

No. 47494-8-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

MUTUAL OF ENUMCLAW INSURANCE COMPANY,

Appellant/Cross Respondent,

v.

MYONG SUK DAY, dba STOP IN GROCERY,

Respondent/Cross-Appellant.

APPEAL FROM THE SUPERIOR COURT
FOR PIERCE COUNTY
THE HONORABLE STANLEY J. RUMBAUGH

BRIEF OF RESPONDENT/CROSS-APPELLANT

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I. INTRODUCTION

After a nine-day trial, a properly-instructed jury found that appellant Mutual of Enumclaw Insurance Co. (MOE), while defending respondent Myong Day under a reservation of rights, in bad faith failed to investigate, resolve, or fully disclose to her the true issue concerning her entitlement to coverage of a multi-million dollar claim for selling alcohol to minors. Having consistently put its own financial interests above its insured's, MOE now relies on its own concession that its insured reached a reasonable settlement with the injured parties – a settlement made while MOE continued to hide potential coverage for the claim – to evade the consequences of its undisputed bad faith. This Court must reject MOE's invitation to ignore decades of settled bad faith law, affirm the trial court's judgment on the jury's verdict, and award respondent her fees on appeal.

II. RESTATEMENT OF ISSUES

1. Is coverage by estoppel the consequence of the jury's finding that MOE acted in bad faith and damaged its insured Day by defending under a reservation of rights despite failing to investigate and disclose to its insured that that her request to MOE's agent for liquor liability coverage bound MOE to provide that coverage?

2. Does the doctrine of coverage by estoppel bind MOE to its insured's settlement with the injured plaintiffs where MOE agreed that the settlement amount was reasonable and not the product of fraud and collusion?

3. May MOE escape liability for its bad faith after representing that entry of judgment in the underlying action was an unnecessary formality "that should be avoided"?

4. May MOE escape liability for its bad faith because its insured did not assign her bad faith claim?

5. With no presumption of harm imposed on MOE in unchallenged instructions, did the jury's finding that the insured proved \$300,000 in damages justify coverage by estoppel?

6. Were MOE's proposed instructions on insurance binders and reformation of contracts relevant to its insured's claim for bad faith based on MOE's failure to follow its own policies?

7. Was the jury's \$300,000 verdict for emotional distress an award of "actual damages" within the meaning of the Insurance Fair Conduct Act, RCW 48.30.015(1), and did the trial court abuse its discretion in awarding an additional \$600,000 in damages under IFCA, RCW 48.30.015(2)?

III. RESTATEMENT OF FACTS

Although MOE does not directly challenge the jury's verdict that it acted in bad faith, the statement of facts in its opening brief is at odds with the jury's verdict, contrary to the rule that all facts must be viewed in the light most favorable to respondent Day. *See Burnside v. Simpson Paper Co.*, 123 Wn.2d 93, 107-08, 864 P.2d 937 (1994). This restatement recites those facts that support the jury's verdict and the court's entry of judgment based on the clear case law governing MOE's liability.

A. MOE authorized its agent Huh to bind it to liquor liability coverage. Unbeknownst to its insured Day, MOE's policy did not include liquor liability even though Day had asked for this coverage.

Respondent Myong Day purchased the Stop-In Grocery (SIG) in Tacoma from a fellow Korean American, Han Kim. (11/20 RP 117-20, 2/1 RP 104) Day trusted Kim, who she had known for decades. (11/19 RP 60, 11/20 RP 112, 126) Day had never owned or run a business before. (11/20 RP 128) She would use the same accountant and vendors as Kim, and sought the same liability protections Kim had. (11/19 RP 55, 11/20 RP 123-26, 128; CP 2378)

Kim's insurance was through MOE, and had always included liquor liability coverage. (Ex. 27 at 4; 11/19 RP 92-93; CP 2378) When Kim in late 2003 introduced Day to MOE's insurance agent

Michael Huh, Day told Huh she wanted the same liability coverage that Kim had. (11/19 RP 55, 11/20 RP 128, 11/24 RP 22; CP 2378) Huh and Kim told Day the insurance coverage would stay the same. (11/19 RP 64-65, 75, 80, 11/20 RP 128-29, 11/24 RP 22, 40)¹ Day's decision to continue the same protection was not surprising. Not only was Day inexperienced in business, including business insurance, Kim's premium for \$1,000,000 in liquor liability coverage was only \$200, and "virtually all" of Huh's grocery store customers had liquor liability. (Ex. 37; 11/20 RP 22; CP 2378)

MOE had given Huh complete authority to instantly bind MOE to coverage requested by insureds, including liquor liability coverage. (11/24 RP 139, 11/25 RP 35-36) When Day told Huh she wanted liquor liability coverage and Huh agreed to obtain that coverage for her, MOE was bound by that agreement and obligated to "step in" and provide coverage, regardless of the terms of its later-issued policy. (11/24 RP 139, 11/25 RP 33; FF 8) (CP 2379)

¹ Day, Kim and Huh conversed in Korean; Day is not a proficient English speaker. (11/19 RP 64-65, 11/20 RP 99-101)

B. When Day tendered a liquor liability claim, MOE initially denied coverage, accepting without question or investigation its agent Huh's claim that Day had declined liquor liability coverage.

David Pavolka claimed he shared beer purchased at SIG with his friends Christopher Stewart and Todd McLaughlin on May 15, 2008. (CP 606-07) Pavolka, Stewart and McLaughlin were all under the age of 21. (CP 606-07) That evening, Stewart lost control of his car in Point Defiance Park, severely injuring pedestrians Dawn Smith and William Lee. (CP 607-08) Smith and Lee sued SIG and Day on August 14, 2009. (CP 604)

Day called Huh when she was served with the lawsuit. (11/20 RP 132) Huh told Day she had insurance that covered the lawsuit, and she should contact MOE. (11/20 RP 132-33) Huh tendered the claim to MOE for Day on September 18, 2009. Huh said nothing about there being no liquor liability coverage in the policy. (11/25 RP 143-44; 12/1 RP 31; Exs. 16, 29) MOE admitted at trial that her tender of the claim suggested that its insured Day believed that she had coverage. (11/20 RP 57-58)

Unbeknownst to Day, however, the policy Huh had obtained for Day and SIG did not include a liquor liability rider. (Ex. 30; CP 2378) Huh had prepared and submitted the application to MOE 10 days after his late 2003 meeting with Day, but it had no "check" in a

box requesting liquor liability, and the policy issued by MOE included no liquor liability rider. (Ex. 29 at 6-8; CP 2378) Day never saw the application (11/20 RP 87), which MOE's Claims Director Robert Klie testified would not in any event have alerted anyone that liquor liability coverage had not been requested. (11/20 RP 17) Even a proficient English speaker could not have determined from the coverage summary or declarations that the policy did not include liquor liability. (11/18 RP 130; Exs. 29, 30)

On September 23, 2009, MOE's claims adjuster called Day, told her there probably wasn't coverage, and "instructed her to contact" her own lawyer. (Ex. 16 at 3; 11/19 RP 88) According to MOE's claim activity log, Day told the adjuster "she was told by the agent that the[re] should be coverage." (Ex. 16 at 3; 11/19 RP 88) MOE's Claims Director Klie testified that alone should have been enough to require MOE to provide Day a defense. (11/20 RP 68) Instead, MOE told Day to get her own lawyer. (11/20 RP 135-36)

MOE did not further investigate why Day thought she had coverage. (11/19 RP 93-94) MOE did not ask Day if she had asked its agent Huh to include liquor liability coverage and did not inform Day that Huh had authority to bind MOE. (11/19 RP 89-91) MOE's Claims Director Klie testified that MOE should have investigated

the coverage issue (11/19 RP 97), and that MOE's failure to follow up on the issue was "inadequate." (11/19 RP 99, 103, 11/20 RP 11)

Instead of investigating or revealing the coverage question to its insured, MOE told Day that the claim was not covered. (Ex. 16 at 3; 11/18 RP 125, 11/20 RP 135) Because MOE had told Day to get her own lawyer, Day hired Lance Hester to defend the claim, and paid Hester a retainer. (11/18 RP 126, 131, 11/20 RP 136)

C. MOE eventually defended under a reservation of rights, without investigating Day's claim to liquor liability coverage, telling her what the true coverage issue was, or making a coverage determination.

