receiving Ms. Xia's complaint, it quickly closed it again based on nothing more than the Assessor's description of the residence as a "single family residence – townhouse." (CP 54, 268-69, 963-64)

ProBuilders took the most self-serving interpretation of the townhome exclusion to deny its insured a defense of a potentially covered claim. This Court should hold that ProBuilders breached its good faith duty to defend.

ProBuilders' summary reliance on the pollution exclusion to deny its insured a defense similarly demonstrates its lack of good faith, regardless whether this Court determines that ProBuilders has a duty to indemnify its insured for Ms. Xia's damages. ProBuilders did no research to determine the mechanism of Ms. Xia's injury or the nuances of Washington law interpreting pollution exclusions before deciding Ms. Xia's claim was "clearly not covered." Given the highly fact specific analysis required by

Washington precedent, and without a coverage opinion, no reasonable insurer analyzing *Kent Farms* and *Quadrant Homes* could summarily conclude as did ProBuilders that the pollution exclusion categorically barred coverage. (CP 961-62) But ProBuilders did not even look for, let alone analyze, Washington law.

As the trial court noted in denying summary judgment on the basis of the pollution exclusion, “*Quadrant* is not on all fours. *Kent* is not on all fours either.” (11/2/12 RP 130) In the absence “of any Washington case directly on point,” ProBuilders could not rely on an “arguable legal interpretation of its own policy” to deny its insured a defense. *Alea*, 168 Wn.2d at 408, 413, ¶¶ 12, 20.

Even if this Court holds that there is no duty to indemnify, ProBuilders breached the good faith duty to defend Issaquah Highlands. Here, as in *Alea*, ProBuilders’ “refusal to defend . . . based upon an arguable interpretation of its policy was unreasonable and therefore in bad faith” as a matter of law. 168 Wn.2d at 414, ¶ 21. ProBuilders breached its duty of good faith as a matter of law by denying a defense without giving its insured the benefit of the doubt, reserving its rights and seeking a judicial determination whether the policy exclusions barred coverage.

2. ProBuilders is estopped to deny coverage and is liable for its insured's reasonable settlement.

Having breached its good faith duty to defend in the face of ambiguous and undefined policy terms, without reserving its rights and obtaining a judicial determination of coverage, ProBuilders is now estopped to deny coverage. ProBuilders is liable as a matter of law for its insured's settlement, which Judge Craighead held to be reasonable and untainted by any fraud or collusion.

An insurer that refuses to defend its insured under a reservation of rights in violation of its duty of good faith is estopped to deny coverage. *See National Sur. Corp. v. Immunex Corp.*, 176 Wn.2d 872, 880, ¶¶ 12- 13, 297 P.3d 688 (2013) (“defending under a reservation of rights enables the insurer to protect its interests insuring itself against potentially disastrous findings of breach, bad faith, waiver and coverage by estoppel”). “If an insurer acts in bad faith, an insured can recover from the insurer the amount of a judgment rendered against the insured, even if the judgment exceeds contractual policy limits.” *Miller v. Kenny*, 180 Wn. App. 772, 799, ¶ 52, 325 P.3d 278 (2014). The insurer is liable for the amount of its insured's stipulated covenant judgment that has been approved by the court after the insurer has been afforded

notice and an opportunity to dispute the reasonableness of the settlement. *Miller*, 180 Wn. App. at 800; *Besel v. Viking Ins. Co. of Wisc*, 146 Wn.2d 730, 738-39, 49 P.3d 887 (2002). “[T]here is no factual determination to be made on damages in the later bad faith claim, at least not with respect to the covenant judgment.” *Bird v. Best Plumbing Group, LLC*, 175 Wn.2d 756, 772, ¶ 34, 287 P.3d 551 (2012).

Having been deprived of a defense to Ms. Xia’s claim, and after giving ProBuilders one last chance to defend, Issaquah Highlands settled Ms. Xia’s claim for \$2 million, a sum found reasonable by Judge Craighead at a hearing in which ProBuilders refused to participate after receiving notice and an opportunity to be heard. (CP 900) ProBuilders has not alleged that the settlement was the product of fraud or collusion in its answer to the instant bad faith lawsuit. (CP 1307-25) *See* CR 8(c). ProBuilders is liable as a matter of law for its insured’s reasonable settlement. *See Besel*, 146 Wn.2d at 739-40.

