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No. 64477-7-I

COURT OF APPEALS, DIVISION I  
OF THE STATE OF WASHINGTON

EMILY L. MORATTI, a minor, by and through her Litigation  
GUARDIAN AD LITEM GERALD R. TARUTIS

Appellant,  
v.

FARMERS INSURANCE COMPANY OF WASHINGTON; FARMERS  
INSURANCE EXCHANGE,  
and DOES 1 through 10 et al.,

Respondents.

APPEAL FROM THE SUPERIOR COURT  
FOR KING COUNTY  
THE HONORABLE JAY V. WHITE

REPLY BRIEF OF APPELLANT

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## I. FACTS IN REPLY

Farmers has dismissed its cross-appeal, and does not properly challenge the sufficiency of the evidence to support the jury's special verdict that its bad faith proximately caused damages to its insured Lipscomb. Its discussion of the evidence to support the jury's findings of fault and causation turns the governing standard of review under CR 50 on its head. This court reviews "the evidence and all inferences that can be drawn from therefrom . . . in the light most favorable" to the party opposing a motion for judgment as a matter of law – in this case, appellant Moratti. *Goodman v. Goodman*, 128 Wn.2d 366, 371, 907 P.2d 290 (1995) (reversing trial court's order setting aside plaintiff's verdict on statute of limitations grounds). Contrary to Farmers' argument that this court should defer to the trial court's decision granting judgment as a matter of law contrary to the jury's verdict, "[n]o element of discretion is involved." *Goodman*, 128 Wn.2d at 371.

Thus, this court must consider not just the evidence (recited at Resp. Br. 37), that Farmers claims supports its argument that plaintiff Emily Moratti's claim could not and would not have settled for anything less than a \$17 million judgment plus \$600,000 of Lipscomb's own money. Instead, this court considers all the evidence, and all of the reasonable inferences from that evidence, supporting the jury's finding

that Moratti's claim could have been settled for insurance limits and \$100,000 from Lipscomb, if only Farmers had acted in good faith and given its insured the chance to achieve such a settlement. And that evidence presented a classic case of "Bad Faith 101:"

First, the jury heard overwhelming evidence of the insured's potential liability for extraordinary damages. The jury heard that Lipscomb as landlord had not installed statutorily-required smoke detectors in the rental unit where the legally fault-free, 18-month-old plaintiff had been horribly burned over 70% of her body, incurring almost \$800,000 in medical bills in four months. (7/29 RP 58-60)

Second, the jury heard overwhelming evidence of the defendant insurer's fault in assigning this serious claim to a novice claims adjuster, with only eight months experience and with extremely limited authority to do anything but "close" claim files in order to improve her "numbers," based not on the insured's very real exposure, but on Farmers' potential exposure. (7/30 [AM] RP 61, 67-69, 8/3 [AM] RP 28, 32-33) The jury heard of the insurer's failure to properly investigate, evaluate, communicate, or attempt to settle this claim based on what Farmers now characterizes as a "mistaken" or "erroneous" liability decision. Any rational assessment (such as the jury made) of Farmers' claims management decisions, however, was that the insurer placed its own

interests above those of its insured by its failure to properly staff and consider this serious claim.

Third, the jury heard overwhelming evidence supporting its special verdict that “Farmer’s [STET] failure to act in good faith proximately cause[d] . . . damage to Mr. Lipscomb.” (CP 4372) Moratti’s claim could have settled early, at far less cost to the insured Lipscomb, had the inexperienced adjuster to whom Farmers assigned the claim realized its insured’s risk and not closed the file based on a “mistaken” “liability decision” (to use Farmer’s own characterization), rather than based on her own case closure statistics. Because they knew that Lipscomb’s assets were heavily encumbered and subject to significant tax liens, Moratti’s lawyers were prepared to settle her claim against Lipscomb for his policy limits, plus Lipscomb’s personal contribution of \$100,000. (8/6 [PM] RP 55-61, 68-69, 8/10 [AM] RP 74-75, 8/10 [PM] 58-59, 99) A superior court commissioner would have approved this settlement if it could have been reached before a lawsuit was filed. (8/11 [AM] RP 56)

Once Farmers told Emily’s lawyers that Farmers would not consider her 400-page settlement package because its “liability decision is final,” (Ex. 16; 7/30 [AM] RP 125, 8/6 [PM] RP 62-64), her lawyers were (quite reasonably, as the jury determined as a matter of fact) no longer willing to settle for \$100,000 plus limits. (7/29 RP 74, 8/6 [PM] RP 65)

That Lipscomb testified only in his (improperly rejected – App. Br. 44-45) offer of proof that he would have contributed \$100,000 – rather than the \$600,000 out-of-pocket he ultimately was required to pay (8/17 [AM] RP 6) – is of no moment given the clear evidence that the smaller contribution from the insured would have settled the underlying case early on.

