

**Court of Appeals No. 43973-5-II**

---

**COURT OF APPEALS, DIVISION II  
OF THE STATE OF WASHINGTON**

---

**WATERS EDGE ASSOCIATES, a Washington general partnership;  
KEY PROPERTY SERVICES, INC. a Washington corporation;  
WATER'S EDGE HOMEOWNERS ASSOCIATION,  
a Washington non-profit corporation,**

*appellants,*

v.

**FARMERS INSURANCE EXCHANGE, a foreign corporation;  
MID-CENTURY INSURANCE COMPANY, a foreign corporation;  
and TRUCK INSURANCE EXCHANGE, a foreign corporation,**

*respondents.*

---

**REPLY BRIEF OF APPELLANTS**

---

**Mark A. Erikson, WSBA #23106  
Erikson & Associates, PLLC  
Attorneys for the appellants  
110 West 13<sup>th</sup> Street  
Vancouver, WA 98660-2904  
Telephone (360) 696-1012  
E-mail: mark@eriksonlaw.com**

**TABLE OF CONTENTS**

**Table of Authorities** ..... ii

**I. Correction of Factual Misstatements** ..... 1

**II. Argument** ..... 5

**Bad faith and collusion** ..... 5

**Failure to defend and indemnify** ..... 7

**Admissibility of evidence** ..... 13

**Prior rulings** ..... 15

**Breach of duty** ..... 16

**Unreasonable, frivolous and unfounded** ..... 20

**Causation** ..... 21

**Summary judgment** ..... 23

**III. Conclusion** ..... 24

**IV. Appendices**

**Appendix 1: RCW 4.22.060**

**Appendix 2: RCW 4.22.070**

**Appendix 3: WAC 284-30-330**

## TABLE OF AUTHORITIES

### Washington Cases

<i>Alpine Industries, Inc. v. Gohl</i> , 30 Wash.App. 750, 637 P.2d 998 (1981) .....	15
<i>American Best Food, Inc. v. Alea London, Ltd.</i> , 168 Wash.2d 398, 229 P.3d 693 (2010) .....	12
<i>Besel v. Viking Ins. Co. of Wisconsin</i> , 146 Wash.2d 730, 49 P.3d 887 (2002) .....	7, 19-20
<i>Bird v. Best Plumbing Group, LLC</i> , 175 Wash.2d 756, 287 P.3d 551 (2012) .....	6
<i>Bosko v. Pitts &amp; Still, Inc.</i> , 75 Wash.2d 856, 454 P.2d 229 (1969) .....	10-11
<i>Chaussee v. Maryland Casualty Co.</i> , 60 Wash.App. 504, 803 P.2d 1339 (1991) .....	5, 6
<i>Farmers Ins. Group v. Century Indem. Co.</i> , 76 Wash.App. 527, 887 P.2d 455 (1995) .....	22
<i>Gaasland Co. v. Hyak Lumber &amp; Millwork, Inc.</i> , 42 Wash.2d 705, 257 P.2d 784 (1953) .....	15
<i>Glover v. Tacoma General Hospital</i> , 98 Wash.2d 708, 658 P.2d 1230 (1983) .....	5, 6
<i>Greer v. Northwestern Nat. Ins. Co.</i> , 109 Wash.2d 191, 743 P.2d 1244 (1987) .....	10
<i>Kirk v. Mt. Airy Ins. Co.</i> , 134 Wash.2d 558, 951 P.2d 1124 (1998) .....	11
<i>Lamon v. McDonnell Douglas Corp.</i> , 91 Wash.2d 345, 588 P.2d 1346 (1979) .....	14

<i>Ledcor Industries v. Mutual of Enumclaw</i> , 150 Wash. App. 1, 206 P.3d 1255 (2009) .....	7-8
<i>Lynch v. Republic Pub. Co.</i> , 40 Wash.2d 379, 243 P.2d 636 (1952) .....	15
<i>Meadows v. Grant's Auto Brokers, Inc.</i> , 71 Wash.2d 874, 431 P.2d 216 (1967) .....	14
<i>Moratti v. Farmers Ins.</i> , 162 Wash.App. 495, 254 P.3d 939 (2011), <i>review denied</i> , 173 Wash.2d 102, 2272 P.3d 850 (2012) .....	19, 21
<i>Mutual of Enumclaw v. Dan Paulson Construction</i> , 161 Wash.2d 903, 169 P.3d 1 (2007) .....	24
<i>Shoulberg v. Public Utility Dist. No. 1 of Jefferson County</i> , 169 Wash.App. 173, 280 P.3d 491 (2012) .....	16
<i>Steinmetz for benefit of Palmer v. Hall-Conway-Jackson, Inc.</i> , 49 Wash.App. 223, 741 P.2d 1054 (1987), <i>review denied</i> , 110 Wash.2d 1006 (1988) .....	11
<i>Tank v. State Farm Fire &amp; Casualty Co.</i> , 105 Wash.2d 381, 715 P.2d 1133 (1986) .....	5, 13, 17, 18, 22
<i>Transamerica Insurance Group v. Chubb &amp; Son, Inc.</i> , 16 Wash.App. 247, 554 P.2d 1080 (1976) .....	21
<i>Waite v. Aetna Cas. &amp; Sur. Co.</i> , 77 Wash.2d 850, 467 P.2d 847 (1970) .....	10
<i>Water's Edge HOA v. Water's Edge Associates, et al.</i> , 152 Wash.App 572, 216 P.3d 1110 (2009), <i>review denied</i> , 168 Wash.2d 1019 (2010) .....	5, 6, 7, 16
<i>Weber v. Biddle</i> , 4 Wash.App. 519, 483 P.2d 155 (1971) .....	22

