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COURT OF APPEALS, DIVISION III
OF THE STATE OF WASHINGTON

JEFFREY WOOD AND ANNA WOOD, husband and wife; MILIONIS
CONSTRUCTION, INC., a Washington corporation; STEPHEN
MILIONIS, an individual,

Respondents

v.

CINCINNATI SPECIALTY UNDERWRITERS
INSURANCE COMPANY,

Appellant (Intervenor Below)

INTERVENOR CINCINNATI SPECIALTY UNDERWRITERS
INSURANCE COMPANY'S REPLY BRIEF

Gary Sparling, WSBA #23208
Attorneys for Appellant/Intervenor
Cincinnati Specialty Underwriters
Insurance Company

SOHA & LANG, P.S.
1325 Fourth Avenue, Suite 2000
Seattle, WA 98101
Telephone: (206) 624-1800
Facsimile No.: (206) 624-3585

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Contrary to the arguments in the Woods' Response Brief,¹ the record below amply demonstrates that the trial court erred:

- by denying Cincinnati the opportunity to take discovery into the final negotiations between its insured and the Woods that led to the inflated stipulated judgment, despite evidence indicating that the settlement was fraudulent, collusive, and/or in bad faith, *cf. Water's Edge Homeowners Ass'n v. Water's Edge Assocs*, 152 Wn. App. 572, 582 ¶ 20, 594-96 ¶¶ 14-60, 216 P.3d 1110 (2009) (discovery allowed by court revealed collusion between the settling parties);
- by disregarding the manifest evidence indicating collusion and bad faith based on the erroneous belief that such evidence was not pertinent to reasonableness, when the law requires courts to look for "any evidence" of bad faith, collusion or fraud in evaluating the reasonableness of a settlement, *see, e.g., Bird v. Best Plumbing Group, LLC*, 175 Wn.2d 756, 766, 287 P.3d 551 (2012); and
- by allowing and considering the parties' improper arguments and briefing regarding Cincinnati's alleged bad faith, when such

¹ The arguments and authorities herein are likewise directed to the joinder filed by respondents Millionis.

matters are irrelevant and contrary to the purpose of reasonableness hearings, *i.e.*, to protect insurers against excessive and collusive judgments, *e.g.*, *Bird*, at 766.²

By failing to meet its duty to provide a full and fair hearing on reasonableness, untainted by irrelevant and extraneous evidence, the trial court flouted the very purpose of the “reasonableness” process: to protect insurers from settlements that are inflated, fraudulent, collusive, and in bad faith. The trial court should therefore be reversed, and this case should be remanded with instructions to allow Cincinnati discovery into the parties’ final settlement negotiations, and to conduct a reasonableness hearing untainted by improper matters and that fully and fairly considers the “reasonableness” factors set forth in *Chaussee v. Maryland Cas. Co.*, 60 Wn. App. 504, 803 P.2d 1339 (1991).

A. The Parties’ Purported Stipulated Facts Are Not “Verities”.

As a preliminary matter, the Woods contend that the so-called “facts” set forth in the stipulated judgment entered below are “verities” because they have not been challenged in this appeal. This, however, misapprehends the purpose of the reasonableness process: to carefully consider and apply the nine *Chaussee* factors to determine whether the

² To the extent not specifically addressed herein, Cincinnati incorporates the arguments in its briefing below and in its opening brief in this appeal.

stipulated settlement amount is objectively reasonable. *See Besel v. Viking Ins. Co.*, 146 Wn.2d 730, 738, 49 P.3d 887 (2002). As part of this process, the court may make factual findings regarding the *Chaussee* factors. *E.g.*, *Water's Edge*, *supra*, 152 Wn. App. at 584 ¶ 25.

The court below, however, made no specific findings of fact on the *Chaussee* factors. It merely granted the parties' Joint Motion for Entry of Judgment finding that the settlement was reasonable, (CP 643-45), and it then signed the Woods' proposed judgment which states, numerous times, the unsupported conclusion that "Plaintiffs Wood have demonstrated they are likely to prove" their claims against Milionis. (*See* CP 648-54.) These were not "findings of fact" on the *Chaussee* elements that could somehow be "verities" in this appeal.