Having already told Day she should hire her own lawyer on September 23, MOE's claims adjuster called agent Huh on September 29, 2009. (11/25 RP 40; Ex. 16) Huh told MOE's claims adjuster the policy had been written correctly, and that he now remembered that Day had "declined" liquor liability coverage. (11/19 RP 135, 139; 11/25 RP 58; Ex. 16)²

In his agency agreement, Huh had agreed to indemnify MOE for any "error or omission in handling of business placed with or

² MOE's underwriting department had spoken to Huh the previous week, on September 21. MOE's underwriting notes from that conversation do not say anything about Huh's claim on September 29 that Day had "declined" liquor liability coverage. (Ex. 51; 11/19 RP 136-37)

intended to be placed with” MOE.³ (CP 431; Ex. 31 at 5; 11/20 RP 27) MOE’s Claims Director Klie testified that Huh’s statements “should not have been taken at face value.” (11/19 RP 117, 11/20 RP 25, 78) Despite Huh’s clear self-interest to claim Day had not asked for liquor liability coverage, MOE did not press Huh, obtain his file, or even ask him for his file notes. (11/19 RP 108, 11/24 RP 150, 11/25 RP 126)

On October 14, 2009, weeks after Day had retained her own lawyer at her own expense, MOE finally accepted Day’s defense with a reservation of rights based on MOE’s claim that the policy issued included no liquor liability rider (still without revealing that the true issue was whether Day had requested liquor liability coverage). (Ex. 19 at 4) MOE retained attorney Scott Clement to defend Day. (11/18 RP 135)

MOE’s Claims Director Klie testified that Day would have been an “important person” to interview about the coverage issue. (11/19 RP 98-99) Day’s insurance expert testified Day was “the

³ Huh resisted when MOE’s claims adjuster told Huh that he should notify his own errors & omissions carrier in January 2010. (11/19 RP 140, 11/25 RP 69) Huh changed his story again, claiming for the first time that Day had affirmatively declined coverage because only she and her sister would be working at the store, and “didn’t need it.” (11/19 RP 140, 11/25 RP 146) This story, three months after the underlying claim had been denied was Huh’s (or anyone’s) first attempt to explain why Day had supposedly rejected liquor liability coverage. Based on Huh’s “self interest[] in the outcome of the litigation” and “his demeanor when testifying,” the trial court found that this version of Huh’s story about his late 2003 meeting with Day was not credible. (CP 2378-79)

most important person you talk to.” (11/24 RP 106) MOE’s Claims Director Klie had “no explanation” for why MOE did not interview Day about the coverage issue. (11/19 RP 99) But MOE never asked Day what she had discussed with Huh, or why she thought she had liquor liability coverage. (11/19 RP 89, 93-94, 98-99) MOE did not tell Day that Huh claimed she had declined liquor liability coverage. (11/20 RP 139) MOE did not tell Day that Huh had the authority to bind coverage, and that the real question was whether Day had asked Huh for liquor liability coverage. (11/18 RP 148, 11/19 RP 89-90, 122-23, 11/20 RP 75) Instead, a November 3, 2009, entry in MOE’s claims file states that Day “declined the coverage.” (Ex. 16 at 7, 11/19 RP 139) MOE’s file contains no explanation for this note, its conclusion, or its source. (11/19 RP 139-40)

D. MOE sued for a determination the claim was not covered, shifting the investigation of liquor liability coverage to its insured Day.

When MOE told Day it would defend under a reservation of rights, it had already hired a lawyer to file a declaratory judgment action against Day to obtain a determination there was no coverage or obligation to defend the injured plaintiffs’ claim. (Ex. 16 at 6) MOE did not give its insured any prior warning before it served its declaratory action in February 2010. (11/19 RP 123) MOE’s Claims

Director Claims Klie testified that it should have alerted Day. (11/19 RP 124, 130) Klie also testified that MOE should have investigated Day's claim for coverage, and that had MOE investigated, it is "possible" MOE would have removed the reservation of rights on its defense of Day. (11/20 RP 33-36) But MOE had no contact with Day after its claims adjuster's September 23, 2009 call instructing her to defend herself until after MOE sued Day in this declaratory judgment action in February 2010. (11/19 RP 89-90, 122, 11/25 RP 93)

MOE subjected its insured Day to not one lawsuit to defend, but two. And MOE in fact had made this "momentous" decision to file a declaratory judgment action months earlier, without investigation, after an October 9 internal "roundtable" discussion of its insured's coverage claim. (11/19 RP 119-20, 123; Ex. 16 at 6) No one at MOE ever told Day that suit was coming. Neither MOE's "boilerplate" October 2009 reservation of rights letter nor its February 2010 declaratory action or any other contact advised Day of the real coverage issue – whether MOE was bound to indemnify Day for liquor liability because Day had asked its agent Huh for the coverage in late 2003. (11/19 RP 122-23, 11/20 RP 75, 83-84, 11/24 RP 118, 11/25 RP 79)

MOE's bad faith conduct devastated Day. Consumed with the lawsuits, Day could not sleep, stopped exercising, gained weight, and developed diabetes. (11/19 RP 66-69) Day cut off contact with her friends and became suicidal. (11/19 RP 66-69, 11/20 RP 138) Because MOE had denied any responsibility to settle or indemnify her against the plaintiffs' claims, Hester referred Day to a bankruptcy lawyer. (11/18 RP 150) Hester would have referred Day to an insurance coverage lawyer if he had known about the "major" coverage issue MOE was hiding. (11/18 RP 150-51, 11/24 RP 117-18)

Hester, who Day had retained to defend the injury case when MOE initially denied a defense, drafted Day's April 2010 counterclaim. Although Hester did not know that Huh had authority to bind MOE, the answer alleged coverage and requested reformation of the insurance contract. (CP 6-9; 11/18 RP 158, 11/19 RP 29) In January 2011, Day learned for the first time through discovery that Huh had the authority to immediately bind MOE to liquor liability coverage when requested by its insured. (CP 37-38, 424-25) In a February 25, 2011 amended answer, Day alleged bad faith, CPA and IFCA violations, and coverage by estoppel, and brought in Huh as a third party defendant. (CP 194-200)

E. Day settled with plaintiffs, assigning claims against the agent Huh and retaining claims against MOE. MOE conceded the settlement was reasonable.

The defense lawyer MOE had retained for Day valued plaintiffs' claims at \$4 million to \$8 million "or even higher;" plaintiffs' medical bills alone were over \$1 million. (CP 527) Although the plaintiffs were willing to settle for limits and sign a full release, MOE refused to pay. (CP 345, 365, 393, 527, 531)

Day settled separately with plaintiffs in June 2011. In exchange for MOE's payment of \$125,000, an assignment of rights against Huh, and entry of consent judgments totaling over \$7,900,000, plaintiffs agreed not to collect from Day. (CP 304-07) MOE had initially conditioned any payment to the plaintiffs on Day dropping her bad faith claims. (CP 299, 304, 453-54) When Day did not agree, MOE made the payment anyway. Plaintiffs took over Day's claim against broker Huh, and Day retained her claims against MOE. (CP 305) The plaintiffs and Day agreed that their settlement was "not intended to benefit any other person or entity, and shall not be construed in any way to release Michael Huh, or MOE, for any liability either may have to Day or to Plaintiffs." (CP 306)