Fourth, that Moratti’s claim was ultimately settled for \$600,000 out-of-pocket, plus a \$17 million judgment against the insured that Farmers conceded was both reasonable and not the result of fraud or collusion (CP 82), is overwhelming evidence of damages. Farmers’ argument that the \$17 million judgment entered against Lipscomb does not constitute the measure of Moratti’s compensable damages in this bad faith claim ignores not only Judge Canova’s partial summary judgment order (CP 3485), which Farmers does not challenge on appeal, but clearly established case law to the contrary. (*See Arg. § II.A, infra* at 5-9)

The jury fully and properly considered and rejected Farmers’ claims that its bad faith did not cause Lipscomb to enter into a settlement requiring payment of \$600,000 of his personal funds and entry of a \$17 million judgment that Farmers concedes was reasonable and not the result of fraud and collusion. Further, because a finding of bad faith establishes a violation of the CPA, the jury’s finding that Farmers’ bad faith proximately caused “damage to Mr. Lipscomb” also establishes that

Farmers' violation of the CPA proximately caused "injury to business or property" under RCW 19.86.090, as a matter of law. (App. Br. 39-41; Reply Arg. § II.A.3, *infra* at 9-11)

## II. REPLY ARGUMENT

### A. **Farmers' Breach Of The Duty Of Good Faith Proximately Caused Its Insured Both "Harm" And "Injury To Business Or Property."**

#### 1. **Judge Canova's Unchallenged Summary Judgment Order, Which Is The Law Of The Case, Bars Farmers' Attempt To Avoid The Consequences Of Its Bad Faith.**

Farmers' argument that the \$17 million judgment entered against Lipscomb does not constitute the measure of Moratti's compensable damages ignores Judge Canova's partial summary judgment order (CP 3485), which Farmers does not challenge on appeal. On summary judgment, as on appeal, Farmers argued that it could not be responsible for the consequences of its failure to investigate or settle the claim against Lipscomb because (1) Moratti's lawyers never sent Farmers a formal settlement demand, (2) Farmers' "erroneous liability decision" was remedied by its subsequent defense, and (3) Farmers tendered its limits prior to entry of judgment. (CP 1574-1632, 2232-55, 2628-52) Rejecting those arguments, Judge Canova held that "upon a verdict or finding by this or other Superior Court that the defendants acted in bad faith with respect to the handling of the Emily Woodrow claim against William E. Lipscomb,

the presumptive measure of damages is the amount of the judgment found to be reasonable in the *Woodrow v. Lipscomb* case.” (CP 3485)

If it intended to challenge this ruling on appeal, Farmers was obligated to assign error to it. RAP 10.3(b); *State v. Kindsvogel*, 149 Wn.2d 477, 481, 69 P.3d 870 (2003). Because Farmers does not argue that Judge Canova’s partial summary judgment was error, it is binding as the law of the case. See *Thompson v. Grays Harbor Community Hospital*, 36 Wn. App. 300, 303 n.1, 675 P.2d 239 (1983) (where neither party assigned error to trial court’s instructions, they become the law of the case). Farmers’ argument that it may evade legal liability for its breach of the duty to investigate and settle because its actions were a “bump in the road on the way to full good faith participation by Farmers” (Resp. Br. 38), and implicated only its “handling of the claim and not . . . the duty to defend, settle or indemnify,” (Resp. Br. 32, citing *St. Paul Fire and Marine Ins. Co. v. Onvia, Inc.*, 165 Wn.2d 122, 133, 196 P.3d 664 (2008)), was considered and rejected on a summary judgment that remains unchallenged on appeal, and that is the law of this case.

**2. Farmers’ Insured Paid \$600,000 Of His Own Money And Bore The Additional Burden of A \$17 Million Judgment That Farmers Concedes Was Reasonable, And Not The Result of Fraud or Collusion.**

