98434-4
No. 79490-6-I

DIVISION I, COURT OF APPEALS
OF THE STATE OF WASHINGTON

UNITED STATES FIDELITY AND GUARANTY COMPANY,

Petitioner,

v.

ROBERT T. ULBRICHT, ET. AL.,

Respondents.

PROPOSED BRIEF OF *AMICUS CURIAE* COMPLEX INSURANCE CLAIMS LITIGATION ASSOCIATION IN SUPPORT OF UNITED STATES FIDELITY AND GUARANTY COMPANY'S PETITION FOR REVIEW

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INTEREST OF AMICUS CURIAE

The Complex Insurance Claims Litigation Association ("CICLA") is a trade association of major property and casualty insurance companies.1 CICLA seeks to assist courts addressing important coverage issues that are of great consequence to insurers, policyholders, and the public, such as the enforcement and determination of the reasonableness of covenant judgments under Washington law here. CICLA's members regularly issue insurance policies within the state of Washington, and many of their policyholders have or will have entered settlements with covenants not to execute. CICLA is thus vitally interested in this case.

STATEMENT OF THE CASE

CICLA incorporates by reference, as if fully set forth herein, Section IV, "Statement of the Case," of United States Fidelity and Guaranty Company's ("USF&G") Petition for Review.

[1] This amicus curiae brief and accompanying motion are filed on behalf of CICLA, which is an incorporated trade association, not its individual members.

SUMMARY OF ARGUMENT

Review of this case is warranted to reconcile conflicting case law, R.A.P. 13.4(b)(1) and (2), and to resolve an issue of substantial public importance, R.A.P. 13.4(b)(4).[2]

First, the Court of Appeals applied an erroneous legal standard which warrants this Court's review. Prior decisions by both this Court and the Court of Appeals make clear that determining whether a covenant judgment is reasonable is an assessment of the underlying claimant's damages against the policyholder, and for that reason focuses on the merits and litigation risks *of the claim being settled.* The merits and risks of pursuing a later bad-faith claim against the settling tortfeasor's insurer has no bearing on the reasonableness settlement value of the underlying claim, and no Washington authority (or any other court to our knowledge) has so held, until now. Here, the Court of Appeals nonetheless held that determining reasonableness may include consideration of the risks and costs to the settling claimant of pursuing a future bad-faith claim. *CBS Corp. v. Ulbricht*, 12 Wash. App.2d 1013 (2020).

[2] The question for review, as articulated by USF&G, is: "Whether it is proper for the trial court to contemplate the costs and risks involved in future insurance coverage litigation when evaluating the reasonableness of the proposed covenant judgment."

Second, this Court should grant review for the independent reason that the Court of Appeals' ruling involves an issue of substantial public importance. The expansion of the reasonableness test contravenes a substantial public policy interest because it effectively would permit a double-recovery for policyholders. The ruling permits the trial court to approve higher settlement amounts that include the "risk" of future coverage litigation pursued by assignees against the insurer. In addition, in later bad-faith litigation against the insurer, the plaintiff-assignee may seek recovery of attorneys' fees for the *entire* consent judgment. Because fee recovery is provided for in later insurance litigation, including future collection costs as "presumed damages" in a covenant judgment leads to a double recovery.

ARGUMENT

I. THE COURT SHOULD ACCEPT REVIEW TO RESOLVE AN IRRECONCILABLE CONFLICT WITH EXISTING AUTHORITY AND TO CORRECT THE ERRONEOUS LEGAL STANDARD APPLIED BY THE COURT OF APPEALS IN DETERMINING THE REASONABLENESS OF A COVENANT JUDGMENT UNDER WASHINGTON LAW.

Review is necessary because the legal standard applied by the Court of Appeals for determining the reasonableness of a covenant judgment under Washington law conflicts with prior rulings of both this Court and of the Court of Appeals. As the ultimate arbiter of Washington

law, this Court's review is necessary to provide guidance to courts applying Washington law, as well as to insurers and policyholders.

By holding that a covenant judgment can reasonably include amounts that reflect the risks *of pursuing a future bad-faith claim against the insurer*, the ruling below contradicts and undermines all prior rulings of this Court and the Court of Appeals on this issue. *E.g.*, *Bird v. Best Plumbing Group*, 175 Wash.2d 756, 298 P.3d 551 (2012); *Besel v. Viking Ins. Co.*, 146 Wash.2d 730, 736, 49 P.3d 887 (2002); *Chaussee v. Maryland Cas. Co.*, 60 Wash. App. 504, 803 P.2d 1339 (1991); *Hamblin v. Garcia*, 9 Wash. App.2d 78, 441 P.3d 1283 (2019).