<i>West v. Thurston County</i> , 168 Wash.App. 162, 275 P.3d 1200 (2012) .....	4
<i>Wilber Development Corp. v. Les Rowland Const. Inc.</i> , 83 Wash.2d 871, 523 P.2d 186 (1974) .....	15
<b>Revised Code of Washington</b>	
RCW 4.22.060 .....	6-7
RCW 4.22.070 .....	8, 12, 18, 24
<b>Washington Administrative Code</b>	
WAC 284-30 <i>et seq.</i> .....	3
WAC 284-30-330 .....	18

## I. CORRECTION OF FACTUAL MISSTATEMENTS

The following chronology corrects the recitation of events leading up to Farmers' reservation of rights:

The underlying action was filed July 1, 2005. *CP 312*.

Farmers sent a letter to Robert M. Hughes dated October 24, 2005, agreeing to provide a full defense to his clients, "Water's Edge Associates [WEA] and Paul A. Nelson . . . subject to a full reservation of . . . rights to deny the existence of coverage." *CP 157; CP 171*. Although the October 24, 2005 letter discussed insurance issued to Key Property Services (KPS), it did so only to deny coverage to WEA and Paul Nelson under that policy:

Although the tender of defense made on behalf of Water's Edge Associates and Paul Nelson does reference the Key Property policy, we have reviewed this policy for coverage in light of the allegations of the Complaint in the Homeowners, Association lawsuit. The named insured shown on the policy Declarations is Key Property Services, Inc. ("Key Property"). Key Property is not a named defendant in the Homeowners Association lawsuit. Nor does the Complaint contain any allegations directed towards Paul Nelson in his capacity as president of Key Property. . . .

Farmers Insurance Exchange is denying coverage under the Key Property policy for claims in the Homeowners Association lawsuit because (1) named insured Key Property is not a defendant in the suit, and (2) Paul Nelson is insured by the policy only for claims related to his role as president of Key Property. Accordingly, the policy does not provide coverage for claims against Water's Edge Associates or Paul

Nelson in the Homeowners Association lawsuit. . . .

*CP 172.*

An amended complaint was filed April 11, 2006, adding, *inter alia*, defendant KPS, the insured under the policy mentioned in the foregoing quotation. *CP 328-38.*

“On September 19, 2006, [Farmers] forwarded a letter to Robert M. Hughes confirming receipt of insurance claims, and noting that all investigation/evaluation of the claims was being performed under full reservation of rights.” *CP 344*, ln. 9-12. On November 14, 2006, Tyna Ek, Farmers’ coverage counsel, sent a letter to Robert M. Hughes indicating that Farmers accepted the tender of KPS’ defense under a reservation of rights:

Mid-Century Insurance Company and Truck Insurance Exchange have agreed to extend a defense to claims against Water’s Edge Associates, Paul Nelson, Key Property Services, Inc., Larry Pruitt, Burke Rice, and Salmon Creek Developers, Inc. under the Key Property Policy. Mid Century, Truck and Farmers are providing defense counsel subject to a full reservation of the right to deny coverage . . .

*CP 198.*

On January 22, 2007, Stephen M. Todd was substituted as counsel of record for WEA, and on January 25, 2007, Mark P. Scheer was substituted as counsel of record for KPS.

Based upon the foregoing, nearly four months passed between filing of the underlying action and Farmers' notification of its decision to defend Paul Nelson and WEA under a reservation of rights. Although 10 to 12 months passed between filing the underlying action and notice *to KPS* that Farmers was reserving rights to deny coverage, five months passed between filing of the amended complaint adding KPS as a defendant and said notification.

\* \* \*

Contrary to Farmers' argument, the complaint in the present proceeding did not allege "that Mr. White's . . . conduct was . . . attributable to Farmers since Farmers appointed Mr. White as assigned defense counsel." *Brief of Respondents* at 9, and *seriatim*. Rather, the complaint alleges that Farmers is liable for its own actions, not for the actions of attorney White:

5.1 Farmers initially breached its duty to defend (as well as its duties under WAC 284-30 *et seq.*) by failing to make a decision within 30 days on whether or not to defend Waters Edge and Key Property in the Underlying Suit. After a significant period of breaching its duty of defense and investigation, and after complaints by one or more plaintiffs concerning its failure to do so, Farmers agreed to defend under reservation of rights.

*CP 55*, ln. 12-16.

Moreover, the complaint alleges: “that Farmers failed to conduct a timely investigation,” that “Farmers failed to understand . . . appointed counsel had only one client,” that “Farmers . . . failed to give timely coverage updates and . . . disclose[] the amount of indemnity available to settle claims,” that “Farmers placed its own financial interest above those of its policyholders,” and that Farmers “fail[ed] to obtain separate counsel to represent the interests of Waters Edge on the one hand and Key Property on the other.” *CP 58*.

\* \* \*

Farmers alleges, without citation to the record, “[i]t is well documented that Associates [WEA] and Key [KPS] agreed to have Mr. White represent them both in the underlying action.” *Brief of Respondent* at 21. “[A]ssertions without citation to the record or to legal authority [are] contrary to the requirements of RAP 10.3(a)(6),” and not considered by the Court. *West v. Thurston County*, 168 Wash.App. 162, 190, 198, 275 P.3d 1200 (2012).

