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THE SUPREME COURT
OF THE STATE OF WASHINGTON

BY RONALD R. CARPENTER



CLERK

MUTUAL OF ENUMCLAW INSURANCE COMPANY,

Respondent/Cross-Petitioner

v.

DAN PAULSON CONSTRUCTION, INC., a Washington corporation,
KAREN and JOSEPH MARTINELLI, and the marital community composed
thereof,

Petitioners/Cross-Respondents.

**BRIEF OF *AMICUS CURIAE* ON BEHALF OF WASHINGTON
DEFENSE TRIAL LAWYERS**

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I. STATEMENT OF THE IDENTITY, INTEREST AND SOURCE OF AUTHORITY OF AMICUS CURIAE

The Washington Defense Trial Lawyers (“WDTL”), is an organization of trial lawyers in the State of Washington that has appeared *pro bono* before this Court as *amicus curiae* on a number of occasions. The organization is devoted, among other things, to the advancement and protection of the interests of defendants in civil litigation in Washington. WDTL’s interest in this matter is based upon the potential impact it might have on the defense of liability claims under reservation of rights in Washington courts. The Court has granted WDTL leave to file this *amicus* brief under RAP 10.6 by letter ruling dated May 10, 2007.

II. FACTS

These facts are pertinent to this *amicus* brief:

The Martinellis brought an arbitration proceeding against Dan Paulson Construction claiming that Paulson was liable for defects in construction and consequential property damage at the house Paulson had built for them. Brief of Appellant at 4-5. Paulson initially defended the claim by its own counsel, but then tendered it to its liability insurer, Mutual of Enumclaw. *Id.* MOE agreed to defend Paulson under a reservation of rights and provided counsel. *Id.*

The claims alleged against Paulson involved some claims that, if proven, would be covered under the MOE policy and other claims that would not be. *Id.* at 5-6. MOE attempted to discover information about those

claims that would be covered in order to be in a position to respond appropriately to any judgment that might be entered against Paulson because a substantial arbitration award would affect Paulson's ability to continue operations. *Id.* at 9. Paulson provided MOE with expert reports but maintained that it hotly disputed whether the Martinellis were entitled to recover anything. *Id.* While the expert reports provided information concerning the claims against Paulson, the critical factor was the claims on which the Martinellis succeeded. To be in a position to evaluate that issue, MOE proposed various ways for it to obtain that information. But Paulson rejected all of MOE's proposals:

- It refused to allow MOE to intervene in the arbitration or to even attend the arbitration. *Id.* at 10.
- When MOE sued for declaratory judgment, Paulson objected claiming MOE should not have brought the action until after the arbitration was completed. *Id.*
- Paulson's coverage lawyer asked the Martinellis, and the Martinellis agreed, to have the arbitrator enter a lump sum award, departing from his usual practice of breaking the award into specific elements of damage. He admitted he took this step to thwart an attempt to segregate the damages into insured and uninsured elements and thereby force MOE to pay all of the award without regard to coverage. He ignored MOE's requests that the arbitrator follow his usual practice. *Id.* at 11.

MOE brought a declaratory judgment action and issued a subpoena on written questions to the arbitrator returnable after the arbitration to permit MOE to segregate insured and uninsured damage elements. *Id.* at 10-11.

Paulson and the Martinellis objected. *Id.* at 11. Then a few days into the arbitration, Paulson stipulated to a lump sum arbitration award of \$1.3 million, assigned its coverage and bad-faith claims against MOE, and obtained a covenant-not-to-execute against Paulson's personal assets. *Id.* at 12-13. The arbitrator entered the settlement amount as an arbitration award. *Id.* at 13. The award was then entered as a judgment in the Superior Court. *Id.*

MOE then brought a new suit for declaratory judgment, asking for a determination of what portions of the award were insured. On cross-motions for summary judgment, the trial court held:

- MOE's discovery requests to the arbitrator were improper but had not harmed Paulson. On reconsideration, however, the court held that Paulson had been harmed by incurring attorneys fees to object to the discovery request. Consequently, MOE was estopped to deny coverage.
- MOE's failure to settle the claims against Paulson was not bad faith.
- MOE's failure to pay any portion of the arbitration award was not bad faith because MOE did not know what portion was insured and what portions were uninsured.
- The stipulated arbitration award and related judgment were reasonable.