B. Cincinnati Should Have Been Allowed To Take Discovery Into The Final Settlement Negotiations.

The Woods assert that the trial court properly denied Cincinnati's request for discovery because Cincinnati funded Milionis's defense in the underlying suit and participated in three mediations. (*E.g.*, Response Brief at p. 14.) According to the Woods, "Cincinnati had access to all of the material information relating to the dispute between the Woods and Milionis Construction and reasonableness of the stipulated judgment"; therefore, (the argument goes), Cincinnati had no need "to conduct

unnecessary and duplicative discovery” in the reasonableness hearing. (*Id.* at pp. 4, 14.)

This misstates the record and misses the point. Cincinnati does not dispute that it had information regarding the Woods’ claimed damages and Milionis’s alleged liability in the underlying suit. Cincinnati sought leave to take discovery on something completely different: the final negotiations between its insured and the Woods leading to the \$1.7 million stipulated amount. Cincinnati was not privy to those negotiations; indeed, Milionis did not even tell its own defense counsel Shane McFetridge that the negotiations were happening. By denying Cincinnati’s request to take discovery on those negotiations, the court deprived Cincinnati of any opportunity to obtain evidence to show, *inter alia*, that its insured’s negotiations with the Woods were collusive and not at “arms-length,” that the stipulated number did not adequately account for Milionis’s defenses to liability and damages, and that the settlement was not the result of an “objectively reasonable settlement process.” *See Water’s Edge* at 591 ¶ 46.

The Woods, nonetheless, suggest that *Water’s Edge* was somehow different, because in that case, “there was actual evidence of bad faith, fraud and collusion.” (Response Brief at p. 24.) To the contrary, in *Water’s Edge* the settling parties’ collusion came to light because the court

allowed the insurer to intervene and take discovery into the negotiations leading to the stipulated judgment. *See Water's Edge* at 582 ¶ 20, 595-96 ¶¶ 58-60. The evidence obtained by the insurer in discovery was central to the court's determination that the settlement in that case was not reasonable. *See id.* at 595-96 ¶¶ 59-60.

Here, by contrast, the court below was apparently unconcerned that facts in this case likewise indicated that the settlement was collusive:

- » Prior to the third mediation, Milionis's defense counsel estimated the reasonable settlement value of the Woods' claims at \$350,000, and the Woods thereafter agreed to settle for \$399,514.58. (CP 414-15, 419-20.) The stipulated amount, however, was substantially inflated to \$1.7 million. *Cf., e.g., Safeco Ins. Co. v. Parks*, 170 Cal. App. 4th 992, 88 Cal. Rptr. 3d 730, 748 (2009) (collusion may exist where there is an agreement to inflate the claimant's damages so as to artificially increase the damages to be claimed against the insurer).
- » Milionis's defense counsel Shane McFetridge filed summary judgment motions that would have potentially gutted the Woods' claims. (*See* Exhibit C-1 at p. 14, Exhibit C-2 at pp.

11, 23.)³ The stipulated settlement stopped those motions from being decided. *Cf., e.g., Fireman's Fund Ins. Co. v. Imbesi*, 826 A.2d 735, 752-58 (N.J. App. Div. 2003) (collusion may be shown by insured's failure to assert defenses or rebut claims).

- » Defense counsel retained by Cincinnati was never told of the final settlement negotiations between Milionis and the Woods. (*See* CP 388-389, CP 427.) *Cf. Water's Edge, supra*, 152 Wn. App. at 595-96, ¶¶ 58-59 (court found it troubling that defense counsel was excluded from settlement discussions). *See also Fireman's Fund Ins. Co. v. Imbesi*, 826 at 752-58 (concealment may indicate collusion).
- » And, despite the strength of its defenses and counterclaim, Cincinnati's insured Milionis waived all of its defenses, admitted full liability, and stipulated to damages of \$1.7 million. (*See* CP 201-209.) *See, e.g., Mutual of Enumclaw Ins. Co. v. T & G Const., Inc.*, 165 Wn. 2d 255, 267 ¶ 18, 199 P.3d 376, 382-83 (2008) (fraud or collusion potentially exists when there is an absence of serious arms-length negotiations on damages).