Although Judge Canova’s unchallenged order disposes of Farmers’

argument, its contention that “the covenant judgment” itself constitutes neither “harm” nor compensable “injury to business or property” (Resp. Br. 13-14), also is erroneous as a matter of law. Leaving aside Lipscomb’s payment of \$600,000 out-of-pocket in settlement of Moratti’s claim, our state Supreme Court has repeatedly held that entry of judgment against an insured, even when coupled with a covenant not to execute, constitutes compensable “harm” to an insured for the insurer’s bad faith. *Besel v. Viking Ins. Co. of Wisconsin*, 146 Wn.2d 730, 738, 49 P.3d 887 (2002) (“[T]he amount of a covenant judgment is the presumptive measure of an insured’s harm caused by an insurer’s tortious bad faith . . . .”); *Safeco Ins. Co. v. Butler*, 118 Wn.2d 383, 398, 823 P.2d 499 (1992). As a secondary rationale for its holding that a covenant judgment in and of itself constitutes “harm,” the *Butler* Court explained that “real harm” to credit and reputation may be presumed from entry of a covenant judgment:

Second, even though the agreement insulates the insured from liability, it still “constitutes a real harm because of the *potential* effect on the insured’s credit rating ... [and] damage to reputation and loss of business opportunities[.]”

118 Wn.2d at 399, quoting *Barr v. General Accident Group Ins. Co.*, 360 Pa.Super. 334, 342, 520 A.2d 485, 489, *app. denied*, 517 Pa. 602, 536 A.2d 1327 (1987) (emphasis added; brackets in original).

Citing *Butler* and *Werlinger v. Clarendon National Ins. Co.*, 129 Wn. App. 804, 120 P.3d 593 (2005), *rev. denied*, 157 Wn.2d 1004 (2006), Farmers argues that an insured cannot establish harm from a covenant judgment in the absence of proof of damage to the insured's credit rating, reputation or lost business. (Resp. Br. 14) But in *Werlinger*, the insured entered into a judgment coupled with a covenant not to execute *after* it had filed for bankruptcy because of unrelated debts. Because the previous unrelated bankruptcy completely protected the insured from suffering *any* consequences of the unenforceable judgment, this court held that the insurer had rebutted the presumption that its insured was harmed. Here, to the contrary, Lipscomb was not similarly immunized from the consequences of an adverse judgment, and suffered "real harm" because the entry of judgment substantially interfered with his ability to participate in the real property partnerships that were his principal source of income. (8/5 [PM] RP 116-18)<sup>1</sup>

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<sup>1</sup> Farmers argues that plaintiff cannot rely on these effects of the judgment because Lipscomb in an answer to a damages interrogatory did not quantify his "damage to reputation and loss of business opportunities." *Butler*, 118 Wn.2d at 399. (Resp. Br. 13, n.13, 50-51) Farmers' argument confuses the "harm" element of a bad faith claim with the quantifiable damages recoverable for bad faith. Lipscomb waived any claim for additional damages beyond the judgment, his out-of-pocket contribution, and attorney fees, but he did not waive the right to establish that he suffered "harm." Plaintiff listed the \$17 million covenant judgment as an element of damages in response to the interrogatory. (CP 1531-33, 3195-96)

Farmers' argument that Lipscomb suffered no "real harm" falters on the more fundamental premise that Lipscomb paid \$600,000, obtained by encumbering real property in which he held an interest. Farmers conceded below that the money paid by its insured constitutes both tangible harm and "injury to business or property" under RCW 19.86.090, (10/26 RP 13-14), and makes no argument on appeal that money is not property. Lipscomb indisputably suffered both "harm" for purposes of bad faith, and "injury to business or property" under the CPA.

**3. The Jury's Finding That Farmers' Bad Faith Proximately Caused Its Insured's Damages Establishes Proximate Cause Under The CPA As A Matter of Law.**

Farmers argues that the jury's finding of causation does not establish its liability for causing "injury to business or property" under the CPA because "the jury was instructed to *presume* causation regarding the bad faith claim, and that presumption did not transfer to Moratti's CPA claim, where she still had the burden of proof." (Resp. Br. 15) (emphasis in original) Farmers misreads the trial court's instructions, which plainly stated that the jury could presume the *fact* of damages, but imposed upon Moratti the burden of proving that Farmers' bad faith *caused* its insured to incur those damages.

Instruction No. 12 told the jury:

If you find that Farmers failed to act in good faith, then the law presumes that William E. Lipscomb was damaged, and you are bound by that presumption unless you find by the preponderance of the evidence that William E. Lipscomb was not damaged.

(CP 4326) But the jury also was instructed that “Plaintiff has the burden of proving . . . [t]hat Farmers’ failure to act in good faith was a proximate cause of Mr. Lipscomb’s damage.” (Instr. No. 9, CP 4322) Thus, the jury’s finding of proximate cause was not based on any presumption, but on an instruction that placed the burden of proving proximate cause on Moratti.