The injured plaintiffs had agreed to conduct a hearing to establish the reasonableness of the settlement and to enter

judgments against Day in their June 2011 settlement with Day. (CP 304) When MOE was apprised of the settlement and asked if the formalities of a covenant judgment and reasonableness hearing were necessary, MOE conceded that the settlement was reasonable, and represented that “if a reasonableness hearing and judgment can be avoided that would be a good thing.” (CP 652, 656, 660, 672) As a consequence, the plaintiffs did not seek formal entry of a judgment or a reasonableness determination. (3/7 RP 11-12; CP 300)

After plaintiffs settled Day’s assigned claim against broker Huh, the underlying case was dismissed. (CP 222-23) Nothing supports MOE’s claim that Day engineered this dismissal. The dismissal was entered without notice to the lawyers representing Day in this pending bad faith action. MOE’s insurance defense lawyer signed off on the dismissal. (CP 623)

F. The trial court entered judgment on the jury’s verdict that MOE’s bad faith had damaged Day.

In July 2013, MOE moved for summary judgment. (CP 204-12) Despite its agreement that the settlement amount was reasonable and that entry of judgment should be “avoided,” MOE argued that Day had not been harmed by MOE’s bad faith because the underlying action had been dismissed (based on the actions of MOE’s defense counsel) and there had been no judgment and no

reasonableness hearing (based on MOE coverage counsel's representations). (CP 209)

The trial court denied summary judgment (CP 314-15), but MOE continued to argue that it was "off the hook" because the underlying action had been dismissed without entry of the judgments it said were unnecessary. (*E.g.*, CP 556, 716-17) Because the plaintiffs were at risk under their settlement with Day for not conducting a reasonableness hearing, they moved to reopen the underlying action to conduct a reasonableness hearing and enter judgments as mandated in the settlement. (CP 625) On January 17, 2014, the trial court granted plaintiffs' motion to vacate the dismissal. (CP 704-12) MOE intervened in the underlying action against Day on February 14, 2014 (CP 776-77), but did not timely appeal the CR 60(b)(6) order vacating the dismissal. RAP 2.2(a)(10).

The court consolidated the underlying injury action with MOE's declaratory judgment action. (CP 784-85) The injury plaintiffs sought a reasonableness determination for the settlement with Day. (CP 754-71) Again, MOE erroneously claims that Day made this motion (MOE 9); the motion was filed and noted by the plaintiffs. (CP 754-71) MOE admitted the settlement was reasonable but opposed entry of judgments. (CP 786-96) The trial

court found the settlement and the covenant judgments to be reasonable and entered judgments on June 27, 2014. (CP 1038-50) MOE did not appeal the orders either.

Prior to trial of Day's bad faith and IFCA claims against MOE, the trial court held that the jury would determine whether MOE breached its duty of good faith, assess any damages for Day's emotional distress, and that the court would decide as a matter of law, based on the jury's verdict, whether to impose the remedy of coverage by estoppel. (11/13 RP 80, 87-88) MOE conceded that if the reasonable settlement amount of the underlying claim constitutes the "floor" for the damages recoverable for MOE's bad faith, there was no basis to introduce evidence of the settlement between the plaintiffs and Day or the resulting judgment. (11/13 RP 75-76) Based on this "consensus" (11/13 RP 87), and MOE's concession that the settlement amount was reasonable and not a product of fraud or collusion (11/13 RP 70; *see* 11/6 RP 30; CP 201-03, 893), the trial court excluded from trial evidence of the covenant settlement and the judgments themselves. (11/17 RP 80-81)

The trial court instructed the jury that Day had the burden to prove damages for "fear, aggravation, or distress" arising from MOE's breach of the duty of good faith, under pattern instructions

governing liability, damages and proximate cause. (CP 1755, 1758-59) MOE did not except to these instructions. MOE agreed that the jury would only answer one liability question, one causation question, and one damages question, applicable to both the IFCA and bad faith claims, and that Ms. Day had the burden of proving “[t]hat Mutual of Enumclaw’s failure to act in good faith was a proximate cause of Ms. Day’s injury.” (CP 1726; 12/3 RP 67-68, 78-80) MOE did not take formal exception when the trial court declined to give its proposed instructions relating to the statutory requirements for binders or the common law requirements for reformation or modification of written contracts. (12/3 RP 49-58) The trial court reasoned there was no basis to instruct the jury on reformation because the court would decide that issue after trial. (12/3 RP 16-18) MOE conceded that the jury need not apportion damages between the IFCA and bad faith claims, that a finding of proximate cause “would apply equally to both claims,” and that if the jury found “emotional distress damages, that would be up to the Court to determine . . . the degree to which, if at all, there should be a multiple on those damages.” (12/3 RP 79-81)

The jury found that MOE had caused Day emotional distress damages of \$300,000. (CP 1765) The trial court held that the

jury's finding established her right to coverage by estoppel and that MOE was liable for the amount of Day's reasonable settlement with the plaintiffs. (See 2/9/15 RP 79, 85)

The trial court was "persuaded" that Day "probably did, at least indirectly, request liquor liability coverage by asking Mr. Huh to write the same policy for her as he had done for Mr. Kim" (CP 2381) but denied Day's claim for reformation under a heightened clear and convincing burden of proving a "clear mutual mistake in coverage terms." (CP 2381) The trial court exercised its discretion under IFCA to add \$600,000 to the \$300,000 general damages awarded to Day (CP 2128-29) and reserved attorney fees for "supplemental judgment." (CP 2129-30)

IV. RESPONSE ARGUMENT

A. MOE does not challenge the jury's undifferentiated verdict, which was supported by overwhelming evidence that MOE placed its own financial interest above its insured Day's.

The jury found, based on overwhelming evidence, unchallenged instructions, and a verdict form accepted by MOE, that MOE breached its duty of good faith under *Tank v. State Farm Fire & Cas. Co.*, 105 Wn.2d 381, 715 P.2d 1133 (1986) by failing to "fully inform the insured of all developments relevant to policy coverage," engaging in "conduct that demonstrates a greater

concern for the insurer's financial interest than for the insured's financial risk," (CP 1753), and violating the Insurance Commissioner's Unfair Claims Settlement regulations, including failing to "promptly provide a reasonable explanation . . . in relation to the facts or applicable law for denial of a claim." (CP 1754) See WAC 284-30-330(13). MOE argued there should be only one liability, causation and damages question to cover both claims (12/3 RP 78-80) and did not propose a verdict form that required the jury to distinguish between these two claims. (12/3 RP 79-81; CP 1727) See *Davis v. Microsoft Corp.*, 149 Wn.2d 521, 539-40, 70 P.3d 126 (2003); Tegland, 15A Wash. Prac., *Handbook on Civil Procedure* § 88.6 (2015-16 ed.) The jury awarded Day \$300,000 in damages under instructions, also unchallenged by MOE, that put the burden of proving harm on Day, not MOE. (CP 1755, 1758)

The jury thus rejected *as a matter of fact* MOE's contention on appeal that by suing Day while providing her a defense under a reservation of rights that did not reveal the true coverage issue, its actions were "exactly the course of action proscribed" by *Am. Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 229 P.3d 693 (2010) (MOE 16 n.4). *Alea* addressed an insurer's choice between providing no defense or a defense under a reservation of rights. But

nothing in *Alea* suggests that an insurer can insulate itself from a bad faith claim by defending under a reservation of rights without investigating the claim for coverage, and without informing the insured of the true coverage issue.

Both the jury's verdict and the trial court's unchallenged findings established that when Day purchased SIG, she was entitled to the same liquor liability coverage as her seller Kim – coverage that would have protected her from a devastating claim for selling liquor to a minor that could have been settled for policy limits. MOE never advised Day that her request for liquor liability coverage would give her the very coverage she needed. Instead, with no investigation of her coverage claims, MOE sued Day for a determination she had no coverage, defending Day under a reservation of rights that did not identify the true coverage question. Because all facts supporting the jury's verdict must be viewed in the light most favorable to Day, *Burnside*, 123 Wn.2d at 107-08, substantial evidence supports the jury's verdict that Day was harmed by MOE's bad faith.