³ Exhibits C-1 and C-2 were admitted into evidence at the reasonableness hearing, and Cincinnati supplemented the Clerk's Papers to include these documents on March 26, 2019.

Despite this and other evidence indicating collusion and a lack of “arms-length” negotiations between Milionis and the Woods, the trial court merely dismissed Cincinnati’s request as a “fishing expedition.” (See RP at 20:8-15.) By denying discovery in the face of the manifest indications of fraud and collusion, the trial court deprived Cincinnati of any opportunity to obtain evidence showing that the settlement was unreasonable. This was a manifest abuse of discretion.

C. The Trial Court Erroneously Believed That Fraud, Collusion, And Bad Faith Are Irrelevant To Reasonableness.

The trial court also erroneously believed that the indications of fraud, collusion and bad faith were not pertinent to its evaluation of the “reasonableness” of the settlement:

THE COURT: Isn’t all that discovery that’s not really to see whether or not it’s reasonable . . . it’s more of a fishing expedition for collusion among the attorneys? It’s not really the whole point of discovery is to say what did you consider to make this reasonable.

This to me sounds more like a fishing expedition to see if there was collusion among the attorneys and not whether or not this is really reasonable.

* * *

All of the discovery that you’re requesting isn’t really going to the reasonableness of the settlement. It’s more of is there a collusion against Cincinnati? I haven’t heard anything at all that says this is totally unreasonable. . . .

(RP at 20:8-15, 47:11-15 (emphasis added).)

Chaussee Factor 7, however, requires the court to affirmatively look for “any evidence” of fraud, collusion or bad faith by the settling parties. *Bird, supra*, 175 Wn.2d at 766. Since the express purpose of the “reasonableness” process is to protect insurers from inflated, fraudulent, collusive and bad faith settlements, *id.*, this is perhaps the most important *Chaussee* factor. The trial court thus erred by dismissing this element as irrelevant to its obligations under *Besel* and other law.

D. The Trial Court Erred By Hearing And Considering Counsel’s Arguments Regarding Cincinnati’s Alleged Bad Faith.

As they did below, the Woods again argue that *Chaussee* Factor 7 (*i.e.*, whether there is “any evidence of bad faith, collusion, or fraud”) allows the court to consider the conduct of a settling party’s insurer rather than the conduct of the settling parties. (*See, e.g.*, Response Brief at 12.) The Woods even go so far as to assert that the trial court properly considered Cincinnati’s alleged “bad faith” because it would “provide the Court with context for it to understand the settlement negotiations and the reasonableness of it.”⁴ (*See id.* at p. 28.)

⁴ As previously noted, the U.S. District Court has ruled that Cincinnati’s policy does not cover any of the Woods’ claimed damages in this case. *Cincinnati Specialty Underwriters Ins. Co. v. Milionis Constr., Inc.*, 352 F. Supp. 3d 1049 (E.D. Wash. 2018). Nonetheless, despite the clear lack of coverage, Cincinnati offered \$100,000 to settle the Woods’ claims against Milionis. (CP 303.) Thus, in addition to being immaterial, the Woods’ assertion that Cincinnati participated in the settlement process “in bad faith” is also false.