On appeal, Division I reversed the trial court, holding that (1) MOE's submission of discovery to the arbitrator was not bad faith and (2) Paulson's attorney's fees were not harm that would justify estoppel.

This Court granted the parties' cross-petitions for review.

III. ISSUES ADDRESSED BY AMICUS

1. Does the mere fact that an insurer is providing a defense subject to a reservation of rights empower an insured to settle a liability claim, with the insurer's money but without the insurer's consent?

2. Is an insurer subject to bad faith liability because it has asked a court or an arbitrator to decide an issue that will assist in resolution of coverage questions related to a defense under reservation of rights?

3. Does the insured have a duty of good faith to its insurer that precludes it from attempting to thwart the insurer's resolution of coverage questions, or to manufacture a bad-faith claim?

4. When an insurer proves that the only consequences of alleged bad faith conduct are small legal bills and the insured's defense of a liability claim does not suffer, is it inappropriate to estop the insurer from denying coverage under the terms of the insurance contract?

IV. ARGUMENT

In *Truck Insurance Exchange v. Vanport Homes, Inc.*, 147 Wn.2d 751, 761, 58 P.3d 276 (2002) this Court stated that when a claim tendered for defense presents debatable coverage questions, an insurer may properly defend the insured under a reservation of rights and bring a declaratory judgment action to resolve the coverage issues. Implicit in *Vanport* was the promise that an insurer who defends under reservation has a right to seek

judicial resolution of the coverage issues on the merits. The question in this case is whether that right is illusory.

This brief addresses the general principles that should apply in reservation of rights cases, with specific reference to the facts in the pending appeal.

A. The existence of a reservation of rights does not authorize the insured to settle the claims with the insurer's money without the insurer's consent.

In *Tank v. State Farm*, this Court outlined an insurer's basic obligations when defending under a reservation of rights. The Court held the insurer must do the following:

- Thoroughly investigate the cause of the insured's accident and the nature and severity of the plaintiff's injuries.
- Retain competent defense counsel for the insured. Both retained defense counsel and the insurer must understand that only the insured is the client.
- Fully inform the insured not only of the reservation of rights defense itself but of all developments relevant to his policy coverage and the progress of the lawsuit.
- Refrain from engaging in any action that would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk.

Tank v. State Farm Fire & Cas. Co., 105 Wash.2d 381, 388, 715 P.2d 1133 (1986).

The *Tank* Court also explained that since in a reservation of rights defense it is the insured who may pay any judgment or settlement, it is the

insured who must make the "ultimate choice" regarding settlement and must therefore have full information concerning all settlement offers and rejections. *Tank*, 105 Wn.2d at 389, 715 P.2d 1133.

None of the first three *Tank* criteria is at issue in this case. Only the fourth criterion is at issue. Paulson claims that by declining to settle the Martinellis' claims or to pay the stipulated award, or by sending written questions to the arbitrator, the insurer has "demonstrated a greater concern for the insurer's monetary interest than for the insured's financial risk." This contention necessarily requires an examination of what this fourth *Tank* criterion means.

This fourth criterion, like the first three, addresses the insurer's duty in the conduct of the defense. The insurer's "monetary interest" in the conduct of the defense is to avoid paying excessive defense costs. The insured's "financial risk" is the risk of an adverse judgment. Thus, this criterion focuses on whether the insurer is unreasonably seeking to minimize defense costs to the detriment of the insured. As the *Tank* decision explained, a reservation of rights is not a license for the insurer to defend less vigorously than it would if its own funds were at stake in the event of an adverse judgment. *Tank*, 105 Wn.2d at 387, 715 P.2d 1133.