3. ProBuilders is liable for penalties and attorney fees under the CPA and IFCA.

An insurer’s breach of the duty of good faith is a per se violation of Consumer Protection Act, RCW ch. 19.86. *Moratti v.*

Farmers Ins. Co. of Wash., 162 Wn. App. 495, 511, ¶ 27, 254 P.3d 939 (2011), *rev. denied*, 173 Wn.2d 1022, *cert. denied*, 133 S.Ct. 198 (2012). A determination that an insurer is liable in bad faith for its insured's reasonable settlement establishes the insurer's liability under the CPA as a matter of law. *Moratti*, 162 Wn. App. at 512, ¶ 28 ("given the jury's determination of the bad faith claim, Moratti is entitled to judgment as a matter of law for Farmers' violation of the CPA").

This Court should also hold that ProBuilders "acted unreasonably in denying a claim for coverage or payment of benefits" under IFCA, RCW 48.30.015(2), and remand for a determination of the amount of civil penalties and an award of attorney fees under RCW 19.86.090 and RCW 48.30.015. Whether or not this Court finds a breach of the duty to defend, it should remand for consideration of Issaquah Highlands' IFCA claims based on ProBuilders' violation of insurance regulations. *See St. Paul Fire and Marine Ins. Co. v. Onvia, Inc.*, 165 Wn.2d 122, 196 P.3d 664 (2008) (insured may maintain claim for bad faith claims handling that is not dependent on the duty to defend or indemnify).

ProBuilders had a duty to conduct a reasonable investigation before denying Issaquah Highlands' claim, WAC 284-30-330(4),

and the obligation to “complete its investigation within thirty days after notification of a claim, unless the investigation cannot reasonably be completed within that time.” WAC 284-30-370. ProBuilders did not complete its investigation within 30 days of receiving Ms. Xia’s claim or notify Issaquah Highlands that it needed additional time. It did not even contact its insured until September 11, 2007, seven weeks following receipt of Ms. Xia’s claim, and then sought only information regarding subcontractors rather than any facts that would allow it to make a reasonable coverage decision. (CP 256, 958-59) It took ProBuilders only eight days to deny coverage after Ms. Xia’s lawyer contacted the insurer, but 52 days to communicate with Issaquah Highlands. (CP 959)

An insurer’s violation of the Insurance Commissioner’s fair practices regulations entitles a first-party claimant, or its assignee, to actual damages, fees and costs. RCW 48.30.015(1)-(3). This Court should direct entry of judgment in favor of Ms. Xia on her CPA and IFCA claims and remand for an award of statutory penalties and attorney fees. At a minimum, this Court should remand to allow a jury to determine whether ProBuilders acted unreasonably in its investigation and failed to timely communicate with its insured.

F. Ms. Xia should be awarded attorney fees in the trial court and on appeal.

Ms. Xia, as the insured's assignee, is entitled to attorney fees in the trial court and on appeal on both statutory and equitable grounds. Ms. Xia is entitled to fees as a prevailing party under the CPA, RCW 19.86.090, and under IFCA, RCW 48.30.015(1), (3). She is also entitled to fees and all expenses incurred under the equitable rule of *Olympic S.S. Co., Inc. v. Centennial Ins. Co.*, 117 Wn.2d 37, 811 P.2d 673 (1991), because, as the insured's assignee, she was forced to sue to establish coverage. See *Panorama Village Condominium Owners Ass'n Bd. of Directors v. Allstate Ins. Co.*, 144 Wn.2d 130, 143-44, 26 P.3d 910 (2001) (insured "must . . . be compensated for **all** of the expenses necessary to establish coverage") (emphasis in original).

This Court should also hold that Ms. Xia is entitled to attorney fees and expenses at trial and on appeal under the equitable rule for the "bad faith conduct of the losing party." See *Miotke v. City of Spokane*, 101 Wn.2d 307, 338, 678 P.2d 803 (1984), *abrogated on other grounds by Blue Sky Advocates v. State*, 107 Wn.2d 112, 727 P.2d 644 (1986). In *McGreevy v. Oregon Mutual Ins. Co.*, 128 Wn.2d 26, 904 P.2d 731 (1995), the Court,

citing *Miotke*, noted that it was unnecessary to find bad faith by the insurer and to award fees under *Olympic Steamship*, because bad faith already triggers attorney fees under one of the established equitable exceptions to the “American rule:”

We did not suggest in *Olympic Steamship*, nor do we now, that the disproportionate bargaining position of the insurer or the frustration of the insured's contractual right to receive the benefit of its bargain is evidence of bad faith on the part of the insurer. If such were the case, the existence of bad faith alone would support the invocation of the court's equitable powers to award attorney fees, and there would be no need for the rule in *Olympic Steamship*.