\* \* \*

## II. ARGUMENT

### **Bad faith and collusion**

The *Brief of Respondents* raises an issue of whether claims alleging bad faith under *Tank* are consistent with the finding of collusion which resulted in a decision that the settlement was unreasonable. *Tank v. State Farm Fire & Casualty Co.*, 105 Wash.2d 381, 715 P.2d 1133 (1986). In the present case, trial court trial court found the settlement amount of \$8,750,000 unreasonable, based upon factors articulated in *Chaussee v. Maryland Casualty Co.*, 60 Wash.App. 504, 803 P.2d 1339 (1991), including collusion. *CP 338-66*. Having found the settlement unreasonable, the court entered its finding that a reasonable settlement would be \$400,000. *CP 366*, ln. 17-21. The trial court's judgment, including its reasonableness determination, was affirmed by the Court of Appeals in *Water's Edge HOA v. Water's Edge Associates, et al.*, 152 Wash.App 572, 216 P.3d 1110 (2009), and review was denied by the Supreme Court, 168 Wash.2d 1019 (2010).

The decision in *Chaussee*, held that factors articulated in *Glover v. Tacoma General Hospital*, 98 Wash.2d 708, 717, 658 P.2d 1230 (1983), "should be weighed in determining a reasonable settlement in an action for bad faith." *Chaussee*, 60 Wash.App. at 512. The Court agreed that a trial

court determination was *not* “presumptively reasonable” because it did *not* consider all of the *Glover* factors. *Id.*

Unlike *Chaussee*, the present case involves a reasonableness determination which *did* consider all relevant *Glover* factors, *Water’s Edge*, 152 Wash.App at 593, 598; and concluded that \$400,000 would be a reasonable settlement. *CP 366*. Hence, the effect of the trial court’s finding of collusion is a lack of presumptive value as to the proposed settlement amount, \$8,750,000, without effecting the presumptive value of the court’s reasonableness determination, \$400,000. *Bird v. Best Plumbing Group, LLC*, 175 Wash.2d 756, 765, 287 P.3d 551 (2012). We acknowledge the Court’s determination that “[w]ithout this presumptive value, the HOA must start from scratch to establish damages in the bad faith claim;” *Water’s Edge*, 152 Wash.App at 596; however, we find no authority supporting a contention that the presumption must be based upon a reasonableness determination which is *equal to* the settlement amount. In fact, such a contention seems to conflict with the rule that the reasonableness determination does not affect settlement:

A determination that the amount paid for a release, covenant not to sue, covenant not to enforce judgment, or similar agreement was unreasonable shall not affect the validity of the agreement between the released and releasing persons nor shall any adjustment be made in the amount paid between the parties to the agreement.

RCW 4.22.060(3).

Of course Farmers seems to take the more exclusive position that the finding of collusion discharges bad faith liability entirely. This argument is contrary to the above-quoted holding in *Water's Edge*, which would allow the bad faith claim to “start from scratch” even without “presumptive value.” *Id.* Moreover, Farmers argument is contrary to Supreme Court holding that “[t]he principles in Butler . . . apply *whenever* an insurer acts in bad faith.” *Besel v. Viking Ins. Co. of Wisconsin*, 146 Wash.2d 730, 737, 49 P.3d 887 (2002), emphasis added.

\* \* \*

**Failure to defend and indemnify**

Farmers alleges that it “fully defended . . . and fully indemnified the insureds,” inferring that payment of the \$215,000 cash component of settlement means WEA and KPS suffered no damage as a result of Farmers’ conduct. *Brief of Respondents* at 3 and *seriatim*. Farmers’ cites *Ledcor Industries v. Mutual of Enumclaw* in support of its argument that expenditures for attorney fees and costs incurred by WEA and KPS are not compensable damages in bad faith litigation:

Ledcor was at all times, before and after its tender to MOE [Mutual of Enumclaw], represented by competent counsel who aggressively defended Ledcor's interests and with whom Ledcor never expressed dissatisfaction. Ledcor's claim that it wanted MOE to take over the defense is belied by the record, and there is no evidence that MOE's involvement might have achieved a different end result. MOE stood ready to pay its share of defense costs, and MOE funded the eventual settlement with Zanetti. MOE's bad faith failure to timely accept tender and promptly become engaged in Ledcor's defense thus made no difference in the outcome. As Ledcor ultimately suffered no harm resulting from MOE's breach of its duties, the court did not err in awarding no damages for bad faith."

*Ledcor Industries v. Mutual of Enumclaw*, 206 P.3d 1255, 1261, 150 Wash. App. 1 (2009).

The HOA offered the following testimonial evidence in satisfaction of the *Ledcor* factors:

Competence of defense:

[A] very strong defense based upon the several liability of the defendants under RCW 4.22.070 had been foreclosed by (a) the failure to assert it, and (b) the fact that Farmers had appointed a single lawyer to defend both WEA and KPS – entities that had different potential liabilities, different defenses and perhaps claims against each other.

*CP 971*, ln. 11-16; *Declaration of Gregory L. Harper*, originally filed under *Declaration of Mark A. Erikson*, December 1, 2011, Exhibit at 0182.

Expression of dissatisfaction and request for replacement counsel:

We still have not heard back from Farmers concerning KPS' request that Farmers approve Oles Morrison as defense counsel for KPS. . . .

Paul [Nelson] feels it is particularly ironic that you [Mark Scheer] are sending all your e-mails to Nancy Kleinrok, who is involved in both the coverage and defense aspects of the case. . . .

A basic part of KPS' position in this case is that Ms. Kleinrok and Bruce White in concert have never prepared the defense of this case for trial . . .