Farmers’ challenge to the sufficiency of the evidence to support the jury’s special verdict ignores the well-established principle that the jury was entitled to infer causation based on all the evidence in the case:

The plaintiff need not establish causation by direct and positive evidence. She need only show by a chain of circumstances from which the ultimate fact required is reasonably and naturally inferable.

*Conrad ex rel. Conrad v. Alderwood Manor*, 119 Wn. App. 275, 281, 78 P.3d 177 (2003) (quotation omitted). Where the facts are disputed and “inferences therefrom may vary, . . . it is for a jury to decide” the issue of proximate cause. *Bernethy v. Walt Failor's, Inc.*, 97 Wn.2d 929, 935, 653 P.2d 280 (1982). Here, the jury’s finding was based on substantial, if not overwhelming evidence, that Lipscomb would have and could have

settled Moratti's claim for \$100,000 if only Farmers had given him the chance. (*See* Fact § I at 3-4, *supra*)

The jury's finding of bad faith and proximate cause also establishes Farmers' liability under the CPA. *See Besel*, 146 Wn.2d at 740 (remanding for entry of damages under CPA as a matter of law). In addition to reversing the judgment as a matter of law to Farmers on the bad faith claim, this court should direct entry of judgment as a matter of law in favor of Moratti under the CPA, remanding for an award of CPA penalties and attorney fees,<sup>2</sup> as well as the damages awarded by the jury for common law bad faith.

**B. The Trial Court Erred In Granting Judgment As A Matter of Law And Vacating The Jury's Verdict On A Bad Faith Claim Filed Less Than Three Years After Entry Of Judgment Against Farmers' Insured.**

**1. The Trial Court Could Not Enter Judgment As A Matter of Law On The Basis Of A Defense That Was Never An Issue At Trial Because It Was Eliminated On Summary Judgment.**

The statute of limitations was not tried to the jury because this defense was dismissed on summary judgment. Farmers' contention that Moratti has been "fully heard" on the statute of limitations issue is true in only one sense – the issue was briefed and argued before Judge Canova,

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<sup>2</sup> As a prevailing party under the CPA, Moratti is entitled to her attorney fees at trial and on appeal as a matter of law. RCW 19.86.090. (App. Br. 41)

who entered a partial summary judgment dismissing the statute of limitations defense that Farmers, having dismissed its cross-appeal, does not challenge on appeal. (CP 3477-78; *see* Arg. § II.A.1 at 6, *supra*)

Indeed, Farmers relies on the summary judgment record before Judge Canova to argue that Moratti cannot now complain that the jury never adjudicated the factual issue of when Lipscomb knew or should have known of each element of his bad faith claim against Farmers in arguing that Moratti “did not rely upon the discovery rule below.” (Resp. Br. 20, n.30, *citing* CP 4462 and 7/14/08 RP 13) But the only reason the discovery rule was not “raised” at trial is because Judge Canova followed established law in ruling that the damages element of a bad faith claim accrues when an adverse judgment is entered against the insured. Because Moratti prevailed on summary judgment, Moratti had no obligation to “preserve” her argument that facts relating to Lipscomb’s discovery of Farmers’ bad faith were not at issue at trial.

Farmers now argues, as it did before Judge Canova, that the discovery rule that was applied to a breach of fiduciary duty claim between partners in *Hudson v. Condon*, 101 Wn. App. 866, 6 P.3d 615 (2000), *rev. denied*, 143 Wn.2d 1006 (2001), requires an insured to sue an insurer when the insured “knew or should have known” that the insurer

committed an act of bad faith.<sup>3</sup> But the jury never heard critical evidence about what Lipscomb knew, or should have known, regarding his ability to sue Farmers before he had been held liable to Moratti – including, but not limited to, his understanding of his obligations to continue cooperating with Farmers in order to preserve coverage, and the effect of the “no action” clause in Farmers’ policy. These factual questions were not at issue because they were removed from the case by Judge Canova’s partial summary judgment.

In any event, the cases cited by Farmers hold only that a contractual limitations period in an insurance policy cannot *shorten* the four-year statute of limitations for CPA claims, or the three-year statute for a claim for bad faith. *See O’Neill v. Farmers Ins. Co.*, 124 Wn. App. 516, 530-31 ¶ 33, 125 P.3d 134 (2004); *Simms v. Allstate Ins. Co.*, 27 Wn. App. 872, 878, 621 P.2d 155 (1980) (Resp. Br. 27). Farmers argues that a “no action” clause does not bar as a matter of law an insured’s claim for bad faith. (Resp. Br. 27) However, the “no action” clause, and whether