B. Given the jury's finding of bad faith and damages, MOE is estopped to deny coverage for the reasonable amount of Day's settlement with the injured plaintiffs.

Just as MOE's statement of facts utterly ignores the jury's verdict that it acted in bad faith, its legal argument asks this Court

to ignore decades of insurance bad faith law to rule as a matter of law that its insured Day was not entitled to the established remedy for its bad faith conduct. An insurer that breaches its good faith duties, particularly while defending under a reservation of rights, is liable in tort to its insured and is estopped from denying coverage of its insured's reasonable settlement of the claim. *Safeco Ins. Co. of America v. Butler*, 118 Wn.2d 383, 392-94, 823 P.2d 499 (1992); *Besel v. Viking Ins. Co. of Wisconsin*, 146 Wn.2d 730, 738-40, 49 P.3d 887 (2002); *Bird v. Best Plumbing Grp., LLC*, 175 Wn.2d 756, 764-65, ¶¶ 14-16, 287 P.3d 551 (2012). The issue here is not whether MOE engaged in merel "procedural" bad faith (MOE 14), whether a "litigated" judgment is essential to coverage by estoppel (MOE 29), or whether a claim for bad faith must be prosecuted by the injured party rather than the insured (MOE 34-35).⁴ Once the jury found that MOE's breach of a core requirement of its duty of good faith harmed its insured, MOE's liability for its insured's reasonable settlement follows as a matter of law.

⁴ Although the answer to each, and all, of these questions, is "no." (See Arg. §§ B.1, B.4, and B.5, *infra*.)

1. MOE's breach of its core duties of good faith was not mere "procedural" bad faith.

MOE's assertion that it engaged in mere "procedural" bad faith ignores that the jury found MOE breached its core duties of good faith while defending under a reservation of rights. MOE claims it satisfies its duties by providing a defense to its insured so long as it does not "structure" the defense to eliminate coverage. (MOE 17) But an insurer's duties, and its liability for bad faith, are much broader than that.

While the Insurance Commissioner's regulations prohibit any insurer from denying coverage of a claim without providing its insured a full explanation of the facts or law, WAC 284-30-330(13), an insurer has heightened duties when defending under a reservation of rights. The insurer's common law good faith obligations include (as the jury was instructed here (CP 1753), without exception) "the responsibility for fully informing the insured not only of the reservation of rights defense itself, but of *all* developments relevant to his policy coverage and the progress of his lawsuit," and to "refrain from engaging in any action which would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk." *Tank*, 105 Wn.2d at 388 (emphasis in original) (quoted at MOE 18 n.5).

“As an insurer defending under a reservation of rights, MOE owed [Day] a duty to refrain from engaging in any unreasonable, frivolous, or unfounded . . . action which would demonstrate a greater concern for [MOE's] monetary interest than for [Day's] financial risk.” *Mut. of Enumclaw Ins. Co. v. Dan Paulson Constr., Inc.*, 161 Wn.2d 903, 916, ¶ 22, 169 P.3d 1 (2007) (quoting *Tank*, 105 Wn.2d at 388; *Kirk v. Mt. Airy Ins. Co.*, 134 Wn.2d 558, 560, 951 P.2d 1124 (1998)) (internal quotation marks omitted). An insurer's failure to fully investigate and keep its insured informed of “all developments” relevant to coverage implicates not only the duty to defend under a reservation of rights (as MOE did here), but the duty to settle the underlying claim and, ultimately, to indemnify the insured from an arguably covered claim. *See Butler*, 118 Wn.2d at 395 (insurer defending under reservation of rights failed to conduct “timely and thorough investigation,” resulting in loss of evidence “that would have been useful . . . in the coverage suit.”).

MOE misplaces its reliance on *St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.*, 165 Wn.2d 122, 196 P.3d 664 (2008) in arguing that coverage by estoppel was not available as a matter of law because its “claims handling” errors constituted mere “procedural” bad faith. (MOE 14) In *Onvia*, the Court considered the measure of

damages where the insurer had *not* breached its good faith duties under *Tank*, noting that “[t]he remedy of coverage by estoppel is not recognized in this context.” 165 Wn.2d at 133, ¶ 24. Based on the assumption in the certified question from the Ninth Circuit that the insurer had “*properly* denied the insured’s tender of defense” of an uncovered claim, the *Onvia* Court recognized that “the duty to defend, either outright or under a reservation of rights, [was] not implicated.” 165 Wn.2d at 131, ¶ 20 (emphasis added). See *Broad v. Mannesmann Anlagenbau, A. G.*, 141 Wn.2d 670, 676, 10 P.3d 371 (2000) (jurisdiction limited to question certified).

In a case that (unlike *Onvia*) did raise the issue, this Court rejected a similar effort to parse an insurer’s bad faith between supposed “procedural” “claims handling” errors and good faith obligations implicating the duty to defend, settle, and indemnify in *Moratti ex rel. Tarutis v. Farmers Ins. Co. of Washington*, 162 Wn. App. 495, 1254 P.3d 939 (2011), *rev. denied*, 173 Wn.2d 1022 (2012). In *Moratti*, the insurer’s argument (also based on a misreading of *Onvia*, 162 Wn. App. at 504, ¶ 13), was that its “procedural” bad faith in inadequately investigating a claim, failing to communicate with its insured, and rejecting the injured party’s initial efforts to settle when the claim was first tendered, were

“cured” by a policy limits tender two years later. This Court held in *Moratti* that “the [*Butler*] principles apply whenever an insurer acts in bad faith, whether by poorly defending a claim under a reservation of rights, refusing to defend a claim, or failing to properly investigate a claim.” 162 Wn. App. at 502-03, ¶ 11 (quoting *Besel*, 146 Wn.2d at 737) (internal citations omitted).

MOE does not cite, much less address, *Moratti* or its affirmative rejection of *Onvia* as a grounds for the insurer to evade the consequences of its bad faith. There is no basis for MOE’s claim that coverage by estoppel is (or should be) available only where an insurer fails to settle or totally denies its insured a defense against a third party claim. (MOE 15-17) The insured in *Coventry Associates v. Am. States Ins. Co.*, 136 Wn.2d 269, 281, 961 P.2d 933 (1998), upon which *Onvia* relies, asserted a claim under a first-party policy, where the insured and insurer’s interests were not in conflict and the reasons for imposing a presumption of harm and coverage by estoppel under *Butler* did not exist. *Coventry* itself confirms that “[i]n third-party reservation of rights cases, though, coverage by estoppel is an appropriate remedy because the insurer contributes to the insured’s loss by failing to fulfill its obligation in some way.” 136 Wn.2d at 284.

This is the “third party reservation of rights” case contemplated by *Coventry*. Here, as in *Butler*, MOE defended under a reservation of rights without investigating coverage, without making a coverage decision based on a proper investigation that its own employees conceded may have led to providing coverage, and without advising its insured Day of the true coverage issue. There is no merit to MOE’s contention that its failure to apprise Day of the facts potentially entitling her to coverage “does not trigger the policy concerns that have led courts to apply the remedies of presumed harm and estoppel.” (MOE 14) The jury found that MOE’s failure to disclose to Day her right to coverage based on her statements to her agent, while providing her a defense under a reservation of rights that did not identify the true coverage question, breached its core good faith duties to defend and indemnify under *Tank*. MOE’s breach of its *Tank* duties were at the heart of its duty of good faith to its insured.

2. As a matter of precedent and policy, coverage by estoppel is the legal consequence of MOE’s bad faith as found by the jury.

Just as the jury properly resolved the *factual* issue of whether MOE acted in bad faith, the trial court correctly imposed the remedy of coverage by estoppel as the *legal* consequence of

MOE's bad faith. When an insurer fails to act in good faith, the insured can settle separately with the injured plaintiff by stipulating to a judgment amount and in exchange receiving a covenant not to execute. *Besel*, 146 Wn.2d at 738-40; *Bird*, 175 Wn.2d at 764-65, ¶ 14-15. A subsequent bad faith judgment must include the reasonable settlement amount of the underlying tort claim; "there is no factual determination to be made on damages in the later bad faith claim, *at least not with respect to the covenant judgment.*" *Miller v. Kenny*, 180 Wn. App. 772, 801, ¶ 55, 325 P.3d 278 (2014) (quoting *Bird*, 175 Wn.2d at 772, ¶ 34) (italics in original).

