No. 100168-1

SUPREME COURT
OF THE STATE OF WASHINGTON

SEATTLE TUNNEL PARTNERS, *Plaintiff-Petitioner*,

WASHINGTON STATE DEPARTMENT OF TRANSPORTATION,
Plaintiff-Petitioner

HITACHI ZOSEN U.S.A. LTD.,
Plaintiff-Intervenor

v.

GREAT LAKES REINSURANCE (UK) PLC, et al.,
Defendants-Respondents.

RESPONDENTS' OPPOSITION TO PETITIONS FOR REVIEW

Philip A. Talmadge,
WSBA #6973
TALMADGE / FITZPATRICK
2775 Harbor Avenue SW,
Third Floor, Suite C
Seattle, WA 98126
Telephone: (206) 574-6661

Matthew L. Gonzalez
Daniel Millea
(*admitted pro hac vice*)
ZELLE LLP
45 Broadway, Suite 920
New York, NY 10006
Telephone: (646) 876-4400

Attorneys for Respondents

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I. INTRODUCTION

Both Seattle Tunnel Partners ("STP") and Washington State Department of Transportation ("WSDOT") ask this Court to grant review of aspects of Division I's August 2, 2021 decision but neither establishes that review is warranted under RAP 13.4(b). Specifically:

- STP asserts that Division I erred by upholding the trial court's ruling that the subject builder's risk property insurance policy's machinery breakdown exclusion ("MBE") encompasses loss caused by design defect; and
- WSDOT argues that Division I erred by upholding the trial court's ruling that the policy requires physical loss or damage to insured property in order to trigger coverage and that the Policy does not afford coverage for WSDOT's inability to use the tunnel while the damaged Tunnel Boring Machine ("TBM") was repaired.

Division I correctly held that the policy's MBE precludes coverage for damage from design defects. STP ignores the plain

wording of the provision, which excludes from coverage damage to the TBM "*by its own* . . . mechanical . . . breakdown." Division I correctly reasoned that this plain language, as written, excludes coverage for mechanical breakdown from design defect, because a TBM that breaks down due to a design defect has necessarily suffered an excluded breakdown. Division I's ruling is consistent with Washington law, the subject policy wording, and the parties' expectations. Accordingly, this Court should decline STP's petition for review.

This Court should also decline WSDOT's petition for review as Division I correctly held that the policy requires physical loss or damage to trigger coverage and that a mere loss of use of the insured property is insufficient. Division I's decision is based on the policy's plain language, which requires "direct physical loss" of property. Moreover, Division I followed well-established case law holding that physical injury to tangible property is required. As the tunnel did not sustain any such

physical loss, injury, or damage, this Court should decline WSDOT's petition for review.[1]

II. RESTATEMENT OF THE CASE

Insurers adopt Division I's recitation of facts and refer this Court to that opinion. Insurers also direct this Court to the following key facts:

- The Insuring Clause of the subject builder's risk insurance policy (the "Policy") provides in pertinent part, "the Insurers will indemnify the Insured in respect of direct physical loss, damage, or destruction not specifically excluded herein . . . happening to the Interest Insured."

[1] Insurers contend that this Court should not grant review of the issues raised by STP and WSDOT. However, if this Court elects to review Division I's decision, Insurers reserve the right to seek review of all issues decided by Division I, including Division I's rulings on the meaning of "item" in the MBE, the number of occurrences, how WSDOT's claimed damages relate to TBM repairs, and the dismissal of WSDOT's claim for declaratory judgment. This Court recognizes that a respondent may raise issues contingently. *Lewis River Golf, Inc. v. O.M. Scott & Sons*, 120 Wn.2d 712, 725, 845 P.2d 987 (1993), *Gertach v. Cove Apts., LLC*, 196 Wn.2d 111, 119 n.4, 471 P.3d 181 (2020).

- Section 1 of the Policy insures the tunnel.
- Section 2 of the Policy insures the TBM.
- Section 2 of the Policy includes a MBE, which excludes indemnification for "Loss of or Damage in respect of any item by its own explosion mechanical or electrical breakdown, failure breakage or derangement. This exclusion does not apply to resultant Damage to the property."

STP and WSDOT's facts are incomplete and ignore that the policy wording, including the MBE, was negotiated by the parties to the contract. In fact, STP's broker, Aon, selected and proffered the policy provisions. CP 724-29. STP and WSDOT also ignore the fact that, when procuring insurance, STP requested affirmative machinery breakdown coverage for the SR 99 TBM, but Insurers rejected that request and instead required that machinery breakdown be expressly excluded. CP 720-21, 730-34. Aon understood that no insurance market would provide machinery breakdown coverage for any tunnel boring machine,

let alone one with a prototype *design* like the SR99 TBM. CP 683-84, 718, 719-20, 721, 731, 732, 739, 740-41, 743-44, 761, 763. Insurers did not want to guarantee or warrant the performance of a complex piece of machinery with an untested and unproven design. CP 743. STP, in fact, obtained a contractual waiver from WSDOT acknowledging that the purchased policy would not insure the TBM for machinery breakdowns. CP 758-59, 767. In other words, none of the parties involved in the insurance placement—STP, Aon, or WSDOT—had any expectation that the Policy would cover the prototype machine if the machine did not function as intended. And yet STP asked the trial court to reform the Policy and insure the TBM for exactly the type of event—machinery breakdown due to defective design—that Insurers refused to insure. Insurers charged no premium for that coverage and have no contractual responsibility to provide it.

III. ARGUMENT

STP seeks review of Division I's ruling as to the MBE under RAP 13.4(b) (1) and (4). WSDOT seeks review of Division I's ruling that the Policy does not afford coverage for WSDOT's inability to use the tunnel during TBM repairs only under RAP 13.4(b)(4).