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<sup>3</sup> *Hudson* was a claim by one partner against another for breach of fiduciary duty. Division Three held that under the discovery rule, the claim accrued when the plaintiff had knowledge of the defendant partner’s notice to their landlord that he intended to vacate the jointly leased premises and terminate the partnership’s lease, because the plaintiff’s own correspondence with the defendant reflected that he had suffered appreciable damages. *Hudson*, 101 Wn. App. at 876 (“A letter from Dr. Hudson dated January 31, 1996 told Dr. Condon, ‘your action has thwarted my efforts to refinance the building and has necessitated my making other arrangements to raise the money[.]’”)

an insured could reasonably believe that he had no right to sue his insurer, would be relevant evidence were the discovery rule applicable to bar an insurer's bad faith claim before entry of judgment.

Farmers' contention that it is entitled to judgment as a matter of law under CR 50 without reconsideration or vacation of Judge Canova's partial summary judgment dismissing the statute of limitations defense would eliminate the rule's requirement that judgment as a matter of law is available only when "*during a trial by jury, a party has been fully heard with respect to an issue.*" CR 50(a)(emphasis added). The trial court erred in granting judgment as a matter of law for Farmers on its statute of limitations defense.

**2. The Statute Of Limitations On A Tort Claim For Breach Of The Duty To Investigate And Settle Accrues When Judgment Is Entered Against The Insured.**

A cause of action does not accrue until a plaintiff suffers actual loss or damage. *Gazija v. Nicholas Jerns Co.*, 86 Wn.2d 215, 219, 543 P.2d 338 (1975) ("Actual loss or damage is an essential element in the formulation of the traditional elements necessary for a cause of action in negligence."). Farmers acknowledges that "harm" to an insured is an essential element of a bad faith claim, but maintains that its insured's claim accrued when "Farmers denied Lipscomb's liability in October 2002." (Resp. Br. 19) But Lipscomb suffered "harm" as a result of

Farmers' bad faith, and "injury to business or property" under the CPA, only when he paid Moratti \$600,000 of his own funds and agreed to a covenant judgment of \$17 million in order avoid an enforceable judgment substantially in excess of policy limits that would have left him insolvent.

Farmers does not cite a single case from any jurisdiction supporting its contention that an insured's claim for breach of the duty of good faith accrues prior to entry of judgment in the underlying action. Further, Farmers concedes that this court has held that a claim for breach of the duty to defend "does not accrue until the third-party litigation involving the insured has ended in a final judgment." *Bush v. Safeco Ins. Co. of America*, 23 Wn. App. 327, 329, 596 P.2d 1357 (1979) (quoted at Resp. Br. 23) While Farmers contends that this rule is limited to the duty to defend, the *Bush* court explained that the insurer did not suffer damages as a result of either the duty to defend or the duty to indemnify until entry of an adverse judgment. 23 Wn. App. at 330. Not only did the *Bush* court adopt this principle followed by "[m]ost courts which have considered the issue," 23 Wn. App. at 329, but 31 years after *Bush* was decided this rule continues to be followed around the country in cases involving a breach of the duty to settle as well as the duty to defend. (App. Br. 21 n.1)

The "judgment rule" adopted in *Bush* is based on the nature of the insurance relationship and basic principles of indemnity. "Liability

insurance is third-party coverage and provides policyholders with two main benefits: payment and defense.” *St. Paul Fire and Marine Ins. Co. v. Onvia, Inc.*, 165 Wn.2d 122, 129, 196 P.3d 664 (2008).<sup>4</sup> An indemnity action accrues when the party seeking indemnity has paid the underlying obligation or has suffered entry of judgment. *Central Washington Refrigeration, Inc. v. Barbee*, 133 Wn.2d 509, 511, 946 P.2d 760 (1997). With respect to the duty to defend, the rule adopted by the *Bush* court is also consistent with the “continuous representation” rule applied by this court to legal malpractice claims, because it allows the insurer “to continue efforts to remedy a bad result . . . even if the client is fully aware of the . . . error.” *Janicki Logging & Const. Co., Inc. v. Schwabe, Williamson & Wyatt, P.C.*, 109 Wn. App. 655, 663, 37 P.3d 309 (2001) (“The doctrine is fair to all concerned parties. The attorney has the opportunity to remedy, avoid or establish that there was no error or attempt to mitigate the damages.”), *rev. denied*, 146 Wn.2d 1019 (2002) (quotations omitted). So long as the insurer continues to provide a defense and no adverse judgment has been entered against the insured on the underlying claim, the insured may yet obtain the principal benefits of the insurance agreement.