Under these precedents, the reasonableness of a covenant judgment, like other settlements governed by RCW 4.22.60, assesses the claimant's *damages* against the policyholder.[3] As this Court has explained, if the amount of the covenant judgment is deemed reasonable

[3] Under RCW 4.22.060 and Washington law, "an insured defendant may independently negotiate a pretrial settlement if the defendant's liability insurer refuses in bad faith to settle the plaintiff's claims." *Bird*, 175 Wash.2d at 764 (citing *Besel*, 146 Wash.2d at 736). This type of settlement agreement is also known as a "covenant judgment," and consists of "three features: (1) a stipulated or consent judgment between the plaintiff and insured, (2) a plaintiff's covenant not to execute on that judgment against the insured, and (3) an assignment to the plaintiff of the insured's coverage and bad faith claims against the insurer." *Id.* at 736-38.

by the trial court, "it becomes the presumptive *measure of damages* in a later bad faith action against the insurer." *Bird*, 175 Wash.2d at 765. [4] This is because under Washington law, damages for insurance bad faith are "the amount of a judgment rendered against the insured." *Besel*, 146 Wash.2d at 736. This extends to settlements, which may be recovered so long as they are "reasonable and in good faith." *Id.* A covenant judgment settlement is an agreement by the claimant to seek recovery *for their insured's wrongdoing* from the proceeds of an insurance policy. *Bird*, 175 Wash.2d at 765.

This Court has made clear that the reasonableness of a covenant judgment is based on consideration of nine factors:

- The [underlying claimant's] damages;
- The merits of the [underlying claimant's] liability theory;
- The merits of the [insured tortfeasor's] relative faults;
- The risks and expenses of continued litigation [between the settling parties];
- The [insured tortfeasor's] ability to pay;
- Any evidence of bad faith, collusion or fraud [between the settling parties];
- The extent of the [underlying claimant's] investigation and

[4] This Court explained in *Besel*, "If a reasonable and good faith settlement amount of a covenant judgment does not measure an insured's harm, our requirement that such settlements be reasonable is meaningless." 146 Wash.2d at 739. The purpose of a reasonableness hearing is to "protect insurers from excessive judgments" that may arise from fraud or collusion. *Id.* at 739; *Chaussee*, 60 Wash. App. at 511 (expressing concern with covenant judgments "that an insured may settle for an inflated amount to escape expense and thus call into question the reasonableness of the settlement.").

preparation of the case;

- The interests of the parties not being released.

Bird, 175 Wash.2d at 766. *See also Besel*, 146 Wash.2d at 739; *Chaussee*, 60 Wash. App. at 512; *Hamblin*, 9 Wash. App.2d at 86. All of these factors involve the merits and risks of the claim being settled – including the risk of continuing the litigation against the insured if no settlement is made – but have never included what it might cost the claimant to collect the settlement amount in future litigation against the tortfeasor's insurer, where attorney's fees are separately recoverable.

For example, in *Besel*, in evaluating the reasonableness of the covenant judgment, the Court noted that "the risk and expense" to *the insured* "of continued litigation was extreme" and the insured "could not pay any judgment against him." 146 Wash.2d at 739. Likewise in *Chaussee*, the Court of Appeals found there had been no assessment of evidence on "the risk and cost of proceeding to trial," explaining:

> While this document does provide an assessment of the potential liability of Chaussee, it does not assess the risks or costs of going to trial that a reasonable person would consider in determining a reasonable settlement, nor does the exhibit include any indication of an assessment of Chaussee's ability to pay. Standing alone, it fails to sufficiently prove *the damages that resulted from the [insurer's] negligence*.

60 Wash. App. at 514 (emphasis added). *See also* 14A Couch on Insurance §203:43 ("In determining whether a settlement was

reasonable, courts should attempt to recreate the same result that would have occurred as if there were an arm's-length negotiation on the merits of the case between interested parties.").[5]

The cases cited by Respondent are inapposite, and provide no support for Respondent's assertion that Washington courts have "recognized the risks attendant to the plaintiff in securing recovery on the covenant judgment." *See* Respondent Karen Ulbricht's Response to USFG's Petition for Discretionary Review at 15. In *Sykes v. Singh*, 5 Wn.App.2d 721, 735, 428 P.3d 1228 (2018), *review denied*, 192 Wn.2d 1025, 435 P.2d 265 (2019), for example, the court considered the "risks and expenses of continuing the litigation" with regard to the underlying litigation, including the effect of a judgment *in that action* on the insured's financial position. It did not consider the claimant's risks in pursuing a bad-faith insurance claim.