*CP 847*; e-mail dated January 12, 2007 from Richard Beal to Mark Scheer, originally filed under *Declaration of Mark A. Erikson*, December 1, 2011, Exhibit at 0058.

Readiness to fund settlement:

Farmers failed to offer more than the \$176,000 . . . at the January 16, 2007 mediation. The amount Farmers offered at mediation was not reasonably calculated to settle the pending claims.

*CP 974*, ln. 4-8; *Declaration of Gregory L. Harper* originally filed under *Declaration of Mark A. Erikson*, December 1, 2011, Exhibit at 0185.

Harm from bad faith:

Farmers chose to combine the lawyering of all the defendants in one law firm. This necessarily prevented Farmers'-appointed counsel from defending KPS on the grounds of several liability.

This issue was problematic during negotiations since it effectively thwarted any effort on my part to negotiate a several stipulated judgment award against KPS.

*CP 803*, ln. 9-13; *Declaration of Richard T. Beal, Jr.*, originally filed under *Declaration of Mark A. Erikson* filed December 1, 2011, Exhibit at 0014.

As a result of Farmers' conduct, . . . KPS was harmed in having to retain my firm to obtain separate representation for KPS, to negotiate settlement of the underlying case which Farmers' had failed to negotiate, and to help formulate a KPS defense strategy to deal with the fact that the case had not been prepared for trial (see admission of Farmer's counsel Steve Todd in his deposition, Exhibit B hereto).

*CP 228*, ln. 4-9; *Declaration of Richard T. Beal, Jr.* The admission in Exhibit B is now *CP 269*, ln. 6-8, 18-19.

In support of its argument that attorney fees incurred in the underlying action are compensable damages in bad faith litigation, the HOA cited a line of authority holding as follows:

In the context of damages created by an insurer's wrongful refusal to defend, . . . [r]ecoverable damages include, among other items, (1) the amount of expenses, including reasonable **attorney fees**, the insured **incurred in defending the underlying action**, and (2) the amount of the judgment entered against the insured in the underlying action."

*Greer v. Northwestern Nat. Ins. Co.*, 109 Wash.2d 191, 743 P.2d 1244 (1987), emphasis added; citing 14 G. Couch, at §§51:157-159; *Waite v. Aetna Cas. & Sur. Co.*, 77 Wash.2d 850, 856, 467 P.2d 847 (1970); *Bosko v. Pitts & Still*,

*Inc.*, 75 Wash.2d 856, 867, 454 P.2d 229 (1969); accord *Kirk v. Mt. Airy Ins. Co.*, 134 Wash.2d 558, 561, 951 P.2d 1124 (1998).

We submit that the question of “whether attorney fees were reasonably incurred in defending the underlying action” should be analyzed based upon the liability risk prior to settlement: “[T]he existence or nonexistence of damage is to be determined by looking at the liability risk faced by the assignor at the time of assignment.” *Steinmetz for benefit of Palmer v. Hall-Conway-Jackson, Inc.*, 49 Wash.App. 223, 226, 741 P.2d 1054 (1987), *review denied*, 110 Wash.2d 1006 (1988). The Court in *Steinmetz* applied its ruling as follows:

[B]ecause the trial court looked at the effect the covenant had on Steinmetz’s personal liability rather than the right to sue possessed by Steinmetz when she assigned the right to Palmer, we conclude that the trial court erred when it concluded as a matter of law that Steinmetz was not damaged and thus awarded summary judgment to Conway.

*Steinmetz*, 49 Wash.App. at 228.

In the present case, attorney fees and costs were incurred in response to Farmers’: (i) failure to reserve rights for four months after WEA was sued and five months after KPS was added as a defendant; (ii) delay of nine months in appointing separate legal counsel to represent WEA and KPS; (iii) failure to provide coverage updates and disclose the amount of indemnity available

to settle; and (iv) elevation of its own financial interests above those of its insureds. At the time of assignment, the trial court's ruling on reasonableness had not been entered, and its effect upon indemnity claims was not known. The HOA was seeking damages in excess of \$17-million, *CP 236, CP 302*, ln. 15-16; which the settlement reduced to \$8,750,000. *CP 118*. Prior to settlement, Farmer's failure to reserve rights and appoint separate defense counsel reasonably appeared to threaten significant liability to WEA and KPS.

Moreover, the failure to appoint separate counsel after KPS was joined as a defendant on April 11, 2006, amounted to *failure to defend* in view of conflicting several liability defenses under RCW 4.22.070. "Once the duty to defend attaches, insurers may not desert policyholders and allow them to incur substantial legal costs while waiting for an indemnity determination." *American Best Food, Inc. v. Alea London, Ltd.*, 168 Wash.2d 398, 405, 229 P.3d 693 (2010). Attorney Gregory L. Harper was retained by WEA because "Farmers had appointed the same law firm, Mitchell, Lang and Smith, to defend both WEA and codefendant . . . ("KPS") which, among other things, foreclosed statutory defenses based upon several liability. RCW 4.22.070." *CP 290*. Attorney Richard T. Beal, Jr., was retained because "KPS . . . believed it had been harmed by various wrongful conduct committed by

Farmers in defense of the underlying suit.” *CP 225*, ln. 2-3, *CP 232*. In this situation, WEA and KPS reasonably incurred attorney fees and costs defending the underlying case based upon the liability risk prior to settlement.

In failing to appoint separate defense counsel, Farmers breached its duty under *Tank* “to retain competent defense counsel for the insured[, and to] understand that only the insured is the [attorney’s] client.” *Tank*, 105 Wash.2d at 388. It boggles the imagination how Farmers could understand that WEA and KPS were the only client of a solitary defense counsel when each had defenses of several liability under RCW 4.22.070.