RAP 13.4(b)(1) states that review is warranted when "the decision of the Court of Appeals is in conflict with a decision of the Supreme Court." RAP 13.4(b)(4) states that review is warranted when "the petition involves an issue of substantial public interest that should be determined by the Supreme Court." STP and WSDOT's petitions fall far short of demonstrating the criteria under either standard.

Neither STP nor WSDOT demonstrate that Division I's decision regarding the interpretation of a bespoke insurance policy exclusion conflicts with a decision of this Court, as required for review under RAP 13.4(b)(1). As explained *infra* III.A., Division I's decision as to the scope of the Policy's MBE

is consistent with the controlling precedent of this Court and other Washington law.

STP and WSDOT also fail to show that this case involves any issue of substantial public interest warranting review under RAP 13.4(b)(4). In deciding whether a case presents issues of continuing and substantial public interest, three factors are considered determinative:

- whether the issue is of a public or private nature;
- whether an authoritative determination is desirable to provide future guidance to public officers; and
- whether the issue is likely to recur.

See State v. Beaver, 184 Wn.2d 321, 330, 358 P.3d 385, 390 (2015). The continuing and substantial public interest exception is typically used in cases dealing with constitutional interpretation, the validity of statutes or regulations, and matters that are sufficiently important to the appellate court. *See id.* at 331.

This case is an insurance coverage dispute and does not implicate any public issue. The Policy is a commercially

negotiated manuscript builder's risk policy applicable only to WSDOT's SR99 project, which has now concluded. STP procured the Policy to satisfy its contractual obligation to WSDOT to obtain insurance covering the project works and TBM. Op. at 3-4. STP's broker, Aon, selected the MBE for inclusion in this Policy. In other words, the Court's review of Division I's interpretation of the Policy's unique terms will have no application outside of the context of this litigation. In addition, STP and WSDOT make no showing of how this Court's ruling in this case would provide future guidance to public officers. The breach of contract action requires the interpretation of policy language applicable only to these insureds.

WSDOT's attempt to frame its Section 1 claim as an issue of first impression aligned with emergent issues in COVID-19-related property insurance coverage disputes also fails to show that this case warrants review. To the extent COVID-19 property insurance litigation presents any novel issue, the issue relates to whether COVID-19 is capable of causing physical loss or

damage to insured property. This case involves no COVID-19 claim—or *any* claim of damage to the insured Section 1 property (i.e., the tunnel). This case simply does not present a question that will be instructive on the question of whether losses arising from an insured's inability to use property due to COVID-19 constitute physical loss or damage. Neither STP nor WSDOT satisfy the requirements necessary to warrant review.

Even if this Court were to agree that the issues presented by STP and WSDOT are of substantial interest, neither the trial court nor the Court of Appeals erred in reaching their decisions. Accordingly, review of these issues is not warranted.

A. Division I Correctly Interpreted the Policy's Machinery Breakdown Exclusion.

Division I ruled that the trial court properly determined on partial summary judgment that the Section 2 MBE "excludes coverage for property damage to the TBM caused by any alleged design defects." Op. at 12. Division I correctly reasoned that the phrase "by its own" in the MBE indicates that the MBE precludes coverage for internal causes of damage and that "a design defect

is an internal cause, since design defects are inherent to the insured subject matter." Because Washington courts have not addressed the issue, Division I properly considered decisions from courts in other jurisdictions. Division I's well-reasoned decision does not conflict with Washington law.

1. Division I's decision that the Machinery Breakdown Exclusion precludes coverage for damage caused by design defects does not conflict with Washington precedent.

STP argues that Division I's ruling that the MBE excludes coverage for damage caused by design defects despite "[t]he absence of an explicit design defect exclusion" conflicts with this Court's decisions in *Vision One*, *Moeller*, and *International Marine Underwriters*. STP Pet. at 6-7 (citing *Vision One, LLC v. Philadelphia Indem. Ins. Co.*, 174 Wn.2d 501, 276 P.3d 300 (2012); *Moeller v. Farmers Ins. Co. of Wash.*, 173 Wn.2d 264, 267 P.3d 998 (2011); *International Marine Underwriters v. ABCD Marine, LLC*, 179 Wn.2d 274, 313 P.3d 395 (2013)). STP fails to demonstrate any conflict between these cases and

Division I's interpretation of the MBE. The cases STP relies on merely describe some of the essential requirements under Washington law for enforcing insurance policy language. For example, in *Vision One*, this Court stated the general principle that a peril that is not specifically excluded in an "all risk" insurance policy is an insured peril. 174 Wn.2d at 513. It is well established that exclusionary language in an insurance policy must be drafted in clear and unequivocal terms. *Moeller*, 173 Wn.2d at 272; *International Marine*, 179 Wn.2d at 288. The decisions STP cites do not involve exclusionary language for machinery breakdowns, design defects, or similar perils. Division I's conclusion that the MBE encompasses mechanical breakdowns caused by design defect does not conflict with the requirements that an excluded peril be specifically excluded and drafted in clear and unequivocal terms. Indeed, Division I's conclusion that the MBE "*as written* excludes coverage for damage from design defects" is based on the express wording of

the MBE, which excludes "Loss of or Damage in respect any item *by its own* . . . mechanical . . . breakdown." Op. at 13-14.