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<sup>4</sup> The duty to settle, which is at issue here, is “[r]elated to the[se] two main benefits of an insurance contract,” *Onvia*, 165 Wn. 2d at 129, *citing Besel*, 146 Wn.2d at 735-36.

Here, Farmers cites to evidence that Lipscomb or his attorneys were put on notice that he may have “valid claims” against Farmers, but Lipscomb did not suffer actual harm until Farmers’ bad faith forced him, on the eve of the trial of the underlying action in 2007, to personally pay Moratti and incur a judgment in an amount that Farmers concedes was reasonable and not the result of fraud or collusion. The trial court instead held that Lipscomb’s bad faith claim accrued *before* Moratti’s lawsuit had even been filed, and that he was required to bring suit against his insurer in 2005, two years before the entry of judgment, when Farmers was providing a defense and before there had been any determination of the extent and amount of Lipscomb’s liability.

Farmers argues that if a bad faith claim does not accrue until entry of an adverse judgment, an insured could “effectively control the statute of limitations” by delaying the resolution of the underlying litigation. (Resp. Br. 27) But it is the plaintiff in the underlying action, not the insured, who controls the filing of a lawsuit against the insured. The reasonableness hearing procedure provides ample safeguard against fraud and collusion between an injured party and an insured. *Heights at Issaquah Ridge Owners Ass’n. v. Derus Wakefield I, LLC*, 145 Wn. App. 698, 703-04 ¶ 10, 187 P.3d 306 (2008), *rev. denied*, 165 Wn.2d 1029 (2009). The rule advocated by Farmers would instead encourage premature litigation,

resulting in a multiplicity of bad faith lawsuits, many of which would either be stayed pending the outcome of the underlying litigation or dismissed because the insured ultimately was not damaged when the underlying litigation is resolved favorably to the insured.

Farmers' contention that the four-year statute of limitations for a CPA claim also accrues when an insured learns of the insurer's breach of duty fails for the same reason. Lipscomb suffered "injury to business or property" under RCW 19.86.090 upon entry of the reasonable judgment against him and payment to Moratti of \$600,000 of his personal funds. The trial court's order granting judgment as a matter of law on Farmers' statute of limitations defense is procedurally defective and erroneous as a matter of law.

**C. The Trial Court Erred In Granting Farmers A New Trial On The Basis Of A Discretionary Evidentiary Ruling And An Instruction That Accurately Stated An Insurer's Obligation Of Good Faith.**

**1. The Jury Was Properly Instructed That The Duty Of Good Faith Requires An Insurer To Conduct Settlement Negotiations, Evaluate Settlement, And Communicate Offers To Its Insured.**

Farmers concedes that this court reviews de novo the grant of a new trial based on the trial court's post-trial belief that it should not have given Instruction No. 11, defining an insurer's duty of good faith. (CP 4903-04, 4324-25) (Resp. Br. 39) Farmers' contention that the standard of

review is abuse of discretion is wholly without merit.<sup>5</sup> To the contrary, because the instruction accurately stated the law, it was the trial court's initial wording of Instruction No. 11, not its subsequent order granting a new trial, that was discretionary. *Schneider v. City of Seattle*, 24 Wn. App. 251, 256, 600 P.2d 666 (1979), *rev. denied*, 93 Wn.2d 1010 (1980). "The question . . . is whether the instructions given were accurate statements of the law and whether [appellant] could argue his theory of the case with those instructions." *Hough v. Stockbridge*, 152 Wn. App. 328, 342 ¶ 29, 216 P.3d 1077 (2009), *rev. denied*, 168 Wn.2d 1043 (2010).

Farmers concedes that Instruction No. 11 did not misstate the law, (Resp. Br. 40), but argues that the reference to "settlement offers" and "settlement demand" was prejudicial because "Moratti never presented any settlement offers or demands to Farmers." (Resp. Br. 41) But plaintiff's theory was that by affirmatively telling Moratti's attorneys that it would not consider her written settlement offer, Farmers prevented Lipscomb from ascertaining that he could obtain a release in exchange for

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<sup>5</sup> The cases relied upon by Farmers deal with the trial court's discretion to grant a new trial for juror or counsel misconduct, or for excessive damages that were the product of passion and prejudice. In these cases, deference is given to the trial court because it "can evaluate first hand candor, sincerity, demeanor, intelligence, and any surrounding incidents; whereas, the reviewing court is tied to the written record." *Baxter v. Greyhound Corp.*, 65 Wn.2d 421, 437, 397 P.2d 857 (1964). This analysis is wholly inapplicable to claimed instructional error. *See also Cox v. General Motors Corp.*, 64 Wn. App. 823, 826, 827 P.2d 1052 (1992) (cited in Resp. Br. 39, nn. 73-75).