This contravenes *Chaussee* and turns the reasonableness process on its head. The law makes it eminently clear that the purpose of a reasonableness hearing is to protect insurers from inflated, bad faith, fraudulent, and/or collusive settlements. *E.g., Bird, supra*, 175 Wn.2d at 766 (reasonableness hearing protects insurers against excessive judgments; trial court must evaluate whether there is any evidence of bad faith, collusion, or fraud). *Chaussee* Factor 7, therefore, requires the court to affirmatively look for “any evidence” of bad faith, collusion or fraud by the settling parties. *See id.*

The court, however, over objection, allowed and considered the parties’ extensive briefing and argument regarding Cincinnati’s alleged “bad faith.” (*See, e.g.,* RP at 26:18-22, 28:10-29:2, 36:17-21.) The record also shows that the court used those improper arguments against Cincinnati to support its ruling on reasonableness:

[T]he Court has some concerns where [Milionis’s defense counsel] testified that he asked Cincinnati for additional authority, and that wasn’t forthcoming. He didn’t ask for additional authority because he knew it wasn’t going to come.

That concerns the Court on whether or not his ability to actually negotiate the case at that point on behalf of Cincinnati concerns the Court. If you’re going in and there’s no authority to settle the case, you already know numbers have gone up. . . .

(RP at 143:14-144:1 (emphasis added).)

None of the *Chaussee* factors allow a court to hear – much less consider – the conduct of a settling party’s insurer in evaluating the reasonableness of a settlement. *See, e.g., Besel, supra*, 146 Wn.2d at 738 (listing nine factors to be considered by court in determining reasonableness). Any allowance or consideration of such evidence is improper and contrary to the expressed purpose of the process: to protect insurers from inflated, fraudulent and collusive settlements. *Bird, supra*. The court’s allowance and consideration of arguments regarding Cincinnati’s alleged bad faith was improper and an abuse of discretion.

E. Conclusion.

For the foregoing reasons (and for the reasons set forth in Cincinnati’s opening brief and briefing below), the trial court manifestly abused its discretion by depriving Cincinnati of the opportunity to take discovery into the final negotiations between its insured and the Woods leading to the \$1.7 million stipulated settlement; by disregarding evidence of collusion and bad faith between the settling parties because it believed such was not relevant to whether the settlement was reasonable; and by considering and relying on improper arguments regarding Cincinnati’s alleged bad faith conduct.

The trial court should therefore be reversed in all respects, and this case should be remanded with instructions that Cincinnati be granted leave

to take discovery into the final negotiations leading to the settlement, and requiring the court to conduct a reasonableness hearing within the bounds of the law and untainted by improper matters.

DATED this 25th day of October, 2019.

SOHA & LANG, P.S.

By: /s/Gary Sparling
Gary Sparling, WSBA # 23208
Attorneys for Appellant/Intervenor
Cincinnati Specialty Underwriters
Insurance Company

CERTIFICATE OF SERVICE

I am employed in the County of King, State of Washington. I am over the age of 18 and not a party to the within action; my business address is SOHA & LANG, PS, 1325 Fourth Avenue, Suite 2000, Seattle, WA 98101.

On OCTOBER 25, 2019, a true and correct copy of INTERVENOR CINCINNATI SPECIALTY UNDERWRITERS INSURANCE COMPANY'S REPLY BRIEF was served on parties in this action Via Court of Appeals E-Filing Portal:

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Kevin W. Roberts
Roberts | Freebourn, PLLC
1325 W. 1st Avenue, Suite 303
Spokane, WA 99201
Tel: (509) 381-5262
Fax: (509) 777-2215
Email: kevin@robertsfreebourn.com
***Attorneys for Defendant Anna Wood
and Jeffrey Wood***

***Court of Appeals E-Filing
Portal***

Brook Cunningham
Randall | Danskin, P.S.
601 West Riverside, Suite 1500
Spokane, WA 99201
Tel: (506) 747-2052
Fax: (509) 624-2528
Email: blc@randalldanskin.com
***Attorneys for Milionis
Construction, Inc. and Stephen
Milionis***

Dated this 25th day of October, 2019.

SOHA & LANG, P.S.

By: /s/Gary Sparling
Gary Sparling, WSBA # 23208
Attorneys for Appellant/Intervenor
Cincinnati Specialty Underwriters
Insurance Company

SOHA & LANG

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