STP essentially argues that the MBE does not include the words "design defect" and therefore does not comport with the requirement of clear, unequivocal, and specific exclusionary terms. STP Pet.7-8. STP's argument mischaracterizes the peril at issue. A machinery breakdown will *always* be traced back to some root cause. Under STP's interpretation, the MBE would never apply because the exclusion of the machinery breakdown event does not specify which causes are at issue. This interpretation renders the MBE meaningless and is wholly inconsistent with the parties' expressed expectations and understanding that the Policy would not insure the TBM if it sustained a machinery breakdown.[2]

[2] Division I properly rejected STP's argument that the MBE circumvents the efficient proximate cause rule, as stated in *Xia v. ProBuilders Specialty Insurance Company*, 188 Wn.2d 171, 182-83, 400 P.3d 1234 (2017), *as modified* (Aug. 16, 2017). The efficient proximate cause rule applies *only* when a covered peril is the efficient proximate cause. The TBM failed due to an

STP's position also conflicts with Washington law, which dictates that an "insured may not avoid a contractual exclusion merely by affixing an additional label or separate characterization" of the causative event at issue. *See Kish v. Ins. Co. of N. Am.*, 125 Wn.2d 164, 170, 883 P.2d 308 (1994) (holding that rain is not a separate and distinct peril from flood and fell within scope of policy exclusion for losses resulting from water damage, notwithstanding that exclusion did not expressly state "rain" was an excluded peril); *Eide v. State Farm Fire & Cas. Co.*, 79 Wn. App. 346, 351, 353, 901 P.2d 1980 (1995) (holding exclusions for perils of earth movement and groundwater encompassed damage from a landslide caused by heavy rain because "weakened soil" is an indistinct peril from "earth movement" and "the ordinary consumer understands that water below the surface of the ground has a source and the source

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internal defect—which is not a covered peril—and the exclusion applies without the need for an efficient proximate cause analysis.

is typically rain"); *Capelouto v. Valley Forge Ins. Co.*, 98 Wn. App. 7, 15-16, 990 P.2d 414 (1999) (rejecting insured's characterization of the cause of damage from a sewage backup as inadequate equipment used for a sewer bypass system and not a defective design of the sewer system and holding damage was excluded by policy's exclusion for faulty, inadequate, or defective design, specifications, workmanship, repair, and construction of property). The MBE specifically excludes loss or damage to the TBM "*by its own* . . . mechanical . . . breakdown," thereby excluding a type of damage: mechanical breakdown. To construe a breakdown as a peril distinct from the design defect that causes the breakdown disregards the fact that every machinery breakdown has a source and that source is typically attributed to some type of defect. Insurers are not obligated to identify every way a machine can sustain machinery breakdown damage for the exclusion to be effective.

STP's contrived allegation that Division I "fashioned an exclusion where none existed," and thereby contradicted the

principle that courts cannot rewrite the parties' contract, also does not establish a conflict with Washington law. STP Pet. at 9-10. Division I's ruling does not rewrite the MBE, it correctly interprets the clear and unequivocal language of the MBE, as is the court's province. *See Quadrant Corp. v. American States Ins. Co.*, 118 Wn. App. 525, 529, 76 P.3d 773 (2003), *aff'd*, 154 Wn.2d 165, 110 P.3d 733 (2005) (stating the "policy should be given practical and reasonable interpretation rather than strained or forced construction that leads to an absurd conclusion, or that renders the policy nonsensical or ineffective"); *Wilson Court Ltd. P'ship v. Tony Maroni's, Inc.*, 134 Wn.2d 692, 705, 952 P.2d 590 (1998) (requiring contracts to be interpreted in a commercially reasonable fashion); *American States Ins. Co. v. Delean's Tile & Marble*, LLC, 179 Wn. App. 27, 35, 319 P.3d 38 (2013) (stating that court may not rewrite a contract that the parties negotiated). Indeed, Division I concluded that "the MBE *as written* excludes coverage for damage from design defects."

Op. at 13 (emphasis added). This interpretation of the MBE provision was proper.

As Division I correctly recognized, machinery breakdown and design defect are not distinct perils, because an inherent or internal defect constitutes a machinery breakdown. *See* Op. at 14-17. Accordingly, the clear and unequivocal meaning of the MBE encompasses and excludes mechanical breakdowns caused by design defect, notwithstanding that the phrase "design defect" is not listed in the MBE.

STP asserts that Division I "failed to attach significance" to the fact that Section 1 of the Policy, which insures the tunneling works, excludes losses resulting from "defects of material workmanship design plan or specification." STP Pet. at 9. In fact, Division I properly rejected this flawed argument. STP ignores the fact that Section 1 and Section 2 are independent coverage sections that insure different risks. The language of each section must be read in the context of the risk it insures.

Section 1 insures the "Project Works," (i.e., the tunnel). The Section 1 exclusion STP cites bars coverage for repair or remediation of design defects in the tunnel because Insurers did not intend to cover the risk of remediating or repairing such defects of material workmanship, design plan, or specification in the tunnel works. Tunnels do not sustain mechanical breakdowns, so there was no need to include a machinery breakdown exclusion in Section 1. In contrast, Section 2 insures the TBM but excludes coverage for mechanical breakdown of the TBM. When a defectively designed TBM fails "*by its own* . . . breakdown," that loss is plainly excluded. As Division I correctly observed, because the MBE "as written excludes coverage for damage from design defects," a Section 2 design defect exclusion "would be superfluous with the MBE[.]" Op. at 13. Adding an exclusion for "design defects" would be redundant and unnecessary because the MBE in Section 2 obviates the need for a separate design defect exclusion.

STP further argues that Division I erred because it reached its decision based on STP's "secondary argument" (that the MBE applies only to internal causes and a design defect is an external cause) rather than its "principal argument" (that the MBE does not apply to design defects because the words "design defect" do not appear in the exclusionary language). STP Pet. 11-12. Division I neither "misapprehended" nor "overlooked" STP's flawed "principal argument." Rather, Division I held that the language of the MBE "as written excludes coverage for damage from design defects," notwithstanding the absence of the explicit phrase "design defect" *and* that the MBE precludes coverage for loss due to internal causes of damage such as design defects. Op. at 13, 16. In other words, Division I concluded that *both* of STP's flawed arguments fail under applicable Washington law, as informed by the analyses of courts in other jurisdictions concerning similar issues and policy language. STP's disagreement with Division I's decision does not demonstrate that Division I's decision conflicts with Washington law.