\* \* \*

#### **Admissibility of evidence**

Without citation to authority, Farmers argues that “the HOA relies solely upon self-serving declarations of . . . attorneys [retained by WEA and KPS], . . . not competent *evidence* sufficient to defeat summary judgment.” *Brief of Respondent* at 22. This argument raises an issue of whether declarations of counsel regarding attorney fees and costs received for representing WEA and KPS in response to Farmers’ acts of bad faith are admissible to show damages.

As an initial matter, the record includes *no* motion to strike the declarations of either Richard T. Beal, Jr., nor Gregory L. Harper (included in the record at: *CP 224; CP 790; CP 289; CP 295*). Neither has Farmers filed a cross-appeal challenging the Court’s consideration of those documents. Hence, the issue of admissibility is not before the court on the present appeal:

Defendant contends that the affidavit produced by plaintiff in opposition to summary judgment is not competent evidence to withstand such a motion. Defendant argues that the engineer's affidavit does not comply with CR 56(e) because, among others, the statement about cabin attendants being required to walk backward in performance of some of their duties is not based upon personal knowledge. The record before us, however, does not reveal any motion to strike the affidavit or any portion thereof prior to the trial court’s action. Failure to make such a motion waives deficiency in the affidavit if any exists.

*Lamon v. McDonnell Douglas Corp.*, 91 Wash.2d 345, 352, 588 P.2d 1346 (1979); citing *Meadows v. Grant's Auto Brokers, Inc.*, 71 Wash.2d 874, 431 P.2d 216 (1967); 10 C. Wright and A. Miller, *Federal Practice and Procedure* §2738 (1973). The Supreme Court, in *Lamon*, held that viewing inferences therefrom in the light most favorable to the nonmoving party, the affidavit “created an issue of material fact which necessitated the denial of summary judgment.” *Lamon*, 91, Wash.2d at 353.

Moreover, attorneys can testify as to the existence or nonexistence of facts which they have observed in proceedings. *Lynch v. Republic Pub. Co.*, 40 Wash.2d 379, 390, 243 P.2d 636 (1952). In the present case, attorneys Beal and Harper attested to the reasons given for their retention, to actions and nonactions of Farmers, and to fees and costs paid to by KPS and WEA. This appeal presents a legal issue of whether such fees and costs are compensable damages in a bad faith proceeding, but attorney testimony consisting entirely of factual allegations based upon first hand knowledge, is admissible under ER 602.

Finally, it is the *fact* of damage, not the *amount*, which must be shown to prevent summary judgment. *Wilber Development Corp. v. Les Rowland Const. Inc.*, 83 Wash.2d 871, 877, 523 P.2d 186 (1974); accord *Gaasland Co. v. Hyak Lumber & Millwork, Inc.*, 42 Wash.2d 705, 712, 713, 257 P.2d 784 (1953); and *Alpine Industries, Inc. v. Gohl*, 30 Wash.App. 750, 754, 637 P.2d 998 (1981). Farmers has a right to question the amount of fees incurred; however, such inquiry raises disputed factual issues reserved for trial.

\* \* \*

### **Prior rulings**

The *Brief of Respondents* argues that issues pertaining to appointment

of separate defense counsel “have already been rejected by the Clark County Superior Court and this Court in *Water’s Edge*,” quoting the trial court’s reasonableness determination as follows:

The necessity for new counsel to be appointed to represent defendants, . . . was a direct result of a manipulation and posturing by coverage counsel, and not Mr. White nor the insurers.

*Brief of Respondents* at 3, 22 (quoting *CP 109*), and *seriatim*. Farmers also claims that the foregoing was affirmed by the Court of appeals. *Id* at 22.

While arguments pertaining to the doctrines of collateral estoppel, law of the case and judicial estoppel have been addressed in the *Brief of Appellants*, we note that the Court of Appeals reviews summary judgment *de novo*, and does not consider controverted facts nor affirm Superior Court findings. *Shoulberg v. Public Utility Dist. No. 1 of Jefferson County*, 169 Wash.App. 173, 177, fn. 1, 280 P.3d 491 (2012).

\* \* \*

**Breach of duty**

The *Brief of Respondent* argues “the record does not support the conclusion that Farmers breached any duty it owed to its insureds.” *Brief of Respondents* at 4, and *seriatim*. At the risk of repetition, we point out the significance of certain evidence of alleged by HOA in relation to the criteria

articulated in *Tank v. State Farm*:

First, the [insurance] company must **thoroughly investigate** the cause of the insured's accident and the nature and severity of the plaintiff's injuries. Second, [the insurance company] must retain **competent defense** counsel for the insured. Both retained defense counsel and the insurer must **understand that only the insured is the client. . . .**

*Tank*, 105 Wash.2d at 388, emphasis added.

Richard Beal, attorney for KPS attested that a single “report from Mark Lawless [Farmers’ damage expert] established that the cost of repairing building problems at Waters Edge *in the year 2000* would have been approximately \$1 million.” *CP 795-96*, emphasis added. Attorney Beal also attested that Farmers failed to retain an expert “to testify that KPS’ property management was in compliance with protocols and practices of condominium property managers.” *CP 799*, ln. 17-20. The foregoing constitutes bad faith because it tends to support a claim of negligent management against KPS, which would diminish WEA’s several damages at the expense of KPS. *CP 802*, ln. 7-12. Any deterioration occurring after completion of construction would appear to be the fault of property managers, and expert testimony would be necessary to show that negligent construction caused continuing damages after the year 2000. Attorney Gregory L. Harper attested:

[A] very strong defense based upon the several liability of the defendants under RCW 4.22.070 had been foreclosed by (a) the failure to assert it, and (b) the fact that Farmers had appointed a single lawyer to defend both WEA and KPS – entities that had different potential liabilities, different defenses and perhaps claims against each other.”