What this criterion cannot logically refer to is any obligation to pay a settlement. Paulson apparently contends, as policyholders frequently do, that whenever an insurer, because of coverage questions, refuses to pay the

claimant's demand when the insured requests, it is demonstrating greater concern for its monetary interests than the insured's risk. If that were true, then an insurer defending under a reservation of rights would always be required to pay a settlement regardless of its coverage defenses. *Tank* does not stand for that proposition. In *Tank*, State Farm declined to settle the claim against the insured, although the insured demanded it. This Court found State Farm had acted properly and affirmed summary judgment for State Farm. *Tank*, 105 Wn.2d at 389, 715 P.2d 1133.

Tank does still grant the insured the "ultimate choice" regarding settlement. *Tank*, 105 Wn.2d at 389, 715 P.2d 1133. Of course, if the insured chooses, it can settle with its own funds. But the insured's "ultimate choice" does not mean that the insured can enter into a settlement without the insurer's consent and require the insurer to pay it, while the insurer continues to vigorously defend the claim. Liability policies – and the MOE policies here are no exception – routinely contain a provision preventing the insured from entering into a settlement with the injured claimant without the insurer's consent. The legal effect of the insured's non-compliance with that requirement is that the insurer is under no obligation to contribute to the settlement. In Washington, the insured's breach of a policy condition relieves the insurer of its coverage obligations if the breach actually prejudices the

insurer.¹ Prejudice exists if the insured's non-compliance creates some concrete detriment that harms the insurer's preparation or presentation of defenses to coverage or liability.² Washington courts repeatedly have held that insured's actions comparable to stipulating to a judgment establish prejudice as a matter of law.³ Therefore, the insurer has no obligation to pay the stipulated award.

Moreover, as one commentator has observed, an insurer should not be obligated to pay a "sweetheart" settlement in which the insured receives a covenant not to execute. As the Texas Supreme Court has explained, as long as the insurer has agreed to provide or pay for a reservation of rights defense, a sweetheart settlement violates public policy.⁴

B. An insurer's request that a court or arbitrator rule on a question related to coverage cannot, as a matter of law, amount to bad faith because an insurer, like all other persons, is entitled to access to the courts.

Just as *Tank's* fourth criterion cannot logically apply to an insurer's obligation to pay a settlement, it also cannot logically apply to an insurer's request for relief from a court or an arbitrator. An insurer, like any other

¹ *Oregon Auto. Ins. Co. v. Salzberg*, 85 Wn.2d 372, 377, 535 P.2d 816 (1975); *Cannon, Inc. v. Federal Ins. Co.*, 82 Wn.App. 480, 485, 918 P.2d 937 (1996).

² *Cannon*, 82 Wn.App. at 485, 918 P.2d 937.

³ See *Felice v. St. Paul Fire & Marine Ins.*, 42 Wn.App. 352, 711 P.2d 1066 (1985); *Northwest Prosthetic & Orthotic Clinic, Inc. v. Centennial Ins. Co.*, 100 Wn.App. 546, 997 P.2d 972 (2000); *Key Tronic Corp. v. St. Paul Fire & Marine Ins. Co.*, 134 Wn.App. 303, 305, 139 P.3d 383 (2006); *MacLean Townhomes, LLC v. American States Ins. Co.*, ___ Wn.App. ___, 156 P.3d 278 (2007).

⁴ *State Farm Fire and Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (1996).

litigant, has a right to access to the courts; and the exercise of that right cannot constitute bad faith. Const. Art. 1, § 10

As this Court stated in *Vanport*, an insurer defending under a reservation of rights is not without a remedy: it can bring a suit for declaratory judgment to determine the coverage question.⁵ If resolution of the declaratory judgment action depends on issues not relevant to the underlying suit, the action can proceed at the same time as the underlying suit. If, on the other hand, the declaratory judgment action hinges on questions of fact common to the underlying lawsuit – for example where the question is whether the insured intentionally injured the underlying plaintiff – the declaratory action may be stayed pending the outcome of the underlying suit. The insurer should not be bound by the result in the underlying case.⁶

By bringing a declaratory judgment action or taking other steps to resolve questions relevant to disputed coverage, the insurer does not place its financial interests above the insured's risk. The insured has an opportunity to oppose the insurer's action. If the court (or arbitrator) grants the insurer's requested relief, then the insurer's action was appropriate. If the court (or arbitrator) denies the insurer's requested relief, then the insured has not been harmed. In either event, the insurer cannot have acted in bad faith because it

⁵ *Vanport*, 147 Wn.2d at 761, 58 P.3d 276.