2. Division I correctly held that design defect is an internal cause of damage excluded by the MBE.

STP argues that Division I erred by ruling that a design error is an internal peril excluded by the MBE. Division I reasoned that "a product's design is something inherent to it and inseparable from it" and, because the parties agreed that this MBE prevents recovery for internal causes, the exclusion encompasses and excludes loss or damage caused by a defect in design.[3] In reaching this conclusion, Division I properly considered cases from other jurisdictions for guidance on the issue of whether a design defect is an internal or an external cause of damage. Op. at 15-16.

Although the general interpretive principles in the cases cited by STP—which Division I *also* relied upon—control the court's analysis, Washington caselaw does not address the

[3] Division I observed that the parties agreed that the MBE is limited to internal causes of damage, and STP does not challenge this aspect of the court's order (STP Pet. at 12).

specific language at issue here. Indeed, STP identifies *no* Washington cases interpreting a similar exclusion or the phrase "machinery breakdown" in the context of a design defect. Lacking controlling Washington caselaw on the precise issue, Division I properly turned to other jurisdictions for guidance. *See State v. Chenowith*, 160 Wn.2d 454, 470-71, 158 P.3d 595, (2007) (observing that Washington appellate courts "may consider well-reasoned precedents from federal courts and sister jurisdictions" that, although "not binding on this court," may provide "persuasive authority").

STP fails to distinguish the cases on which Division I relied. STP Pet. 14-15. *GTE Corporation v. Allendale Mutual Insurance Company*, 372 F.3d 598 (3d Cir. 2004) and *Acme Galvanizing Co. v. Fireman's Fund Insurance Company*, 270 Cal. Rptr. 405 (Cal. App. 1990) are instructive because they explain the difference between loss by an internal or inherent defect and damage to an insured machine from an external cause. Division I relied on the *GTE* decision, not because the case

involved an identical exclusion, but because the case discusses the distinction between external threats and design defects, which are inherent vices. Op. at 15 (quoting *GTE*, 372 F.3d at 609-13). Similarly, in *Acme Galvanizing*, *supra*, the court held that when defective design results in the property's failure before the end of its normal life, and the defect is not apparent upon reasonable inspection but only after a post-failure examination by an expert, the loss is caused by a latent defect. As Division I recognized, the term "latent defect" is synonymous and interchangeable with "inherent defect" and internal cause. Op. at 16 n.12 (citing 11 Steven Plitt et al., COUCH ON INSURANCE § 153:77 (3d ed. & Supp. 2020); *Connie's Const. Co., Inc. v. Cont'l W. Ins. Co.*, 227 N.W.2d 204, 207 (Iowa 1975) ("'Latent defect' also presupposes that the loss was caused by an internal defect in the machine."); *Caldwell v. Transportation Ins. Co.*, 364 S.E.2d 1, 3 (Va. 1988) ("[W]e hold that the effect of its exclusion of losses caused by structural or mechanical breakdown or failure

is restricted to losses arising from internal or inherent deficiency or defect, rather than from any external cause.")).

Applying the logic of *GTE* and *Acme Galvanizing*, as Division I properly did, if the TBM broke down because of a design defect, that defect is an internal or inherent cause and the loss falls within the Policy's MBE. The very language of the MBE contemplates that internal and inherent defects are subsumed in the exclusion ("Loss of or Damage in respect any item *by its own* explosion mechanical or electrical breakdown, failure breakage or derangement." (emphasis added)). Division I properly determined that the MBE excludes machinery breakdown arising out of an internal or inherent defect.

STP also fails to demonstrate that Division I incorrectly rejected application of two out-of-state cases that Division I had previously cited with approval—for a totally different proposition. STP Br. at 13 (citing *Frank Coluccio Const. Co., Inc. v. King Cnty.*, 136 Wn. App. 751, 150 P.3d 1147 (2007)). In fact, Division I cited *N-Ren Corporation. v. American Home*

Assurance Company, 619 F.2d 784 (8th Cir. 1980) and *Standard Structural Steel Company v. Bethlehem Steel Corporation*, 597 F. Supp. 164 (D. Conn. 1984) in *Frank Coluccio* for the proposition that "not every all risk builder's risk insurance policy contains a 'faulty workmanship' exclusion." 136 Wn. App. at 774. This is not at issue here. STP offers no explanation why Division I's analysis of these decisions in the instant case is inconsistent with its citation of them for a totally different proposition in *Frank Coluccio Construction Co.*

Division I properly rejected application of *N-Ren* and *Standard Structural Steel* here. In *N-Ren*, the court did not address a machinery breakdown exclusion or the language "by its own."[4] 619 F.2d at 788. Rather, the policy at issue specifically insured loss or damage "from any external cause" and excluded "errors in design," but insured ensuing collapse. *Id.* at 785. The

[4] Significantly, STP seeks to distinguish *Acme Galvanizing* because it did not involve the policy language "by its own" that is before this Court.

N-Ren court held that the policy responded to an ensuing collapse from a design error. *Id.* at 788. In contrast, here, the Policy's wording "by its own" contemplates that internal and inherent defects are subsumed in the exclusion, as Division I recognized. Op. at 16 n.13.