*CP 791*, ln. 11-16. Of course, the allocation of several liability between WEA as builder, and KPS as manager, is a conflict of interest in any event.

Tank also requires the insurer to fully inform the insured, including any reservation of rights:

Third, the [insurance] company has the responsibility for **fully informing the insured** not only of the **reservation of rights** defense itself, but of all developments relevant to his policy coverage and the progress of his lawsuit.

*Tank*, 105 Wash.2d at 388, emphasis added. Coextensive regulation under WAC 284-30-330 is discussed in the *Brief of Appellants*. In the present case, appointed defense counsel, Bruce M. White, testified on deposition:

Q. “Is it correct that you first learned that Farmers had issued a reservations of rights letter to Key Property Services in early November of 2006 from Paul Nelson? . . .

A. “That’s my recollection.”

*CP 282*, ln. 19-24.

The foregoing constitutes bad faith because Farmers had already considered the policy issued to KPS when it denied coverage thereunder to

WEA and Paul Nelson on October 24, 2005, because “[t]he named insured shown . . . is Key Property Services, Inc., . . . not a named defendant in the Homeowners Association lawsuit.” *CP 172*. Hence, when KPS was added as a defendant on April 11, 2006, *CP 328*, Farmers had in its possession all information necessary to know that rights had not been reserved on KPS claims. Farmer’s failure to provide notification for five months resulted in harm to KPS, which was forced to pay attorney fees and costs upon learning that its interests were in conflict with those of WEA, and were not protected by Farmers appointment of a solitary defense counsel.

As noted in *Moratti*, the duty of good faith includes good faith efforts to settle the claim:

The insured is not required to prove that the insurer acted dishonestly or that the insurer intended to act in bad faith.

The duty of good faith requires the insurer to: . . .

(2) If its investigation discloses a reasonable likelihood that its insured may be liable, make a good faith effort to settle the claim. This includes an obligation at least to conduct good faith settlement negotiations sufficient to ascertain the most favorable terms available and make an informed evaluation of the settlement demand;

*Moratti v. Farmers Ins.*, 162 Wash.App. 495, 506, 254 P.3d 939 (2011); *review denied*, 173 Wash.2d 102, 2272 P.3d 850 (2012); accord *Besel*, 146

Wash.2d at 737.

Attorney Harper attested that “mediation occurred on January 16, 2007, as scheduled[, and] Farmers did not inform WEA of the amount of money Farmers had determined was available to settle the claims against it.” *CP 300*, ln. 18-21; *CP 966*. Attorney Beal complained of the lack of such information in an e-mail to Mark Scheer, appointed replacement counsel, dated January 17, 2007, with a copy to Tyna Ek, Farmers’ coverage counsel:

So far, Farmers has failed to disclose the amount of indemnity available at the mediation to settle the claims against any of the insureds, and Bruce White had earlier reported that Nancy Kleinrok was not in a position to mediate on [January] 16<sup>th</sup> [2007] since White had no defense damage numbers. It is now Friday afternoon, the last day before the mediation, and if Bruce White knows how much money Farmers is making available for settlement, he’s not telling his own clients.

*CP 847*. The foregoing constitutes bad faith because both WEA and KPS were forced to entertain settlement negotiations without knowledge of available funds. Small wonder they sought independent counsel to guide them through the resulting maze.

\* \* \*

**Unreasonable, frivolous and unfounded**

Farmers argues that “the issuance of a reservation of rights letter after the assignment of counsel is not unreasonable, frivolous, or unfounded.”

*Brief of Respondent* at 21. Contrary to Farmers argument, the failure to issue a reservation-of-rights letter for nearly four months after filing of the complaint against WEA, and for five to six months after filing the amended complaint adding KPS, is a clear violation of the rule articulated in *Transamerica Insurance Group*, holding that failure to reserve rights was prejudicial because: (i) it “deprived the [insureds] of their valuable right to retain private counsel;” (ii) it deprived the insureds of their “right to arrange for the initial investigation, settlement negotiations and the conduct of the law suit;” and (iii) it raised “the possibility of a conflict of interest.” *Transamerica Insurance Group v. Chubb & Son, Inc.*, 16 Wash.App. 247, 251-52, 554 P.2d 1080 (1976).

\* \* \*

### **Causation**

Farmers argues that “there is no evidence whatsoever that the issuance of the reservation of rights letter in any way caused any actual damage.” *Brief of Respondent* at 21. As in *Moratti*, “Farmers ignores the principle that the duty to settle is intricately and intimately bound up with the duty to defend and to indemnify.” *Moratti*, 162 Wash.App. at 504. In the present case, it was combination of Farmers’ failure to reserve rights, failure to appoint

separate counsel to represent WEA and KPS, failure to participate meaningfully in settlement negotiations, and elevation of its own interests above those of the insureds which caused WEA and KPS to incur \$92,106.44 in attorney fees and costs. “The insurer is not free to proceed through negotiation and defense stages of litigation safeguarding only its own interests and neglecting those of its insureds.” *Truck Ins. Exchange of Farmers Ins. Group v. Century Indem. Co.*, 76 Wash.App. 527, 533, 887 P.2d 455 (1995); quoting *Weber v. Biddle*, 4 Wash.App. 519, 525, 483 P.2d 155 (1971).