⁶ *Wear v. Farmers Ins. Co. of Washington*, 49 Wn.App. 655, 745 P.2d 526 (1987).

cannot be bad faith for an insurer to request relief from a tribunal – that, after all, is what courts are for.

This result does not change because the insurer's application to the tribunal causes the insured to feel "less secure." Litigation, by its very nature, can be stressful and upsetting to the participants. But that fact cannot logically form the basis of a bad faith claim against an insurer based on the insurer's exercise of its legal right to seek relief in the courts. "Resort to a judicial forum is not *per se* bad faith or unfair dealing on the part of the insurer regardless of the outcome of the suit."⁷ This result does not change if the insurer's application to the tribunal is frivolous or unfounded. The insured has a remedy under the court rules and related statutes (e.g. CR 11, CR 37, RCW 4.84.185) - not a bad faith claim; and surely not the draconian relief of coverage by estoppel. As one court expressed it:

Allowing litigation conduct to serve as evidence of bad faith would undermine an insurer's right to contest questionable claims and to defend itself against such claims. As a district court in this circuit aptly noted, permitting allegations of litigation misconduct would have a "chilling effect on insurers, which could unfairly penalize them by inhibiting their attorneys from zealously and effectively representing their clients within the bounds permitted by law."^[8]

An insurer would be placed in an untenable position if the pursuit of relief in litigation or arbitration to resolve a coverage question constitute bad

⁷ *Timberlake Construction v. United States Fidelity & Guaranty*, 71 F.3d 335, 340 (10th Cir. 1995).

⁸ *Timberlake Const. Co. v. U.S. Fidelity and Guar. Co.*, 71 F.3d 335, 341 (10th Cir.1995).

faith and result in coverage by estoppel. If the insurer's litigation conduct is improper, the appropriate remedy is right there in the Civil Rules (or in the applicable rules of arbitration), including a motion to strike, compel discovery, secure a protective order or impose sanctions.⁹

C. The insured has a duty of good faith to its insurer; the existence of a reservation of rights is not a license for an insured to thwart the insurer's resolution of coverage questions or to manufacture bad-faith claims.

The record reflects that Paulson objected to all of MOE's efforts to resolve the coverage issues raised in its reservation of rights, in the hope that by presenting MOE with an undifferentiated judgment, it could force MOE to pay all damages, whether covered or not. This conduct violated the insured's own duty of good faith to its insurer under Washington law.

RCW 48.01.030 -- the statutory basis for an insurer's duty of good faith -- imposes a duty of good faith on insurer and insured alike. Our courts have confirmed that both parties to an insurance contract have a duty of good faith and fair dealing -- as is true of any contractual relationship.¹⁰

Given these mutual duties of good faith, it follows that an insurer should be entitled to seek a resolution of legitimate coverage issues on the

⁹ *Id.*

¹⁰ *PEMCO v. Kelly*, 60 Wn. App. 610, 619, 805 P.2d 822; *rev. denied*, 116 Wn.2d 1031, 813 P.2d 582 (1991); *see also Tank*, 105 Wn.2d at 381, 715 P.2d 1133.

merits; and the insured should not be permitted to obstruct the insurer's attempts to address those issues in court or arbitration.

This case demonstrates, however, that the possibility of obtaining coverage by estoppel when an insurer seeks to resolve a coverage question provides a strong incentive for insureds and claimants to work together to prevent any such resolution. An insured should not be permitted to resist the insurer's effort to obtain a resolution of the coverage questions supporting its reservation of rights; assert that the insurer is acting in "bad faith" by attempting to resolve those questions; and then claim that the cost of resistance constitutes the "harm" necessary to support coverage by estoppel as a result of "bad faith."