Similarly, Division I properly distinguished aspects of *Standard Structural Steel*, 597 F. Supp. 164. In *Standard Structural Steel*, a contractor's equipment policy excluded mechanical breakdown. The "design defect" at issue was the insureds' failure to follow engineering specifications for an object they constructed. *Id.* at 194-95. The defect, therefore, was in the construction of the object, rather than the object's design, as is the case here. *Id.* at 195 ("The causative agent of damage resulting from this design defect did not emanate from an inherent vice within the property itself, but from without. It came from negligently failing to follow the engineering specifications."). Here, Insurers contend that the TBM broke down because it was not designed to handle the expected loads.

This is a design flaw inherent in the TBM itself.[5] Division I's analysis of *N-Ren* and *Standard Structural Steel* is neither inconsistent with Washington law nor involves an issue of substantial public interest. Op. at 16 n.13.

STP acknowledges that the manifestation of a design defect may be internal to the TBM but argues that *this* defect is *external* because it was caused by an architect, engineer, or other designer at a time prior to construction. STP Pet. at 13. As addressed *supra* III.A.1., this flawed argument misconstrues the peril, because an inherent or internal defect in the TBM is indistinct from the machinery breakdown. Indeed, STP misplaces its reliance on *Standard Structural Steel* for this proposition. STP Pet. at 13-14. As Division I correctly observed,

[5] Indeed, the *Standard Structural Steel* court also recognized that a functional defect in the moving parts of a machine—as occurred here—could constitute a mechanical breakdown, but because the failure at issue in *Standard Structural Steel* was not a functional defect, no mechanical breakdown occurred. *Id.* at 197 (citing *Connie's Constr.*, 227 N.W.2d at 207).

the *Standard Structural Steel* court stated that "[a] cause is external if damage which arises from it does not result wholly 'from an inherent defect in the subject matter or from the inherent deficient qualities, nature and properties of the subject matter.'" 597 F. Supp. at 193 (quoting *Compagnie des Bauxites de Guinee v. Insurance Co. of N. Am.*, 566 F. Supp. 258, 261 (W.D. Pa. 1983)). Op. at 16 n.13. This is precisely the distinction Division I identified between an external and internal defect. Op. at 15-16. Hitachi's design defect is a deficiency in the mechanical function of the machine, a condition that is inherent to the TBM and is thus excluded as an internal cause of harm.

STP's assertion that Division I erroneously interpreted the phrase "by its own" in the Respondents' favor and thereby violated the rule requiring construction of ambiguous policy language against the insurers, is not properly before this Court. STP Pet. at 15-16. No party argued to the trial court that the exclusion is ambiguous. Indeed, STP argued in support of its affirmative motion for summary judgment to the trial court that

the Policy is *not* ambiguous. *See, e.g.*, CP 1389-90. STP's attempt to avoid application of the exclusion based on an unsupported and newly raised ambiguity claim should be disregarded.

STP has not established that review is warranted under RAP13.4(b). STP also fails to demonstrate that Division I erred in ruling that the MBE excludes coverage for design defects.

B. Division I Correctly Relied on Well-Settled Washington Law Finding That Physical Loss or Damage Is A Pre-Requisite to Coverage Under A Builder's Risk Property Policy.

Division I correctly upheld the trial court's ruling that Section 1 of the Policy does not provide coverage for (1) an inability to use the tunnel while the TBM was being repaired, or (2) damage to the tunnel envelope resulting from construction of an access shaft to retrieve the TBM.

The Policy specifically states that Insurers "will indemnify the Insured in respect of "*direct physical loss, damage or destruction* not specifically excluded herein . . . happening to the

Interest Insured." (emphasis added). It is undisputed that the "Interest Insured" under Section 1 is the tunnel. Division I correctly noted that the plain language of the Policy does not provide coverage for the loss of use of the tunnel. Op. at 22. Moreover, Division I correctly relied on well-established Washington case law and rejected WSDOT's assertion that loss of use of the tunnel is a type of "physical loss, damage or destruction." *See Prudential Prop. & Cas. Ins. Co. v. Lawrence*, 45 Wn. App. 111, 45 P.2d 418 (1986); *Guelich v. American Prot. Ins. Co.*, 54 Wn. App. 117, 772 P.2d 536 (1989).

WSDOT's criticisms of Division I's reliance on these two cases are baseless. First, WSDOT argues that the cited opinions are not binding on this Court because they were issued by intermediate courts. Yet WSDOT urges the Court to instead follow an unreported decision and out-of-state opinions that purportedly support its position. Second, the cited cases support Division I's ruling and are consistent with well-established Washington law.

The courts in both *Prudential Property* and *Guelich* analyzed the meaning of the phrase "property damage." In both cases, the courts noted that the policies defined "property damage" as "*physical injury* to tangible property." *Prudential Prop.*, 724 Wn. App. at 115; *Guelich*, 54 Wn. App. at 118, 120. Focusing on the word "*physical*," both courts held that the policies were unambiguous and explicitly required physical damage. *Id.* WSDOT attempts to differentiate the instant case from *Prudential* and *Guelich* by arguing that the policy in those cases did not promise coverage for "physical *loss*, damage or destruction." WSDOT's focus on the word "loss" is a distinction without a difference. Washington courts have held that direct physical loss or damage to property requires "actual" or "discernible" physical damage to insured property. The following cases illustrate this point:

- *Wolstein v. Yorkshire Ins. Co.*, 97 Wn. App. 201, 985 P.2d 400 (1999): An insurer issued a builder's risk policy that covered all risks of "physical loss of or damage to" the

yacht that was to be constructed. *Id.* at 203-04. After the yacht's builder "shut its doors," delaying production of the yacht, the buyer submitted an insurance claim under the builder's risk policy. *Id*. at 204-05. Division I held there was no coverage, explaining that "the insured object must sustain actual damage or be physically lost to invoke . . . coverage" and that the builder's "financial difficulties, while prolonging completion of the [yacht] and increasing the costs of her completion, did not inflict *physical damage* to the [yacht] or result in the *physical loss* of the yacht." *Id.* at 212 (emphasis added). In short, the court held that inability to use the insured property (the yacht) due to production delays did not constitute "direct physical loss of or damage to" that property. *Id.*