Farmers’ argues “there is no case cited by the HOA for the proposition that Farmers is somehow obligated to provide its insureds with legal advice.” *Brief of Respondents* at 21. While the HOA has cited no such authority, the claim on appeal is that Farmers breached its *own* duties under *Tank*. After specifying criteria to satisfy the enhanced obligation when defending under a reservation-of-rights, the Court in *Tank* observed that defense counsel may *also* become liable for breach of the duties of loyalty and disclosure:

In addition to the specific criteria *to be met by the company*, defense counsel retained by insurers to defend insureds under a reservation of rights must meet distinct criteria as well.

*Tank*, 105 Wash.2d at 388, emphasis added. Farmers’ mischaracterization of its duties under *Tank* does nothing to lessen the impact of its breach.

Farmers argues that “the HOA has not provided any evidence that Mr. White’s representation had any negative impact on the defense.” *Brief of Respondents* at 21-22. This allegation is true, but trivially so; the HOA has presented evidence that KPS and WEA paid attorney fees and costs in the amount of \$92,106.44 “to negotiate settlement of the underlying case which Farmers failed to negotiate, and to help formulate a KPS defense strategy to deal with the fact the case had not been prepared for trial,” *CP 228*, ln. 7-15;” and because Farmers appointed the same law firm to defend both WEA and KPS, which foreclosed statutory defenses based upon several liability under RCW 4.22.070. *CP 228*, ln. 7-15; *CP 290*. When faced with a conflict of interest, attorney White withdrew on December 29, 2006, *CP 844-45*, and Farmers was forced to retain replacement counsel, with trial was scheduled to commence in seven weeks, on February 20, 2007. *CP 232*, ln. 17-19; *CP 296*, ln. 12, 24. Farmers failure to appoint separate counsel in April 2006 resulted in a situation where replacement counsel was forced to prepare for a complicated trial in less than two months.

\* \* \*

### **Summary judgment**

The insurer bears the burden of showing that it acted in good faith:

As between the insured and the insurer, it is the insurer that controls whether it acts in good faith or bad. Therefore, it is the insurer that appropriately bears the burden of proof with respect to the consequences of that conduct.

*Mutual of Enumclaw v. Dan Paulson Construction*, 161 Wash.2d 903, 921, 169 P.3d 1 (2007).

\* \* \*

### III. CONCLUSION

Summary judgment should be reversed because Farmers failed to carry the burden of showing that it acted in good faith: (i) in defending without notice that it was reserving rights to contest indemnity; (ii) in failing to appoint separate legal counsel for codefendants with several liability defenses under RCW 4.22.070; (iii) in failing to disclose the amount of funds available for settlement; and (iv) in elevating its own financial interests above those of its insured, as evidenced by the foregoing.

**RESPECTFULLY SUBMITTED** this 23<sup>rd</sup> day of May, 2013.

ERIKSON & ASSOCIATES, PLLC  
Attorneys for the appellants

By: \_\_\_\_\_

Mark A. Erikson, WSBA #23106

**CERTIFICATE OF SERVICE**

I certify that on the 23<sup>rd</sup> day of May 2013, I caused a true and correct copy of this *Reply Brief of Appellants* to be served on the following in the manner indicated below:

**Counsel for the defendants**

Eric J. Neal, WSBA #31863  
Thomas Lether, WSBA #18089  
Lether & Associates, PLLC  
3316 Fuhrman Avenue E., Suite 250  
Seattle, WA 98102

Telephone: (206) 467-5444  
E-mail: eneal@letherlaw.com  
tlether@letherlaw.com

US Mail  
 Hand Delivery  
 E-mail, as agreed by recipient

By:   
Kris Eklove

West's Revised Code of Washington Annotated

Title 4. Civil Procedure (Refs & Annos)

Chapter 4.22. Contributory Fault--Effect--Imputation--Contribution--Settlement Agreements (Refs & Annos)

West's RCWA 4.22.060

4.22.060. Effect of settlement agreement

Currentness

(1) A party prior to entering into a release, covenant not to sue, covenant not to enforce judgment, or similar agreement with a claimant shall give five days' written notice of such intent to all other parties and the court. The court may for good cause authorize a shorter notice period. The notice shall contain a copy of the proposed agreement. A hearing shall be held on the issue of the reasonableness of the amount to be paid with all parties afforded an opportunity to present evidence. A determination by the court that the amount to be paid is reasonable must be secured. If an agreement was entered into prior to the filing of the action, a hearing on the issue of the reasonableness of the amount paid at the time it was entered into may be held at any time prior to final judgment upon motion of a party.

The burden of proof regarding the reasonableness of the settlement offer shall be on the party requesting the settlement.

(2) A release, covenant not to sue, covenant not to enforce judgment, or similar agreement entered into by a claimant and a person liable discharges that person from all liability for contribution, but it does not discharge any other persons liable upon the same claim unless it so provides. However, the claim of the releasing person against other persons is reduced by the amount paid pursuant to the agreement unless the amount paid was unreasonable at the time of the agreement in which case the claim shall be reduced by an amount determined by the court to be reasonable.

(3) A determination that the amount paid for a release, covenant not to sue, covenant not to enforce judgment, or similar agreement was unreasonable shall not affect the validity of the agreement between the released and releasing persons nor shall any adjustment be made in the amount paid between the parties to the agreement.

**Credits**

[1987 c 212 § 1901; 1981 c 27 § 14.]