California courts have recognized that insureds often have a strong incentive to prevent resolution of coverage questions when the insurer defends under reservation. One California Supreme Court Justice has remarked on the phenomenon:

It seems to me that attorneys who handle policy claims against insurance companies are no longer interested in collecting on those cases, but spend their wits and energies trying to maneuver the insurers into committing acts which the insureds can later trot out as evidence of bad faith.¹¹

Sound public policy supports the rule, implicit in *Vanport*, that an insurer defending under reservation of rights should be free to seek relief in

¹¹ *White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985) (Kaus J., concurring and dissenting).

court or in arbitration to resolve coverage issues, at the same time it vigorously defends the claims against its insured. If an insured is able to obstruct the insurer's efforts to resolve coverage questions, as *Vanport* directs the insurer to do, and at the same time claim that such efforts constitute "bad faith," the premium paying public eventually pays the price.

What we have here, at bottom, is an effort by [the insured] to concoct a bad-faith claim out of whole cloth . . . with the "ingenious assistance of counsel." . . . [The insured] has attempted to position to pursue a high stakes, bad-faith case, seeking punitive damages, for which it hopes to emerge not only with the [underlying] claim disposed of at no cost to [the insured], but a profit as well in the form of damages recovered from [the insurer].

Bad-faith litigation is not a game, where insureds are free to manufacture claims for recovery. Every judgment against an insurer potentially increases the amounts that other citizens must pay for their insurance premiums.¹²

The same type of gamesmanship appears to be at work in this case – which is in many respects characteristic of all reservation of rights cases – and is the product of these factors:

1. The claimant has substantial claim that may not be covered by the defendant's liability insurance policy in whole or in significant part.
2. The defendant has no significant assets (beyond the insurance policy) to respond to the claim if it is successful.

¹² *J.B. Aguerre, Inc. v. American Guaranty & Liability Ins. Co.*, 59 Cal. App. 4th 6, 68 Cal. Rptr. 2d 837, (1997). See also *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal. App. 4th 999, 71 Cal. Rptr. 2d 882 (1998).

3. The claimant and the insured defendant have a shared interest in having the claim paid by the insurer.

4. The insurer has legitimate coverage defenses.

The temptation for the insured and the claimant – with their unity of interest in seeing that a stranger pay the loss – to manufacture some alleged bad faith as a panacea is overwhelming. This Court, like the California courts, could not -- consistent with general contract case law and RCW 48.01.030 – countenance such bad faith *by insureds*.

D. Even if the insurer's court action could be bad faith, the insured's law costs cannot be "harm" within the meaning of Butler, nor should this Court adopt the Martinellis' argument that any harm to the insured is sufficient to justify an estoppel.

The trial court and the Court of Appeals agreed that MOE rebutted any presumed harm to Paulson's defense arising out of MOE's alleged bad faith conduct. But the two courts differed on whether legal expenses Paulson incurred to challenge MOE's subpoena constituted "harm" within the meaning of this Court's decision in *Safeco Ins. Co. of America v. Butler*, 118 Wash.2d 383, 823 P.2d 499 (1992), thereby justifying coverage by estoppel for the entire \$1.3 million arbitration award. The Court of Appeals correctly ruled that it did not. The harm presumed under *Butler* and its progeny is that the insurer's wrongful conduct prejudiced the handling of the tort claim to the detriment of the insured. When the insurer proves that such prejudice did not occur, the "presumption" is rebutted and liability should be limited to the insured's actual damages, if any.