- *Fujii v. State Farm Fire & Cas. Co.*, 71 Wn. App. 248, 857 P.2d 1051 (1993), *review denied*, 123 Wn.2d 1009 (1994): A landslide occurred above plaintiffs' property, causing soil instability around their home. *Id.* at 249. Plaintiffs

argued that their homeowners' policy should provide coverage "because the landslide undermined the lateral support of the covered dwelling, and the loss of lateral support constituted a direct physical loss to the dwelling." *Id.* Interpreting similar policy language, Division I found no coverage because it was "undisputed that there was no discernible physical damage to the dwelling" even though plaintiffs would have to pay to re-stabilize the property, and "[u]nder the plain terms of the policy," coverage is triggered only "by direct physical loss to the dwelling." *Id.* at 250-51.

- *Villella v. Public Emps. Mut. Ins. Co.*, 106 Wn.2d. 806, 725 P.2d 957 (1986): This Court held that wet and destabilized soil under a house did not constitute "physical damage" to the house as required by the policy. *Id.* at 811-12. Although the wet soil *later* caused physical damage, there was no coverage because the damage did not occur during the policy period. *Id.*

- *Vision One, supra*: This Court rejected the insured's argument that financial losses resulting from a floor collapse (defined as "soft costs" under the policy) could be considered "physical" loss or damage. 174 Wn.2d at 522-53. The Court found that, although the policy was an all-risk policy, coverage extended only to "physical" losses to covered property and therefore did not cover alleged financial losses. *Id.* at 523.

The above authority makes clear that Washington law has long required some physical alteration to property to trigger insurance coverage when the policy, like the Policy here, requires "direct physical loss, damage or destruction to" property.[6]

[6] These Washington cases are consistent with numerous cases nationwide holding that property insurance policies do not cover purely economic losses caused by a loss of use of property that has not been physically lost or damaged. *See, e.g., Pentair, Inc. v. American Guarantee & Liab. Ins. Co.*, 400 F.3d 613, 616 (8th Cir. 2005) (rejecting argument that "mere loss of use or function of property constitutes 'direct physical loss or damage'" without demonstrable physical damage); *Roundabout Theatre Co. v. Cont'l Cas. Co.*, 751 N.Y.S.2d 4, 8 (N.Y. App. 2002) (rejecting insured's argument that loss of use of theater

WSDOT also cites decisions in the COVID-19 context that address a policy requirement of direct physical loss or damage.[7] Surprisingly, however, WSDOT overlooks recent Washington state case law on this very issue. In *Hill and Stout*

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constituted "direct physical loss" of insured property); *Northeast Georgia Heart Ctr., P.C. v. Phoenix Ins. Co.*, No. 2:12-cv-00245, 2014 WL 12480022, at *6 (N.D. Ga. May 23, 2014) ("The court will not expand 'direct physical loss' to include loss-of-use damages when the property has not been physically impacted in some way. To do so would be equivalent to erasing the words 'direct' and 'physical' from the policy").

[7] WSDOT's arguments premised on COVID-19 insurance coverage litigation are unpersuasive for the obvious reason that this case does not present *any* issue related to COVID-19 losses. Insurance coverage disputes concerning claims for losses allegedly due to COVID-19 are being litigated in state and federal trial courts and undoubtedly will be subject to appellate review. Many of these cases turn on the question of whether the presence of COVID-19 on or at an insured property causes physical loss of or damage to the property. The instant case, however, is fundamentally distinct in that it does not involve any COVID-19 claims and—significantly—does not present the issue of whether COVID-19 causes physical loss of or damage to property. Here, WSDOT does not point to *any* force or substance that impacted the tunnel physically. It simply alleges that it temporarily lost the ability to use the tunnel. Under Washington law, this temporary loss of use does not constitute an insured physical loss.

PLLC v. Mutual of Enumclaw Ins. Co., No. 20-2-07924-1 SEA, 2021 WL 4189778, at *3 (Wash. Super. Sept. 9, 2021), the King County Superior Court ruled that the phrase "direct physical loss or damage" unambiguously requires "some external physical force that causes direct physical change to the properties" and rejected the insured's argument that a physical deprivation of its property satisfies this requirement.[8]

Hill and Stout aligns with decisions by Washington federal courts. For example, in *Nguyen v. Travelers Casualty Insurance Company of America*, Judge Barbara Rothstein recently dismissed dozens of COVID-19 insurance coverage complaints under Washington law, noting the "overwhelming consensus" among the courts that "COVID-19 does not cause the physical loss or damage to property required as a condition precedent to

[8] In reaching this decision, the court specifically rejected the deprivation of property argument, which was asserted in *Perry Street Brewing Company LLC v. Mutual of Enumclaw Ins.*, No. 20-2-02212-32, 2020 WL 7258116 (Wash. Super. Ct. Nov. 23, 2020) and *Snoqualmie Entertainment Authority v. Affiliated FM Ins. Co.*, No. 21-2-03194-0 (Wash. Super. Ct. Sept. 2, 2021).

trigger coverage." 2021 WL 2184878, at *1 (W.D. Wash. May 28, 2021), *reconsideration denied sub nom. Vita Coffee LLC v. Fireman's Fund Ins. Co.*, 2021 WL 3077922 (W.D. Wash. July 21, 2021). Judge Rothstein's well-reasoned decision is consistent with long-standing Washington precedent holding that insurance policies requiring physical loss of or damage to property are triggered only upon a showing of discernable "physical alteration" of covered property.