Notes of Decisions (110)

West's RCWA 4.22.060, WA ST 4.22.060

Current with 2013 Legislation effective through May 13, 2013

West's Revised Code of Washington Annotated

Title 4. Civil Procedure (Refs & Annos)

Chapter 4.22. Contributory Fault--Effect--Imputation--Contribution--Settlement Agreements (Refs & Annos)

West's RCWA 4.22.070

4.22.070. Percentage of fault--Determination--Exception--Limitations

Currentness

(1) In all actions involving fault of more than one entity, the trier of fact shall determine the percentage of the total fault which is attributable to every entity which caused the claimant's damages except entities immune from liability to the claimant under Title 51 RCW. The sum of the percentages of the total fault attributed to at-fault entities shall equal one hundred percent. The entities whose fault shall be determined include the claimant or person suffering personal injury or incurring property damage, defendants, third-party defendants, entities released by the claimant, entities with any other individual defense against the claimant, and entities immune from liability to the claimant, but shall not include those entities immune from liability to the claimant under Title 51 RCW. Judgment shall be entered against each defendant except those who have been released by the claimant or are immune from liability to the claimant or have prevailed on any other individual defense against the claimant in an amount which represents that party's proportionate share of the claimant's total damages. The liability of each defendant shall be several only and shall not be joint except:

(a) A party shall be responsible for the fault of another person or for payment of the proportionate share of another party where both were acting in concert or when a person was acting as an agent or servant of the party.

(b) If the trier of fact determines that the claimant or party suffering bodily injury or incurring property damages was not at fault, the defendants against whom judgment is entered shall be jointly and severally liable for the sum of their proportionate shares of the claimants [claimant's] total damages.

(2) If a defendant is jointly and severally liable under one of the exceptions listed in subsections (1)(a) or (1)(b) of this section, such defendant's rights to contribution against another jointly and severally liable defendant, and the effect of settlement by either such defendant, shall be determined under RCW 4.22.040, 4.22.050, and 4.22.060.

(3)(a) Nothing in this section affects any cause of action relating to hazardous wastes or substances or solid waste disposal sites.

(b) Nothing in this section shall affect a cause of action arising from the tortious interference with contracts or business relations.

(c) Nothing in this section shall affect any cause of action arising from the manufacture or marketing of a fungible product in a generic form which contains no clearly identifiable shape, color, or marking.

**Credits**

[1993 c 496 § 1; 1986 c 305 § 401.]

APPENDIX 2

Notes of Decisions (120)

Page 2 Of 2

West's RCWA 4.22.070, WA ST 4.22.070

Current with 2013 Legislation effective through May 13, 2013

---

End of Document

© 2013 Thomson Reuters. No claim to original U.S. Government Works.

Washington Administrative Code Currentness  
Title 284. Insurance Commissioner, Office of  
Chapter 284-30. Trade Practices  
The Unfair Claims Settlement Practices Regulation

WAC 284-30-330

284-30-330. Specific unfair claims settlement practices defined

The following are hereby defined as unfair methods of competition and unfair or deceptive acts or practices of the insurer in the business of insurance, specifically applicable to the settlement of claims:

- (1) Misrepresenting pertinent facts or insurance policy provisions.
- (2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.
- (3) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies.
- (4) Refusing to pay claims without conducting a reasonable investigation.
- (5) Failing to affirm or deny coverage of claims within a reasonable time after fully completed proof of loss documentation has been submitted.
- (6) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear. In particular, this includes an obligation to promptly pay property damage claims to innocent third parties in clear liability situations. If two or more insurers share liability, they should arrange to make appropriate payment, leaving to themselves the burden of apportioning liability.
- (7) Compelling a first party claimant to initiate or submit to litigation, arbitration, or appraisal to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in such actions or proceedings.
- (8) Attempting to settle a claim for less than the amount to which a reasonable person would have believed he or she was entitled by reference to written or printed advertising material accompanying or made part of an application.
- (9) Making a claim payment to a first party claimant or beneficiary not accompanied by a statement setting forth the coverage under which the payment is made.
- (10) Asserting to a first party claimant a policy of appealing arbitration awards in favor of insureds or first party claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration.



End of Document

© 2013 Thomson Reuters. No claim to original U.S. Government Works.

APPENDIX 3

Page 3 of 3

# ERIKSON & ASSOCIATES LAW

**May 23, 2013 - 4:03 PM**

## Transmittal Letter

Document Uploaded: 439735-Reply Brief.pdf

Case Name: Waters Edge et al v Farmers Insurance et al

Court of Appeals Case Number: 43973-5

**Is this a Personal Restraint Petition?** Yes  No

### The document being Filed is:

Designation of Clerk's Papers                      Supplemental Designation of Clerk's Papers

Statement of Arrangements

Motion: \_\_\_\_

Answer/Reply to Motion: \_\_\_\_

Brief: Reply

Statement of Additional Authorities

Cost Bill

Objection to Cost Bill

Affidavit

Letter

Copy of Verbatim Report of Proceedings - No. of Volumes: \_\_\_\_

Hearing Date(s): \_\_\_\_\_

Personal Restraint Petition (PRP)

Response to Personal Restraint Petition

Reply to Response to Personal Restraint Petition

Petition for Review (PRV)

Other: \_\_\_\_\_

### Comments:

No Comments were entered.

Sender Name: Kris Eklove - Email: **kris@eriksonlaw.com**

A copy of this document has been emailed to the following addresses:

eneal@letherlaw.com  
tlether@letherlaw.com