\$100,000 as surely as if Farmers had tossed Moratti's 400-page settlement offer in the trash. "The flat refusal to negotiate, under circumstances of substantial exposure to liability, a demonstrated receptive climate for settlement, and limited insurance coverage may show lack of good faith." *Hamilton v. State Farm Ins. Co.*, 83 Wn.2d 787, 794, 523 P.2d 193 (1974) (quotation omitted). Farmers' truncated notion of its duty of good faith in connection with settlement would have improperly given the jury no explanation why the duty to investigate, and the duty to "make a good faith effort to settle the case," is such a critical aspect of an insurer's duty of good faith, *Truck Ins. Exch. v. Century Indem. Co.*, 76 Wn. App. 527, 534, 887 P.2d 455, *rev. denied*, 127 Wn.2d 1002 (1995), and would have prevented Moratti from arguing her theory of the case.

By contrast, Instruction No. 11 allowed Farmers to fully argue its theory of the case that its duty of settlement did not arise because Moratti's lawyers never sent Farmers a settlement demand. (8/17 [PM] RP 68, 83-84) The jury was free to reject these excuses and find, consistent with the overwhelming evidence, that by telling Moratti's lawyers that it would not consider any offer to settle even if they insisted on sending it, Farmers deprived its insured of the opportunity to evaluate and consider settlement offers and to achieve a release from further liability in exchange for a \$100,000 personal contribution.

Moreover, Farmers was not prejudiced by the trial court's reference to "settlement offers" or by its refusal to define those terms in a supplemental instruction. The consequence of the trial court's Instruction No. 11 is a far cry from the prejudice that arose from erroneous instructions in *Manzanares v. Playhouse Corp.*, 25 Wn. App. 905, 611 P.2d 797 (1980) (Resp. Br. 42-43), or *Zwink v. Burlington Northern, Inc.*, 13 Wn. App. 560, 536 P.2d 13 (1975) (Resp. Br. 42, nn 81-82). In *Manzanares*, the jury was erroneously instructed that a tavern owner was negligent as a matter of law if it permitted topless dancing in violation of a Liquor Board regulation. 25 Wn. App. at 907-08. The Court of Appeals reversed because the plaintiff, who had been assaulted by a tavern employee, "concede[d] . . . that violation of this regulation was not the proximate cause of the assault." *Manzanares*, 25 Wn. App. at 911. In *Zwink*, this court held that because the defendant railroad's agent knew that its crossing signal was not working, the trial court did not err in granting plaintiff a new trial when the trial court had erroneously instructed the jury that it could find for the railroad if the railroad neither knew nor should have known that its signal was defective, ignoring the principle that the railroad is held to the knowledge of its agent. 13 Wn. App. at 563-67.

Farmers also was not prejudiced because, as it concedes, there was overwhelming evidence to establish breach of its duty to investigate, and its duty to “conduct good faith settlement negotiations,” under the first two paragraphs of Instruction No. 11, and Farmers failed to ask for a special verdict that would have allowed the jury to specify the basis of its finding that Farmers failed to act in good faith. The Supreme Court definitively rejected the rule advocated by Farmers in *Davis v. Microsoft Corp.*, 149 Wn.2d 521, 539, 70 P.3d 126 (2003), holding that “in cases such as the present one, where a general verdict is rendered in a multitheory case and one of the theories is later invalidated, remand must be granted if the defendant proposed a clarifying special verdict form.”

Farmers concedes that it failed to propose a special verdict, but asserts that the trial court “would not have granted Farmers’ request for a special verdict form if such request had been made.” (Resp. Br. 41, n.78, *citing* 10/16 RP 62) The cited transcript does not support Farmers’ assertion. Instead, when the trial court noted that Farmers had failed to propose a special verdict, Farmers stated that obtaining one was an “indomitable task.” The court replied, “I’m not quite sure how Farmers knew I wouldn’t permit it.” (10/16 RP 62) Farmers’ failure to propose a special verdict clarifying the basis for the jury’s decision bars its post-trial challenge to the general verdict as a matter of law.