Likewise in *Werlinger v. Warner*, 126 Wash. App. 342, 109 P.3d 22 (2005), on which the Court of Appeals erroneously relied in support of

[5] Under this test, "whether a settlement is reasonable and prudent is what a reasonably prudent person in the insured's position would have settled for "on the merits of the claimant's case," with a "reasonably prudent person" meaning one who "(1) has the ability to pay a reasonable settlement amount from their own funds; and (2) makes the settlement decision as though the settlement amount came from those personal funds." 14A Couch on Insurance §203:43.

its ruling here, the insured's status as bankrupt was considered not as a "risk of continuing the litigation," but with respect to the insured's ability to pay a judgment if the underlying case were not settled. The court explained: "By virtue of the bankruptcy discharge, Warner had a complete defense to personal liability… the reasonableness of a settlement with an insured who is not personally liable for a settlement is open to question because the insured will have no incentive to minimize the amount." *Id*. at 351.[6]

In sum, under existing precedent, the reasonableness of a covenant judgment should turn on the merits and risks of the case between the claimant and the defendant – not on the prospect of the coverage claim against the defendant's insurer. Washington courts have never before applied the fifth factor to account for continued *coverage* litigation.

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[6] Respondent's citation to *Heights at Issaquah Ridge Owners Ass'n. v. Derus Wakefield I, LLC*, 145 Wash. App. 698, 187 P.3d 306 (2008), is even further afield. There the covenant judgment involved a construction defect claim against the insured. In that context, the court, held, the *Chausee* reasonableness factors are relevant only to the extent they inform whether the settlement was the product of collusion or fraud. The case provides no support for the proposition that the risks of obtaining recovery in future bad-faith litigation are at all relevant to the reasonableness determination. Indeed, the court went on to reject the claimant's request for attorney's fees against the insurer, precisely because the reasonableness of the underlying settlement was an entirely separate question from whether attorneys' fees could be recoverable in a bad-faith action. 145 Wash. App. at 707-708.

Rather, the fifth factor has always been applied only to assess the risks and expense of the continued *underlying* litigation which the settlement purports to resolve. *Besel*, 146 Wash.2d at 739; *see also Chaussee*, 60 Wash. App. at 513-14. This Court should accept review to resolve this irreconcilable conflict between the Court of Appeals' decision and existing Washington case law.

II. THIS COURT SHOULD ACCEPT REVIEW TO RESOLVE AN ISSUE OF SUBSTANTIAL PUBLIC IMPORTANCE.

The Court of Appeals' decision will have serious and immediate consequences in the state of Washington. Because covenant judgments always anticipate later coverage litigation, all covenant judgments under the Court of Appeals' formulation here would necessarily lead to higher settlements; going forward, litigants would now always factor into the amount of the judgment a factor to account for the claimant's risk of succeeding on the later bad-faith claim. The Court of Appeals' ruling will thus have immediate effect on much of the state's population, with a direct and substantial financial bearing on the insurance industry in Washington.

Further, the Court of Appeals' decision violates an important public policy interest. The reasonableness hearing required by RCW 4.22.60 is an equitable proceeding, intended to protect insurers against the risk of fraud and collusion by their insureds and underlying claimants.

Bird, 175 Wash.2d at 770. By treating the risk and expense of pursuing bad-faith litigation as part of "presumptive damages," the Court of Appeals decision subjects insurers to the costs of the coverage action both as part of the covenant judgment, and as part of the awardable costs under the claimant's later Insurance Fair Conduct Act ("IFCA") claim. Requiring insurers to pay twice for the costs of coverage litigation violates basic principles of equity, and public policy against double recovery.

A reasonableness determination must follow basic principles of equity. *E.g.*, *Hamblin v. Castillo Garcia*, 9 Wash. App.2d 78, 88-89, 441 P.3d 1283 (2019) (covenant judgment, which guaranteed a portion of the settlement amount to be paid back to the insured, was not reasonable, because "the settlement underlying the covenant judgment must be structured to avoid unjustly enriching either insured or insurer."). Likewise if the Appellate Court's ruling here were permitted to stand, the covenant judgment would be inequitable because it is structured to permit double recovery. It is critical that this Court grant review because resolving these important questions governs not only the parties to this dispute, but all insurance contracts subject to Washington law.

CONCLUSION

Because the ruling below conflicts with existing rulings of this Court and of the Court of Appeals and presents questions of substantial

public importance to the insurance system and Washington public policy, this Court should grant the Petition for Review.

RESPECTFULLY SUBMITTED this 16th day of June.

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DATED this 16th day of June.

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