In *Besel*, for instance, the Court remanded with instructions to enter a bad faith judgment that included the underlying reasonable settlement amount as a matter of law. 136 Wn.2d at 740. In *Butler*, "[i]f . . . the Butlers prevail on their bad faith claim, then Safeco [was] estopped from asserting [its] coverage defense." 118 Wn.2d at 406. Washington courts have consistently rejected the argument advanced by MOE here – that because the insured's settlement with the injured plaintiff protects the insured from the consequences of an adverse judgment, the insurer is instead immunized from the consequences of its bad faith.

A covenant not to execute “is not a release permitting the insurer to escape its obligation.” *Besel*, 146 Wn.2d at 737. MOE’s bad faith made it liable, as a matter of law and policy, for any covenant judgment its insured Day agreed to in a reasonable settlement with the plaintiffs:

Where the insured has caused damages exceeding policy limits, an insurer’s failure to offer policy limits exposes the insured to the **risk** of an excess judgment. Once it is determined that the insurer acted in bad faith by failing to settle, typically the chief component of the insured’s damage caused by that failure will be the insured’s liability to the third party.

Miller, 180 Wn. App. at 801-02, ¶ 57 (emphasis added). It is the *risk* of a judgment over policy limits that causes the courts to impose coverage by estoppel whenever an insurer’s bad faith implicates its obligations of defense, settlement, or indemnification to its insured. “The coverage by estoppel remedy creates a strong incentive for the insurer to act in good faith, and protects the insured against the insurer’s bad faith conduct.” *Kirk*, 134 Wn.2d at 564; *Butler*, 118 Wn.2d at 394 (“An estoppel remedy . . . gives the insurer a strong disincentive to act in bad faith.”).

After the jury found that MOE’s bad faith caused Day harm, the trial court correctly concluded that the remedy of coverage by estoppel applied for the same reason it was initially imposed in

Butler to deter an insurer's breach of its duty of good faith to its insured and to alleviate the "almost impossible burden" on the insured to prove what would have happened had there been no bad faith conduct by the insurer. "The course cannot be rerun, no amount of evidence will prove what might have occurred if a different route had been taken." *Butler*, 118 Wn.2d at 391 (quoting *Transamerica Ins. Group v. Chubb & Son, Inc.*, 16 Wn. App. 247, 252, 554 P.2d 1080 (1976), *rev. denied*, 88 Wn.2d 1015 (1977)); quoted in *MOE v. Don Paulson Constr., Inc.*, 161 Wn.2d at 921, ¶ 36; *Moratti*, 162 Wn. App. at 508, ¶ 21). The trial court correctly recognized that MOE's argument – that if it had done everything Day says it should have done, the claims against her would have come out the same – can be said in every bad faith case. (2/9 RP 92)

MOE's attempt to distinguish *Butler* on the grounds that "the insurer corrupted the insured's defense in potentially unquantifiable ways in order to improve its coverage position" is particularly misguided. (MOE 26) The bad faith conduct in *Butler* is no different from MOE's actions here, where it failed to investigate or tell its insured of the "major" coverage issue posed by Day's claim that she had asked MOE's agent for liquor liability coverage, in order "to improve [MOE's] coverage position." (MOE 26)

MOE's argument against coverage by estoppel here is an unwarranted assault on the legal principles well-established in a consistent line of precedent from this Court and the Supreme Court. (See MOE 19, complaining of an "incautiously written portion of *Butler*") No one will ever know whether Day would have established liquor liability coverage had she been told the issue and given immediate access to all the information MOE had back in 2009, when the injured plaintiffs made their claim.⁵ No one will ever know if MOE had timely and thoroughly investigated coverage, and made an impartial coverage decision, whether MOE would have removed the reservation of rights and covered the claims, just as its Claims Director testified it should have. MOE's reliance on the trial court's decision not to reform the policy wrongly imposes on its insured Day the consequences of its bad faith decision to place its own financial interest above those of its insured.

⁵ MOE's reliance on its claims adjuster's post-hoc, post-trial assurance by affidavit that Day's reformation claim "was unlikely to be successful" (MOE 43) is a good example of its misguided belief that the insurer is always in the best position to decide what the coverage decision should be, and that as a consequence the insured need not be given access to all relevant information.

3. Day's reasonable settlement with the injured plaintiffs established only the "floor" for MOE's bad faith liability.

MOE does not dispute the established rule that the insured's reasonable settlement constitutes the "floor, not a ceiling, on the damages" for bad faith. *Miller*, 180 Wn. App. at 782, ¶1. "[A]n insurer had no right to litigate the reasonableness and good faith [of the insured's settlement with the injured party] as part of a subsequent bad faith action." *Bird v. Best Plumbing Grp., LLC*, 161 Wn. App. 510, 523, ¶ 25, 260 P.3d 209 (2011), *aff'd*, 175 Wn.2d 756, 287 P.3d 551 (2012) (citing *Besel*, 146 Wn.2d 730). The courts consider the reasonableness of the settlement amount using the *Glover* factors to establish the "floor" for bad faith damages. *Besel*, 146 Wn.2d at 738; *See Chaussee v. Maryland Cas. Co.*, 60 Wn. App. 504, 512, 812 P.2d 487, *rev. denied*, 117 Wn.2d 1018 (1991).

Here, MOE attempted to use its concession of reasonableness to evade the legal consequences of its bad faith. (3/7 RP 6; 6/27 RP 5-6) MOE was bound by a settlement found to be reasonable, as a legal consequence of the jury's finding of bad faith. *Mut. of Enumclaw Ins. Co. v. T & G Constr., Inc.*, 165 Wn.2d 255, 199 P.3d 376 (2008). The trial court correctly entered

judgment against MOE for the amount of Day's reasonable settlement with the plaintiffs.

4. MOE may not rely on the injured plaintiffs' initial failure to enter formal judgment to escape the consequences of its bad faith.

MOE complains that the stipulated judgment for the reasonable settlement, coupled with a covenant by the plaintiffs not to execute on that judgment, was "unrecognizable as any kind of legal obligation." (MOE 29) But that is true in any bad faith case where the insured receives a covenant not to execute. An insured does not have to subject itself to a "litigated judgment" (MOE 29); in every bad faith case where the stipulated judgment is the measure of damages, the insured is no longer subject to financial risk to the injured party. *Besel*, 146 Wn.2d at 737.

No court has held that formal entry of judgment is a predicate for imposing coverage by estoppel against the insurer. In *Miller*, for instance, there was never a formal judgment entered against Safeco's insured because "[a]ll parties . . . agreed to treat the remaining \$4.15 million as if judgment in that amount had been entered against Kenny." *Miller*, 180 Wn. App. at 785, ¶ 12. "A reasonableness hearing became unnecessary when Safeco, in May 2005, stipulated to an order finding that \$4.15 million was the

reasonable total net amount for the stipulated covenant judgments.” *Miller*, 180 Wn. App. at 784, ¶ 12.

That is exactly what happened here. The injured plaintiffs in their settlement with Day agreed to obtain a reasonableness determination on the agreed \$7.9 million in damages and to enter judgment against Day. MOE’s coverage counsel represented that MOE had no objection to entry of the reasonable consent judgment, but that, as in *Miller*, “if a reasonableness hearing and judgment can be avoided that would be a good thing.” (CP 652, 656, 660-72) Remarkably, MOE now attempts to rely on its concession to argue that Day had not suffered “harm” because of its bad faith. To the contrary, MOE waived any right to insist on entry of judgment or a reasonableness hearing by conceding the reasonableness of Day’s settlement. *See Unigard Ins. Co. v. Mut. of Enumclaw Ins. Co.*, 160 Wn. App. 912, 923, ¶ 20, 250 P.3d 121 (2011).