**2. The Trial Court Did Not Abuse Its Discretion In Excluding Evidence That The Insured Had Unsuccessfully Sued His Broker For Malpractice After Repeatedly Balancing Under ER 403 The Probative Value Of The Lawsuit Against Its Potential To Confuse The Jury.**

Because the trial court's *original* decision under ER 403 to exclude evidence regarding Lipscomb's previous suit against his insurance broker was not an abuse of discretion, the trial court's *subsequent* order granting a new trial based upon its *discretionary* decision to exclude that evidence was an error of law. *Coleman v. Dennis*, 1 Wn. App. 299, 301, 461 P.2d 552, *rev. denied*, 77 Wn.2d 962 (1970) (App. Br. 35). Farmers' contention that the trial court's decision to overturn the jury's verdict is reviewed for abuse of discretion is directly at odds with this court's holding in *Coleman*, a case that Farmers does not cite or discuss.

Farmers argues that evidence of Lipscomb's litigation with his broker was "probative regarding Lipscomb's motive not to settle" (Resp. Br. 47), but fails to acknowledge that ER 403 allows the court to exclude even relevant evidence where "its probative value is substantially outweighed by the danger of . . . confusion of the issues, or misleading the jury, or by considerations of undue delay. . ." "Actions previously taken by the court itself, either in the present case or in other cases" are frequently excluded under ER 403 as prejudicial and confusing to the jury.

Tegland, 5 *Wash. Practice* § 403.3 at 447 (5<sup>th</sup> Ed. 2007). See *Tewell, Thorpe & Findlay, Inc., P.S. v. Continental Cas. Co.*, 64 Wn. App. 571, 578-79, 825 P.2d 724 (1992) (trial court properly exercised its discretion to exclude evidence of dismissal of underlying malpractice claim in law firm’s subsequent action against insurer challenging denial of coverage).

The cases cited by Farmers hold only that the court has broad discretion during trial to balance the probative value of proffered evidence against its potential to confuse or distract the jury from the central issue, and affirm that discretionary decision where the trial court has balanced the relevant factors on the record. See *State v. Stein*, 140 Wn. App. 43, 66, 165 P.3d 16 (2007), *rev. denied*, 163 Wn.2d 1045 (2008); *Alston v. Blythe*, 88 Wn. App. 26, 40-41, 943 P.2d 692 (1997) (both affirming trial court’s discretionary decision to admit evidence challenged as unduly prejudicial under ER 403) (Resp. Br. 47, n. 92). As Farmers concedes, the trial court thoroughly and repeatedly engaged in the required balancing before deciding that evidence that Lipscomb had sued his broker would “cause confusion . . . or mislead the jury” (7/27 [AM] RP 9) and that its exclusion would not prevent Farmers from arguing that Lipscomb “just wouldn’t settle.” (7/27 [AM] RP 13-15)

The trial court properly exercised its discretion under ER 403 during trial. Because its initial ruling was within the range of reasonable

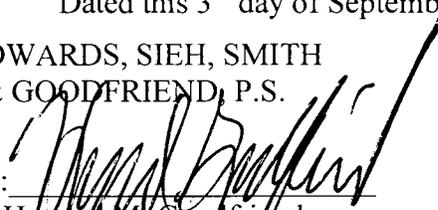
choices, the trial court's subsequent decision to grant a new trial was an error of law.

### III. CONCLUSION

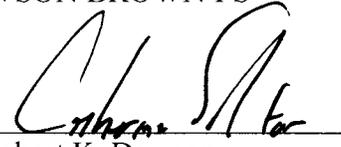
Farmers' failure to act in good faith increased its insured Lipscomb's exposure from \$100,000 to the \$17 million in damages actually suffered by Emily Moratti from her catastrophic burn injuries. For the reasons set out in this and the opening brief, this court should reverse and reinstate the judgment on the jury's verdict.<sup>6</sup>

Dated this 3<sup>rd</sup> day of September, 2010.

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<sup>6</sup> Farmers argues that Moratti is entitled only to judgment interest at the tort rate under RCW 4.56.110, rather than at the rate set forth in the underlying judgment entered against Lipscomb. (Resp. Br. 59-61) Lipscomb owes Moratti judgment interest at 6.151% until that underlying judgment is satisfied. (CP 87, 4611) By virtue of the assignment and settlement agreement, Farmers is liable to Moratti for interest at the rate set forth in the underlying judgment pursuant to RCW 4.56.110(1):

Because the interest is part of the "amount to be paid" on a contract implementing a settlement of a tort suit, the court does not have authority to adjust the specified interest rate once the court has determined that the amount to be paid is reasonable.

*Jackson v. Fenix Underground, Inc.*, 142 Wn. App. 141, 147 ¶ 13, 173 P.3d 977 (2007).

**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 September 3, 2010, I arranged for service of the foregoing Reply Brief of Appellant, to the court and to the parties to this action as follows:

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**DATED** at Seattle, Washington this 3rd day of September, 2010.

  
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Carrie Steen