WSDOT cites *Kingray Ins. v. Farmers Group Inc.*, 523 F. Supp. 3d 1163 (C.D. Cal. 2021), in which the trial court denied an insurer's motion to dismiss. This case, however, has no precedential or persuasive value because the Ninth Circuit effectively overruled it earlier this year, finding that the phrase "physical loss of or damage to" requires an insured to allege physical alteration of the property. Specifically, the Ninth Circuit observed in *Mudpie, Inc. v. Travelers Cas. Ins. Co. of America*, 15 F.4th 885, 892 (9th Cir. 2021), that "California courts have carefully distinguished 'intangible,' 'incorporeal,' and

'economic' losses from 'physical' ones." In distinguishing "intangible," "incorporeal," and "economic" losses from "physical" losses, the Ninth Circuit rejected the argument that "direct physical loss of or damage to" is synonymous with "loss of use." *Id.* at 892. Moreover, as in *Mudpie,* WSDOT's complaint does not identify a distinct, physical alteration of the property in question (i.e., the tunnel)—because there was none.

The Ninth Circuit in *Mudpie* also distinguished *Hughes v. Potomac Ins. Co. of the District of Columbia*, 18 Cal. Rptr. 650 (Cal. App. 1962), which WSDOT also relies on. The *Mudpie* court first observed that the court in *Hughes* did not interpret a "direct physical loss" provision; rather, the court addressed whether the policy's definition of "dwelling" included the ground underneath a home in addition to the structure itself. *Mudpie,* 15 F.4th at 891. Second, the *Mudpie* court observed

> *Hughes* did not imply that an insured need not show any physical change to the insured property to prove 'direct physical loss.' To the contrary, the court in

> *Hughes* concluded that the home sustained 'real and severe damage when the soil beneath it slid away and left it overhanging a 30-foot cliff' and deemed the home uninhabitable.

Id. at 891. In this case, unlike the insured property in *Hughes*, the tunnel itself did not sustain any actual damage.

WSDOT also cites *Studio 417, Inc. v. Cincinnati Insurance Company*, 478 F. Supp. 3d 784 (W.D. Mo. 2020) and *Elegant Massage, LLC v. State Farm Mutual Automobile Insurance Company*, 506 F. Supp. 3d 360 (E.D. Va. 2020), to support its position that property that is rendered "unusable for its intended purpose" satisfies the physical loss and physical damage prerequisites. Numerous courts, however, have since rejected the holdings in these two outlier cases. In fact, in almost 600 cases across the country addressing this issue in the COVID-19 context, courts have agreed that direct physical loss or damage unambiguously requires a tangible alteration to property.

Lastly, WSDOT relies on several out-of-state cases to support its position that loss of use equates to physical loss or damage. However, all of these cases involve a change in the

actual physical condition of the premises that rendered the premises completely uninhabitable, which equated to a direct physical loss or physical damage. *See Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am.*, No. 2:12-cv-04418, 2014 WL 6675934, at *3, 6 (D.N.J. Nov. 25, 2014) (finding direct physical loss of or damage when discharged ammonia rendered the property "unfit for normal human occupancy and continued use," caused evacuation across a one-mile radius, and "physically transformed the air within [the] facility so that it contained an unsafe amount of ammonia or that the heightened ammonia levels rendered the facility unfit for occupancy until the ammonia could be dissipated."); *Port Auth. of New York & New Jersey v. Affiliated FM Ins. Co.*, 311 F.3d 226, 236 (3d Cir. 2002) (finding physical loss or damage where the presence of asbestos rendered the property "useless or uninhabitable," but noting that "[t]he mere presence of asbestos, or general threat of future damage from that presence, lacks the distinct and demonstrable character necessary for first-party insurance coverage."); *American*

Guarantee & Liab. Ins. Co. v. Ingram Micro, Inc., No. 99-185 TUC ACM, 2000 WL 726789, at *1-3 (D. Ariz. April 18, 2000) (finding direct physical loss or damage to insured computer systems that, as a result of a power outage, were rendered inoperable, and the computer system and world-wide computer network "physically lost the programming information and custom configurations necessary for them to function" during the outage.); *Western Fire Ins. Co. v. First Presbyterian Church*, 437 P.2d 52, 55 (Colo. 1968) ("This particular 'loss of use' was simply the consequential result of the fact that because of the accumulation of gasoline around and under the church building the premises became so infiltrated and saturated as to be uninhabitable, making further use of the building highly dangerous. All of which we hold equates to a direct physical loss…"); *Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co.*, 968 A.2d 724, 734 (N.J. App. 2009) (holding that a power grid was "physically damaged" during a blackout because, "due to a physical incident or series of incidents, the grid and its

component generators and transmission lines were physically incapable of performing their essential function of providing electricity.").[9]

Division I correctly determined that the record showed no costs arising from any claimed damage to the tunnel or tunnel envelope, which is necessary to trigger coverage under Section 1 of the Policy. Op. at 24-26. None of WSDOT's cited cases conflict with this decision.

[9] WSDOT also cites two Minnesota appellate court cases, which are also unavailing. First, in *General Mills, Inc. v. Gold Medal Insurance Company*, 622 N.W.2d 147, 150 (Minn. App. 2001), the insured property (i.e., cereal products) was contaminated with a pesticide not approved by the government and therefore could not be sold. The court determined that this was "sufficient to support a finding of physical damage." *Id.* at 152. Second, in *Sentinel Management Co. v. New Hampshire Ins. Co.,* 563 N.W. 2d 296, 298 (Minn. App. 1997), the insured building contained asbestos. The court held that the asbestos constituted direct physical loss or damage. *Id.* at 300. Unlike these two cases, where the condition of the physical property constituted physical loss or damage, here *only* the TBM, which is covered under Section 2, sustained damage; the tunnel itself, covered under Section 1, did not sustain *any* damage.