MOE also asserts that Day had “a *complete release*.” (MOE 32) (emphasis in original) But the agreement with Lee and Smith did not release Day. Instead, Lee and Smith agreed to provide a covenant not to execute and to enter a judgment against Day. It was only because MOE said a reasonableness hearing and judgment should be avoided if possible (CP 660), that the injured plaintiffs did

not do so immediately and agreed to a dismissal. (3/7 RP 11-12) MOE cannot rely on its own concession that Day was at risk for a judgment exceeding \$7.9 million when she resolved the underlying claim for that amount to argue that its insured had not suffered harm. In any event, judgments *were* entered against Day, after MOE's objections were fully heard.⁶ While entry of judgment is not an element of a bad faith claim, MOE ignores the judgments that were in fact entered.

MOE in particular misplaces its reliance on *Werlinger v. Clarendon Nat'l Ins. Co.*, 129 Wn. App. 804, 120 P.3d 593 (2005), *rev. denied*, 157 Wn.2d 1004 (2006) in arguing that Day was not harmed by its bad faith. (MOE 36) In *Werlinger*, the insured had filed for bankruptcy prior to the auto accident, and was insulated from liability long before the claim had been tendered to the insurer. Here, to the contrary, MOE's bad faith caused Day to be consumed by the prospect of bankruptcy and losing her business. (11/24 RP 17; *see also* 11/19 RP 66-69, 11/20 RP 138)) This Court distinguished *Werlinger* in *Moratti*, which rejected the insurer's

⁶ MOE's challenge to the procedure by which the judgment was entered ignores that it did not challenge (or timely appeal) either the vacation of the dismissal or the judgment subsequently entered. RAP 2.2(a)(10); *see Cork Insulation Sales Co., Inc. v. Torgeson*, 54 Wn. App. 702, 707, 775 P.2d 970, *rev. denied*, 113 Wn.2d 1022 (1989). The argument (MOE 33, 38-40) that the procedure was invalid or improper cannot be raised in this appeal.

argument (identical to that here), that a “live judgment” is necessary to prove harm. *Moratti*, 162 Wn. App. at 511, ¶ 27. The absence of a bankrupt party (much less a bankruptcy filed *before* the claimed tortious conduct) and a sham agreement are critical differences between this case and *Werlinger*.

5. Coverage by estoppel protects the insured and deters the insurer from bad faith conduct.

MOE ignores not only the precedent, but the policies underlying the remedy of coverage by estoppel. Depriving insureds of the remedy of coverage by estoppel where an insurer has successfully hidden the facts that would establish coverage of an adverse claim would give insurers an incentive to avoid their obligations to insureds under *Tank*. But it also would undermine another purpose of insurance – providing full compensation to injured parties by driving them to settle for far less than the reasonable value of their claims – just as the plaintiffs here did, through “litigation fatigue” (CP 1986), because MOE kept its insured (and the injured plaintiffs) in the dark about the possible right to liquor liability coverage.

MOE attempted to thwart those policies here – MOE got off “cheap” in the payment it made to the injured plaintiffs after refusing to pay the limits demand, telling Day and the injured

plaintiffs there was no coverage without fully investigating, informing them of the true coverage issue, and forcing its insured to defend a declaratory judgment action to uncover the true coverage issue. MOE even attempted to persuade Day to give up her bad faith claim before it would make *any* payment to the injured plaintiffs. MOE cannot rely on the fact that Day retained her bad faith claim to absolve itself of its own misconduct.

Although MOE claims that an insured's failure to "assign her rights to her victim is immaterial" (MOE 31), its argument boils down to claiming that because the injured parties will not recover an assigned judgment, the insured has not been harmed. (MOE 35) MOE argues that its insured Day could not pursue her own bad faith claim against her own insurer MOE because the plaintiffs accepted an assignment of her claim against her broker, rather than against MOE. (MOE 34) But as assignees, injured plaintiffs can have no rights greater than the insured from whom any assigned bad faith claim derives. *Besel v. Viking Ins. Co. of Wisconsin*, 105 Wn. App. 463, 472, 21 P.3d 293 (2001), *rev'd on other grounds*, 146 Wn.2d 730, 49 P.3d 887 (2002); *Trinity Universal Ins. Co. of Kansas v. Ohio Cas. Ins. Co.*, 176 Wn. App. 185, 201, ¶ 29, 312 P.3d

976 (2013), *rev. denied*, 179 Wn.2d 1010 (2014) (“without assignment, a third party claimant has no “bad faith] right of action.”). “The coverage by estoppel remedy . . . protects *the insured* against the insurer’s bad faith conduct.” *Kirk*, 134 Wn.2d at 564 (emphasis added).

When an insurer acts in bad faith, as MOE did here, “it is in no position to argue that the steps the insured took to protect himself [or herself] should inure to the insurer’s benefit.” *Besel*, 146 Wn.2d at 737 (alternation in original) (quoting *Greer v. Northwestern Nat’l Ins. Co.*, 109 Wn.2d 191, 204, 743 P.2d 1244 (1987)). This Court recently rejected an insurer’s claim that an insured’s assignee could not prove “harm” because the insured had reserved claims to himself in *Miller*, 180 Wn. App. at 795, ¶ 43. Similarly, the outcome of claims against the insurer’s broker was irrelevant to the bad faith claim in *Moratti*, 162 Wn. App. at 510, ¶ 25.

MOE’s liability for the consequence of its breach of duties to its insured under *Tank* were in no way “mooted” by subsequent events. *Moratti*, 162 Wn. App. at 503-04, ¶ 12. MOE makes this argument based on a misreading of *Harbor Lands, LP v. City of Blaine*, 146 Wn. App. 589, 191 P.3d 1282 (2008), which held a developer’s suit to reverse stop work orders that had been rescinded

by the city was moot. (MOE 38) Day is not asking for a “purely advisory opinion, instructing another court how to rule” (MOE 39, quoting *Harbor Lands*) but for affirmance of a judgment holding MOE liable for the consequences of its bad faith as found by a jury.

The only “abusive tactics . . . at play here” (MOE 40) are MOE’s failure to inform its insured Day of the facts that would have given her liquor liability coverage when she tendered the claim back in 2009. MOE may not rely on the injured plaintiffs’ decision not to take an assignment of Day’s bad faith claim to escape the consequences of its bad faith.

6. The jury found that Day was harmed by MOE’s bad faith under instructions that did not impose a presumption of harm.

MOE’s argument that it was deprived of the ability to “rebut the presumption of harm” is meritless because the jury found that Day was harmed by MOE’s bad faith under instructions which placed the burden of proving liability and damages on Day, not MOE. The trial court appropriately let the jury decide those factual issues under instructions to which MOE took no exception. CR 51(f); see *Goehle v. Fred Hutchinson Cancer Research Center*, 100 Wn. App. 609, 615-16, 1 P.3d 579, rev. denied, 142 Wn.2d 1010 (2000).

MOE's contention that it should have been allowed to argue that Day suffered no harm is erroneous because the legal consequence of the jury's findings is a question of law. See §B.2, *supra*. Equally without merit is MOE's evidentiary argument that the jury should have been allowed to consider all the facts surrounding the settlement, because MOE conceded below that if the court ruled that the covenant judgment was the base amount or "floor" for damages if the jury found bad faith, there would be no basis to introduce the settlement or the covenant. (11/13 RP 76)

Even had MOE not conceded that the facts of settlement were irrelevant if the remedy of coverage by estoppel applied, its argument about the presumption of harm arising from a breach of its duty of good faith ignores that "[t]his presumption may be rebutted only by a showing of fraud or collusion." *Bird*, 175 Wn.2d at 782, ¶ 56. Because MOE conceded that its insured's settlement with the plaintiffs was reasonable and not the product of fraud or collusion, it could not rebut the presumption of harm even had the trial court imposed one.