In *Butler*, Safeco allegedly directed the defense of its insured with a design to gain an advantage on the coverage issues. In such a case it would be difficult for either party to prove what would have happened if the insurer had defended properly. The Court therefore reasoned that harm must be presumed because “[t]he shifting of the burden [to the insurer] ameliorates the difficulty insureds have in showing that a particular act *resulted in prejudice.*” *Butler*, 118 Wn.2d at 392 (emphasis added). The Court further reasoned that the remedy of coverage by estoppel was necessary to create a disincentive for bad faith conduct and “better protect[s] the insured against the insurer’s bad faith conduct.” *Butler*, 118 Wn.2d at 394.

In *Kirk v. Mt. Airy Ins. Co.*, 134 Wn.2d 558, 563, 951 P.2d 1124 (1998), the Court again discussed the rationale for coverage by estoppel and presumed harm in the context of a bad faith failure to defend:

The rebuttable presumption of harm must be applied because an insured *should not be required to prove what might have happened had the insurer not breached its duty to defend in bad faith; that obligation rightfully belongs to the insurer who caused the breach.*

Kirk, 134 Wn.2d at 563, 951 P.2d 1124 (emphasis added).

Here, there was no detriment to the insured’s defense. MOE’s attempts to intervene in the arbitration and to obtain an explanation of the arbitrator’s ruling were rejected. The arbitration proceeded unhindered for six days, and before the arbitrator rendered any decision, the parties reached a settlement. This settlement was not segregated between covered and

uncovered claims, preserving the stipulated, pre-existing directive to the arbitrator. Now, before this Court, the Martinellis do not even attempt to show that there was any detriment to Paulson's defense, and indeed, they cannot possibly do so.

Since there was no prejudice -- real or imagined -- to Paulson's defense, the Martinellis resort to a fall-back argument. This rests upon two propositions: first, even trivial monetary harm suffices to justify coverage by estoppel, and second, courts should impose coverage by estoppel even where the insured has suffered no harm directly related to the defense of the underlying liability claim.

When the insurer proves its conduct did not prejudice the insured's defense, but merely caused the insured to incur legal expenses to resist a motion or other legal action by the insurer, coverage by estoppel is an inappropriate remedy completely out of proportion to the insured's actual loss. In this instance, the insurer has met the burden this Court described in *Kirk* by proving what would have happened if the insurer had not breached (the insured would not have incurred legal fees). Awarding \$1.3 million in coverage by estoppel for claims that are not otherwise covered under the policy, as a remedy for a reasonably small sum in attorneys' fees incurred, is no more justified than if the insurer's conduct has caused no harm at all. In both cases the remedy would be arbitrary and punitive in nature.

Thus, the proper remedy for an insured who has incurred “minor attorney fees” as a result of the insurer's conduct is as provided in *Coventry Associates v. American States Ins. Co.*, 136 Wn.2d 269, 961 P.2d 933 (1998) – the insured may recover the *actual damages* it suffered. In *Coventry*, the Court noted that “[i]n third party reservation of rights cases. . . coverage by estoppel is an appropriate remedy because the insurer *contributes to the insured's loss* by failing to fulfill its obligation in some way.” *Coventry*, 136 Wn.2d at 284 (emphasis added). Here, as is the case with expenses an insured incurs in connection with a bad faith investigation of a first party claim, Paulson’s attorney fees did not contribute to its exposure to the Martinellis, and coverage by estoppel for that exposure is not warranted.

Should a court ignore the nonexistence of harm to the insured’s defense to create coverage by estoppel solely because an act by the insurer is found to be in “bad faith”? The Court of Appeals’ decision in this case recognized that adopting the Martinellis’ position would make the presumption of harm irrebuttable: “If harm . . . broadly encompasses the entire penumbra of losses, then it is unreasonable to presume that harm because the insurer can never rebut it.” *Mutual of Enumclaw Ins. Co. v. Dan Paulson Constr., Inc.*, 132 Wn.App. 803, 816, 134 P.3d 240 (2006). The Court of Appeals further recognized that adopting such a rule would permit any slight to the insured (“the entire penumbra of losses”) to satisfy the harm requirement. In addition to the quantifiable expense of paying coverage

counsel, the insured's alleged anxiety caused by uncertainty about coverage is one such harm that the Martinellis contend suffices to justify estoppel. Indeed, the Alaska Supreme Court case relied upon by the Martinellis apparently adopts such a position: "Impropriety of the kind that PacMar committed is intolerable if it has *any adverse effect* on the insured party." *Lloyd's & Institute of London Underwriting Cos. v. Fulton*, 2 P.3d 1199, 1208 (Alaska, 2000), quoted in Martinelli's Supplemental Brief at 12 (emphasis Martinellis').