128 Wn.2d at 37 (emphasis added).

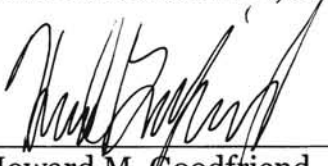
Ms. Xia is entitled to her attorney fees in the trial court and on appeal. RAP 18.1.

VI. CONCLUSION

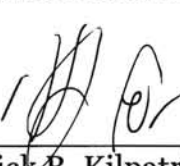
This Court should reverse and direct entry of judgment in favor of Ms. Xia, and award her attorney fees at trial and on appeal.

Dated this 14th day of November, 2014.

SMITH GOODFRIEND, P.S.

By: 
Howard M. Goodfriend
WSBA No. 14355

KILPATRICK LAW GROUP, PC

By: 
Dick B. Kilpatrick
WSBA No. 7058

Attorneys for Appellant

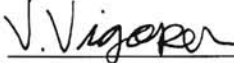
DECLARATION OF SERVICE

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on November 14, 2014, I arranged for service of the foregoing Brief of Appellant, to the court and to the parties to this action as follows:

Office of Clerk Court of Appeals - Division I One Union Square 600 University Street Seattle, WA 98101	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> E-File
Richard B. Kilpatrick Kilpatrick Law Group, P.C. 1750 112th Ave N.E., Ste D-155 Bellevue, WA 98004-3727	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input type="checkbox"/> U.S. Mail <input checked="" type="checkbox"/> E-Mail
Stephen G. Skinner Andrews Skinner, PS 645 Elliott Ave W Ste 350 Seattle, WA 98119	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input checked="" type="checkbox"/> U.S. Mail <input checked="" type="checkbox"/> E-Mail

DATED at Seattle, Washington this 14th day of November, 2014.



Victoria K. Vigoren

The Honorable Carol Schapira
Re: Hearing Date: December 20, 2013

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR THE COUNTY OF KING

ZHAOYUN XIA, a single person, ISSAQUAH
HIGHLANDS 48, LLC, a Washington
Limited Liability Company, ISSAQUAH
HIGHLANDS 50, LLC, a Washington Limited
Liability Company, GOTTLIEB ISSAQUAH
HIGHLANDS, 48 LLC, a Washington Limited
Liability Company, and GOTTLIEB
ISSAQUAH HIGHLANDS 50, LLC, a
Washington Limited Liability Company,

Plaintiffs,

v.

PROBUILDERS SPECIALTY INSURANCE
COMPANY RRG, a foreign insurance
company authorized to conduct business within
the State of Washington, et al.,

Defendants.

NO. 11-2-20319-1 SEA

ORDER GRANTING DEFENDANT
PROBUILDERS SPECIALTY
INSURANCE COMPANY, RRG'S
MOTION FOR SUMMARY JUDGMENT,
DENYING PLAINTIFF'S MOTION FOR
SUMMARY JUDGMENT AND
DISMISSING CASE

[PROPOSED]

THIS MATTER HAS COME ON regularly before this Court on Defendant's Motion for
Summary Judgment and Plaintiff's Motion for Summary Judgment. All parties appeared by and
through counsel. Having considered the pleadings and files in this matter, specifically including:

1. Defendant ProBuilders Specialty Insurance Company, RRG's Motion for Summary
Judgment;

ORDER GRANTING DEFENDANT PROBUILDERS
SPECIALTY INSURANCE COMPANY, RRG'S
MOTION FOR SUMMARY JUDGMENT - 1

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9050

App. A

- 1 2. Declaration of John C. Parker, with exhibits thereto;
- 2 3. Declaration of Stephen G. Skinner, with exhibits thereto;
- 3 4. Plaintiffs' Opposition to Defendant ProBuilders Specialty Insurance Company,
- 4 RRG's Motion for Summary Judgment;
- 5 5. Declaration of Richard Kilpatrick, with exhibits thereto;
- 6 6. Declaration of Wes Giesbrecht, with exhibit thereto;
- 7 7. Declaration of Nikalous Armitage, with exhibits thereto;
- 8 8. Declaration of David Lambin;
- 9 9. Defendant's Reply;
- 10 10. Declaration of Andrea Griggs in Support of Defendant ProBuilders Specialty
- 11 Insurance Company, RRG's Motion for Summary Judgment;
- 12 11. Plaintiff's Motion for Summary Judgment Against Defendant ProBuilders;
- 13 12. Declaration of Richard Kilpatrick, with exhibits thereto;
- 14 13. Declaration of Michael Lierman;
- 15 14. Declaration of Dennis Smith, with exhibits thereto;
- 16 15. Declaration of David Mandt, with exhibits thereto;
- 17 16. Declaration of Warren Harris, with exhibit thereto;
- 18 17. Olympic Advantage and Treacy Duerfelt's Opposition to ProBuilders' Motion for
- 19 Summary Judgment;
- 20 18. Declaration of Jennifer Smitrovich;
- 21 19. Defendant ProBuilders Specialty Insurance Company, RRG's Opposition to

22 ORDER GRANTING DEFENDANT PROBUILDERS
SPECIALTY INSURANCE COMPANY, RRG'S
MOTION FOR SUMMARY JUDGMENT - 2

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- Plaintiff's Motion for Summary Judgment;
- 20. Declaration of Bernd Heinze;
- 21. Declaration of Stephen G. Skinner in Opposition to Plaintiff's Motion for Summary Judgment, with exhibits thereto;
- 22. Plaintiff's Reply.
- 23. Xia's Brief Supporting Order of Summary Judgment for Xia;
- 24. Declaration of Dick Kilpatrick re: presentation of orders;
- 25. Defendants' Opposition to Xia's Brief Supporting Order of Summary Judgment for Xia;
- 26. Xia's Opposition to Defendant's Order of Summary Judgment.

Having heard the arguments of counsel, and being otherwise fully advised in this matter;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that Defendant ProBuilders Specialty Insurance Company, RRG's Motion for Summary Judgment is GRANTED. When ProBuilders denied coverage in its January 17, 2008 letter it was correct because the townhouse exclusion properly applied and excluded all coverage. Nothing thereafter changed the situation for the insurer, including that there was no request for a defense of the suit from or on behalf of the insureds to Defendant ProBuilders. Based on the foregoing, ProBuilders owed no duty to defend or indemnify its insureds with respect to the underlying lawsuit and later consent judgment. The plaintiff also has not asserted that after Ms. Xia acquired the assigned claims of Highlands 48 and others, Ms. Xia acquired any greater personal rights than those of the assignees

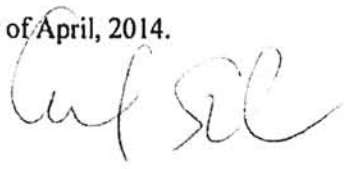
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ORDER GRANTING DEFENDANT PROBUILDERS
SPECIALTY INSURANCE COMPANY, RRG'S
MOTION FOR SUMMARY JUDGMENT - 3

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1 IS THEREFORE FURTHER ORDERED, ADJUDGED AND DECREED that Plaintiff
2 Xia's Motion for Summary Judgment is DENIED and the case is DISMISSED with prejudice.

3
4 DONE IN OPEN COURT this ¹⁶ day of April, 2014.



5
6 _____
7 The Honorable Carol Schapira
8 King County Superior Court Judge

9 Presented by:

10
11
12 By 
13 Stephen G. Skinner, WSBA #17317
14 Attorneys for Defendant ProBuilders Specialty
Insurance Company, RRG

15 Copy received and notice of presentation waived

16 KILPATRICK LAW GROUP PC

17 s/ Dick Kilpatrick
18 Richard B. Kilpatrick, WSBA #7058
19 Shannon M. Kilpatrick, WSBA #41495
Attorneys for Plaintiff Zhaoyun Xia

20
21
22 ORDER GRANTING DEFENDANT PROBUILDERS
SPECIALTY INSURANCE COMPANY, RRG'S
MOTION FOR SUMMARY JUDGMENT - 4

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