C. MOE has not preserved any other issues related to jury instructions, which are in any event meritless.

MOE complains of the trial court's failure to give an "appropriate instruction" that would have allowed it to rebut the

presumption of harm, or to instruct the jury on the supposed “legal rules” governing reformation of insurance policies. (MOE 42, 47) These issues have not been preserved for review, and in any event lack merit.

First, MOE did not take formal exception to the failure to give any of the instructions set out in its brief at 47. CR 51(f). Nor has it assigned error to the failure to give any instructions, as required by RAP 10.3(a)(4) and RAP 10.3(g). In any event, MOE has provided no legal argument in support of its proposed instructions. *See Ang v. Martin*, 154 Wn.2d 477, 486-87, ¶ 17, 114 P.3d 637 (2005) (refusing to consider appellant’s “incidental allusion” to claimed instructional errors).

The issues for the jury did not require it to find a temporary “binder” under RCW 48.18.230 (CP 1715), or whether the statute of frauds, RCW 48.18.190, applied (CP 1716), but whether MOE’s own policies required coverage. (12/3 RP 52-53) *Tank* (and its robust progeny), not a decision of the intermediate appellate court in Kansas (CP 1719), governed MOE’s duties to investigate coverage here. And to the extent reformation of the insurance contract had any effect on the parties’ rights and obligations (MOE 47), the court decided the issue after trial. (*See Cross-Appeal, infra* at § V)

D. The trial court did not abuse its discretion in trebling Day’s “actual damages” for emotional distress under IFCA.

The trial court properly exercised its discretion in awarding additional damages under the Insurance Fair Conduct Act, RCW 48.30.015, for double the damages for emotional distress found by the jury on Day’s claims. Not only are these “actual damages” under IFCA, MOE consented to an award of emotional distress damages below, and its argument is not preserved for appellate review.

1. MOE waived any challenge to emotional distress damages under IFCA by failing to raise it in the trial court.

MOE does not challenge the sufficiency of the evidence or the instructions under which the jury found that MOE violated IFCA. MOE raises its argument that IFCA does not authorize recovery for emotional distress for the first time on appeal.⁷ Here, MOE agreed that the jury could award Day damages for her “fear, aggravation or distress” (CP 1755), and compensate her “for such

⁷ MOE has not preserved any challenge to the undifferentiated special verdict, which (as proposed by MOE) did not differentiate between a finding of common law bad faith and a violation of IFCA. (CP 1765) MOE proposed and did not except to the verdict form, and did not propose (and resisted) a verdict form that would have required the jury to distinguish between these two claims. (12/3 RP 79-81; CP 1727) *See Davis v. Microsoft Corp.*, 149 Wn.2d 521, 539-40, 70 P.3d 126 (2003); Tegland, 15A Wash. Prac., *Handbook on Civil Procedure* § 88.6 (2015-16 ed.) (defendant must propose a special verdict that segregates challenged theories from those that the defendant concedes properly went to the jury in order to preserve challenge to one of the theories on appeal).

fear, aggravation, or distress as you find were proximately caused by [MOE]’s failure to act in good faith and/or violation of the Insurance Fair Conduct Act.” (CP 1758; see 12/3 RP 80-81) MOE has failed to preserve its objection to these damages by raising the issue for the first time on appeal. *Ainsworth v. Progressive Cas. Ins. Co.*, 180 Wn. App. 52, 80-81, ¶ 45, 322 P.3d 6 (2014).

2. Emotional distress damages are “actual damages” under IFCA.

Even had MOE timely challenged the availability of emotional distress damages, IFCA authorizes an award of “actual damages sustained” to an insured whose insurer has “unreasonably denied a claim for coverage or payment of benefits.” RCW 48.30.015(1). Washington courts have interpreted the term “actual damages” to include emotional distress damages under other remedial statutes. See *Ellingson v. Spokane Mortg. Co.*, 19 Wn. App. 48, 56-58, 573 P.2d 389 (1978) (emotional distress damages available as “actual damages” under RCW 49.60.030(2)).⁸

⁸ By contrast, the statutory term “actual damages” may be limited where the “statute’s plain and ordinary meaning” indicates an intent to limit recovery to a particular type of pecuniary loss. See *Segura v. Cabrera*, 184 Wn.2d 587, 593, ¶ 14, 362 P.3d 1278 (2015) (RCW 59.18.085 “does not address or encompass emotional distress damages” because it “sets the parameters of the damages available to a tenant” to “tenant’s actual costs of relocation that exceed relocation assistance amount”).

MOE relies exclusively on a single district court opinion in *Schreib v. American Family Mut. Ins. Co.*, 2015 WL 5175708 (W.D.Wash., Sep. 03, 2015), to support its argument that “actual damages” under RCW 48.30.015 exclude a policy holder’s emotional distress. (MOE 49) First, this Court is not bound by a federal court’s interpretation of a Washington statute. *In re Elliott*, 74 Wn.2d 600, 602, 446 P.2d 347 (1968). Second, contrary to *Schreib’s* erroneous analysis, Washington courts have allowed recovery of emotional distress damages upon an insurer’s breach of the duty of good faith. *See Miller*, 180 Wn. App. at 800-02, ¶¶ 54-57; *Anderson v. State Farm Mut. Ins. Co.*, 101 Wn. App. 323, 333, 2 P.3d 1029 (2000), *rev. denied*, 142 Wn.2d 1017 (2001).

Finally, MOE ignores the obvious remedial purpose of IFCA, which justifies a liberal, not narrow construction, of the term “actual damages” under its ordinary and common law meaning.⁹ “The purpose of IFCA is to protect individual policy holders from unfair practices by their insurers.” *Trinity Universal Ins. Co.*, 176

⁹ The Legislature need not expressly direct a liberal construction for a statute to be considered remedial. *See Schilling v. Radio Holdings, Inc.*, 136 Wn.2d 152, 159, 961 P.2d 371 (1998) (Wage Withholding Act, RCW 49.52.070, held remedial despite authorizing award of double damages). *See Johnston v. Beneficial Mgmt. Corp. of Am.*, 85 Wn.2d 637, 642, 538 P.2d 510 (1975) (“although the [CPA] imposes civil penalties, it is not subject to the strict construction which is ordinarily required where a statute imposing criminal penalties is involved.”).

Wn. App. at 201, ¶ 31 (citing S.B. Rep. on Engrossed Substitute S.B. 5726, at 2, 60th Leg., Reg Sess. (Wash. 2007); H.B. Rep. on Engrossed Substitute S.B. 5726, at 1, 60th Leg., Reg Sess. (2007)). As a different federal district court noted, “the remedy IFCA provides is not necessarily punitive.” *F.C. Bloxom Co. v. Fireman's Fund Ins. Co.*, No. C10-1603 RAJ, 2012 WL 5992286, at *7 (W.D. Wash. Nov. 30, 2012). Even had MOE preserved its argument, this Court should hold that “actual damages” under RCW 48.30.015(1) include emotional distress damages.

3. The trial court did not abuse its discretion in awarding additional damages under IFCA.

The trial court did not abuse its discretion in increasing the jury’s award of \$300,000 and making an additional award of \$600,000 for MOE’s breach of IFCA. IFCA’s plain language allows an award of “three times the actual damages:”

The superior court may, after finding that an insurer has acted unreasonably in denying a claim for coverage or payment of benefits or has violated a rule in subsection (5) of this section, increase the total award of damages to an amount not to exceed three times the actual damages.

RCW 48.30.015(2).