While it is true that bad faith estoppel and traditional estoppel differ, there is no denying that estoppel has its genesis in equity.¹³ The Court of Appeals appropriately recognized this: "When the damages greatly outweigh the relatively minor economic harm, the remedy becomes more punitive than equitable." *MOE v. Dan Paulson*, 132 Wn.App. at 817. Applying coverage by estoppel as casually as the Martinellis advocate offends that equitable origin, and ought not be countenanced by this Court. Moreover, the "any adverse effect" standard is not consistent with prior Washington cases, where the conduct justifying estoppel increased the insured's exposure to the tort claimant.¹⁴

¹³ See, e.g., *Underwriters at Lloyds v. Denali Seafoods, Inc.*, 927 F.2d 459 (9th Cir. 1991); *Hayden v. Mutual of Enumclaw Ins. Co.*, 141 Wn.2d 55, 1 P.3d 1167 (2000); *Saunders v. Lloyd's of London*, 113 Wn.2d 330, 779 P.2d 249 (1989).

¹⁴ *Besel v. Viking Ins. Co. of Wisconsin*, 146 Wn.2d 730, 49 P.3d 887 (2002) (insurer ignored opportunities to settle claim within \$25,000 policy limits); *Vanport*, 147 Wn.2d 751, 58 P.3d 276 (2002) (bad faith refusal to defend); *Kirk*, 134 Wn.2d 558, 951 P.2d 1124.

Though justified in part by a desire to deter bad faith conduct, coverage by estoppel must remain fundamentally an equitable and compensatory remedy -- not a punitive remedy that applies whenever an insurer commits a misstep, no matter how slight, and no matter in what context. Where the existence and extent of harm is inherently uncertain, as in the case of a wrongful refusal to defend, the *Butler* formula errs on the side of protecting the insured to reduce the risk the insured will suffer the consequences of the bad faith conduct. But if the insurer overcomes the presumption of harm and shows that either (1) the insured's harm is readily quantified, or (2) the insured did not suffer detriment to its defense to the tort claimant's suit, it makes no sense to require the insurer pay a judgment that was not caused by the insurer's conduct and that is many, many times the actual amount of the insured's actual damages. The Martinellis' proposed "any adverse effect" rule is arbitrary, unfair, and unnecessary. In addition, it would invite tactical gamesmanship and lack of cooperation into the already tense relationship of insurer and insured when there is a defense under reservation of rights.

This Court should rule that coverage by estoppel is not available when the harms established are (1) not prejudicial to the defense against the insured's liability to a third party, or (2) can be proven and quantified, as in

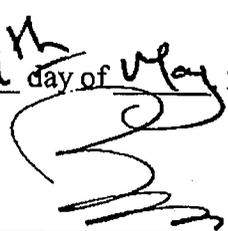
(same); *Butler*, 118 Wn.2d at 392, 823 P.2d 499 (bad faith management of a reservation of rights defense).

the case of attorney's fees incurred to respond to legal action taken by the insurer seeking to resolve a coverage issue.

V. CONCLUSION

The WDTL, as *amicus curiae*, asks the Court to affirm the basic principles of insurance law described in this brief and to decide the pending appeal in accordance with these principles.

DATED and respectfully submitted this 14th day of May 2007.

By  

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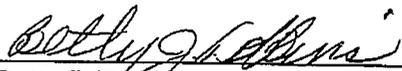
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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED at Seattle, Washington this th 15 day of May, 2007.


Betty J. Dobbins

FILED AS ATTACHMENT
TO E-MAIL