IV. CONCLUSION

For the reasons set forth above, Division I did not err in ruling that the MBE excludes damage from a breakdown caused by design defect and that the mere inability to use the tunnel does not constitute physical loss or damage under the Policy at issue. Moreover, neither STP nor WSDOT have satisfied the threshold burden that review is warranted in the first instance. Accordingly, STP and WSDOT's petitions for review should be denied.

This document contains 7,005 words, excluding the parts of the document exempted from the word count by RAP 18.17.

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Respectfully submitted,

/s/ Philip A. Talmadge
Philip A. Talmadge, WSBA #6973
Talmadge/Fitzpatrick
2775 Harbor Avenue SW

Third Floor, Suite C
Seattle, WA 98126
(206) 574-6661

Matthew L. Gonzalez
Daniel Millea
(admitted *pro hac vice*)
Zelle LLP
45 Broadway, Suite 920
New York, NY 10006
(646) 876-4400

Attorneys for Respondents

DECLARATION OF SERVICE

On said day below I electronically served a true and accurate copy of the ***Insurers Response to STP WSDOT Petition for Review*** in Supreme Court Cause No. 100168-1:

Counsel for Seattle Tunnel Partners
Dale L. Kingman (dkingman@gordontilden.com)
Matthew F. Pierce (mpierce@gordontilden.com)
Gregory D. Pendleton (gpendleton@gordontilden.com)
John D. Cadagan (jcadagan@gordontilden.com)
Guin Becker Bogusz (gbogusz@gordontilden.com)
Gordon Tilden Thomas & Cordell
One Union Square
600 University Street, Suite 2915
Seattle, WA 98101

Haley K. Krug (hkk@aswblaw.com)
Anderson Schwartzman Woodard Brailsford
101 S. Capitol Blvd., Suite 1600
Boise, ID 83702

Leonard J. Feldman (feldman@pwrfl-law.com)
Peterson Wampold Rosato Feldman Luna
1001 Fourth Avenue, Suite 4131
Seattle, WA 98154

Pro Hac Vice for Seattle Tunnel Partners
Joseph L Luciana III (jluciana@dfllegal.com)
Samantha Brutout (sbrutout@dfllegal.com)
Dingess, Foster, Luciana, Davidson & Chleboski, LLP
PNC Center, Third Floor
20 Stanwix Street
Pittsburgh, PA 15222

Co-Counsel for Insurers Respondents
Michael McCormack (michael.mccormack@bullivant.com)
Bullivant Houser Bailey PC
1700 Seventh Avenue, Suite 1810
Seattle, WA 98101-1397

Pro Hac Vice for Defendants Insurers
Matthew Gonzalez (mgonzalez@zelle.com)
Dan Millea (dmillea@zelle.com)
Zelle LLP
45 Broadway, Suite 720
New York, NY 10006

Counsel for WSDOT
David R. Goodnight (david.goodnight@stoel.com)
Karl F. Oles (karl.oles@stoel.com)
Bart W. Reed (bart.reed@stoel.com)
Rachel Dunnington Groshong (rachel.groshong@stoel.com)
Jill Bowman (jill.bowman@stoel.com)
Stoel Rives, LLP
600 University Street, Suite 3600
Seattle, WA 98101

Guy W. Bowman (GuyB1@atg.wa.gov)
Assistant Attorney General
Transportation and Public Construction Division
7141 Cleanwater Drive SW
Olympia, WA 98504-0113

Counsel for Hitachi Zosen U.S.A. Ltd.
Richard O. Prentke (rprentke@perkinscoie.com)
V. L. Woolston (vwoolston@perkinscoie.com)
Nicholas P. Gellert (ngellert@perkinscoie.com)
Perkins Coie, LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099

Pro Hac Vice for Hitachi Zosen U.S.A. Ltd.
Vivek Chopra (vchpora@perkinscoie.com)
Perkins Coie LLP
700 Thirteenth Street NW, Suite 600
Washington, D.C. 20005-3960

Lester O. Brown (lbrown@perkinscoie.com)
Perkins Coie LLP
3150 Porter Drive
Palo Alto, CA 94304-1212

Counsel for Potential Amicus Party Vulcan
Jessica Bucher (JenniferB@vulcan.com)
Vulcan, Inc.
505 Fifth Avenue S, Suite 900
Seattle, WA 98104

Original e-filed with:
Supreme Court Clerk's Office

I declare under penalty of perjury under the laws of the State of Washington and the United States that the foregoing is true and correct.

DATED: November 15, 2021, at Seattle, Washington.

/s/ Will Cummins
Will Cummins, Legal Assistant
Talmadge/Fitzpatrick

TALMADGE/FITZPATRICK

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- mbludorn@gordontilden.com
- mgonzalez@zelle.com
- michael.mccormack@bullivant.com
- mpierce@gordontilden.com
- nancy.masterson@stoel.com
- ngellert@perkinscoie.com

- rachel.groshong@stoel.com
- rprentke@perkinscoie.com
- vchopra@perkinscoie.com
- vwoolston@perkinscoie.com
- will@tal-fitzlaw.com

Comments:

Sender Name: Will Cummins - Email: will@tal-fitzlaw.com
Filing on Behalf of: Philip Albert Talmadge - Email: phil@tal-fitzlaw.com (Alternate Email: matt@tal-fitzlaw.com)

Address:
2775 Harbor Avenue SW
Third Floor Ste C
Seattle, WA, 98126
Phone: (206) 574-6661

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