An award of statutory penalties is reviewed for abuse of discretion, “[b]ecause the trial judge was in a proper position to

determine whether an award of enhanced damages would be appropriate.” See *Ethridge v. Hwang*, 105 Wn. App. 447, 458-59, 20 P.3d 958 (2001). The trial court’s award in its discretion of an additional \$600,000 was intended to “reflect punishment for the wrongs done, be sufficient to reflect the severity of the wrongs and be sufficient to educate and deter this defendant and other insurers.” (CP 2166) RCW 48.30.015(2) refutes MOE’s contention (MOE 50 n.19) that the trial court had to find “reprehensible,” rather than “unreasonable” conduct to award enhanced damages:

No one reading the statute could find an indication that the Washington legislature intended to require proof of more reprehensible conduct. Instead, the legislature left it to the discretion of superior court judges to decide how much to enhance damages.

F.C. Bloxom Co, 2012 WL 5992286, at *6. The trial court’s enhanced damages award of \$600,000 under IFCA was not an abuse of discretion.¹⁰

¹⁰ Were the Court to consider it, MOE’s passing argument that due process precludes an award of statutory enhanced damages, relegated to a footnote, is without merit. The Supreme Court has not applied its analysis of common law punitive damages to statutory treble damages remedies. See *F.C. Bloxom Co.*, 2012 WL 5992286, at *8 (“So far as the court is aware, no court has ever struck down a state treble damages provision on Due Process grounds.”); *Sanders v. Allison Engine Co., Inc.*, 703 F.3d 930, 949 (6th Cir. 2012) (treble damages awarded by statute do not “implicate the same due process concerns” as punitive damage awards), *cert. denied*, 133 S.Ct. 2855 (2013).

E. Day is entitled to attorney fees on appeal.

Day is entitled to an award of attorney fees and expenses on appeal on both statutory and equitable grounds. First, Day is entitled to fees under IFCA, which authorizes an award of “reasonable attorneys’ fees and actual and statutory litigation costs” to the prevailing insured. RCW 48.30.015(3). Second, Day is entitled to fees in this coverage dispute under *Olympic S.S. Co., Inc. v. Centennial Ins. Co.*, 117 Wn.2d 37, 811 P.2d 673 (1991). Finally, Day is entitled to fees under the equitable exception to the “American rule” for bad faith conduct. See *McGreevy v. Oregon Mut. Ins. Co.*, 128 Wn.2d 26, 37, 904 P.2d 731 (1995) (“existence of bad faith alone would support the invocation of the court’s equitable powers to award attorney fees”). This Court should award Day her fees or direct the trial court to include appellate fees and expenses in its supplemental judgment for fees following return of the mandate. RAP 18.1(i).

V. CROSS-APPEAL

A. Introduction.

While it should not be necessary in order to resolve MOE’s appeal and affirm the trial court’s judgment, this cross-appeal preserves the alternate arguments that Day suffered harm as a

matter of law and that the policy should have been reformed to include liquor liability.

B. Assignments of error on cross-appeal.

1. The trial court erred in denying Day's motion for partial summary judgment. (CP 314-15)

2. The trial court erred in entering its Findings of Fact and Conclusions of Law denying respondent Day's claim for reformation, and in particular Conclusion of Law 7, refusing to grant reformation on the ground that "there is not clear, cogent and convincing evidence of a clear mutual mistake in coverage terms."

C. Issues related to cross-appeal.

1. Whether Day was entitled to partial summary judgment that she had suffered harm where it was undisputed that she incurred fees in defending claims that could have been settled within policy limits and in defending this lawsuit and discovering her right to coverage?

2. Whether the remedy of reformation of an insurance policy is available based on proof that the policy holder mistakenly believed she had coverage and the insurer in bad faith did not disclose her right to coverage?

D. Argument on Cross-Appeal.

1. Day suffered harm as a matter of law.

While the jury's finding that Day suffered emotional distress damages establishes that MOE was not prejudiced by the trial court's refusal to instruct the jury on the presumption of harm (Arg. § B.6, *supra*), the issue should have been resolved as a matter of law on summary judgment because it was undisputed that the claims against Day could have been settled for policy limits of \$1 million. (CP 351-53, 447) In addition to the emotional distress found by the jury, Day suffered harm because MOE's conduct created uncertainty and risk, and caused her to lose control of the defense of the injured plaintiffs' claims without assurance of coverage. *Dan Paulson*, 161 Wn.2d at 922-23, ¶ 38. Day incurred fees and costs in defending the underlying claims (CP 412-15) and in discovering what MOE hid from her – that she had a right to liquor liability coverage based on her request for coverage to Huh. (CP 503-04) As a matter of law, MOE could not meet its burden to show that no harm occurred. *Dan Paulson*, 161 Wn.2d at 920-21, ¶¶ 34-35.

2. The trial court erred in holding Day to the standard of reformation of a contract based on mutual mistake.

The trial court improperly analyzed the reformation issue solely as a question of “mutual mistake” rather than as an issue of the insurer’s inequitable conduct. The trial court found, based upon a preponderance of the evidence, that when Day told Huh she wanted liquor liability coverage and Huh agreed to obtain that coverage for her, MOE was bound by that agreement and obligated to “step in” and provide coverage (CP 2379), but refused to reform the policy based on its determination that Day’s proof did not meet the requisite standard of proof for reformation of a contract on the ground of mutual mistake. (CP 2381)

Where, as here, a quasi-fiduciary engages in inequitable conduct, rather than requiring clear and convincing proof of *mutual* mistake, the court should ask whether clear and convincing evidence of inequitable conduct by the insurer deprived the insured of the full benefits of the policy to which she believed she was entitled. *See Associated Petroleum Products, Inc. v. Northwest Cascade, Inc.*, 149 Wn. App. 429, 437-38, ¶ 16, 203 P.3d 1077, *rev. denied*, 166 Wn.2d 1034 (2009). This is the standard used for reformation of an ERISA plan:

To obtain reformation, plaintiff must show: (1) violations of ERISA §§ 404(a) and 102(a), based on the preponderance of the evidence; (2a) mistake or ignorance by employees of “the truth about their retirement benefits,” based on clear and convincing evidence; and (2b) “fraud or similar inequitable conduct” by the plan fiduciaries, based on clear and convincing evidence.

Osberg v. Foot Locker, Inc., 2015 WL 5786523, at *24 (S.D.N.Y. Oct. 5, 2015) (citing *Amara v. CIGNA Corp.*, 775 F.3d 510, 525-31 (2d Cir. 2014)). Requiring an insured to prove *mutual* mistake under a heightened burden of proof rewards an insurer for its bad faith, allowing it to evade coverage even when it knows the insured believes she has coverage – and *why* the insured believes she has coverage.

The trial court should have analyzed the reformation issue by inquiring whether Ms. Day established clear and convincing evidence *she* was mistaken about liability coverage – rather than that both she and Huh, MOE’s agent, were mistaken. It then should have determined whether clear and convincing evidence supports the jury’s finding that MOE breached its duty of good faith or engaged in inequitable conduct by concealing from Day the basis for liquor liability coverage.

A contract can be reformed when one party is mistaken and the other party has engaged in fraud or inequitable conduct. *Washington Mut. Sav. Bank v. Hedreen*, 125 Wn.2d 521, 526, 886

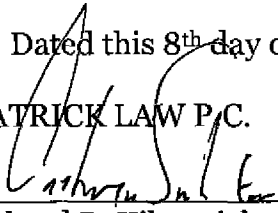
P.2d 1121 (1994). “A party has engaged in fraud or inequitable conduct if it conceals a material fact that it has a duty to disclose to the other party.” *Associated Petroleum Products*, 149 Wn. App. at 437, ¶ 16. MOE’s failure to disclose to its insured Day the basis for her coverage claim may be grounds for reformation of its policy. While unnecessary to affirm the trial court’s judgment, if this Court reverses the trial court’s application of coverage by estoppel, it should remand for a determination of Day’s reformation claim under the proper legal standard.

VI. CONCLUSION

This Court should affirm the judgment, award Day her fees on appeal, and remand for entry of a supplemental judgment for fees, costs and expenses.

Dated this 8th day of February, 2016.

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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 February 17, 2016, I arranged for service of the foregoing Brief of Respondent/Cross-Appellant, to the court and to the parties to this action as follows:

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Jenna L. Sanders

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