

No. 79027-2

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IN THE SUPREME COURT  
OF THE STATE OF WASHINGTON

Court of Appeals No. 55342-9-I

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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.

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SUPPLEMENTAL BRIEF OF PETITIONERS/CROSS-  
RESPONDENTS KAREN AND JOSEPH MARTINELLI

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**I. Supplemental Statement of Issues**

1. Does an insurer's commencement of a declaratory judgment action immunize it from liability for "unreasonable, frivolous or unfounded" conduct that interferes in its insured's defense under a reservation of rights?

2. Should the Court re-affirm its bright-line rule of *Butler* that an insurer's bad faith conduct while defending under a reservation of rights results in a presumption of harm?

3. Should the *Butler* presumption of harm apply when an insurer fails to comply with Washington Administrative Code standards for timely adjustment and payment of third-party claims against the insured?

4. Did Mutual of Enumclaw raise a genuine issue of fact concerning the reasonableness of its insured's underlying settlement?

**II. Insurers May Not Unreasonably Interfere In The Insured's Reservation Of Rights Defense, Whether Under The Guise Of Declaratory Judgment Proceedings Or Otherwise**

In *Tank v. State Farm Fire & Casualty Co.*, 105 Wn.2d 381, 385, 387, 715 P.2d 1133 (1986) this Court held that an insurer that defends under a reservation of rights "must fulfill an enhanced obligation to its insured as part

of its duty of good faith” because of the “potential conflicts of interest between insurer and insured inherent in this type of defense.” Insurers, therefore, must give “equal consideration *in all matters* to the insured’s interests” and “refrain from engaging in any action which would demonstrate a greater concern for the insurer’s monetary interest than for the insured’s financial risk.” *Id.*, at 386, 388 (emphasis by the Court). Thus, once the insurer assigns counsel to represent the insured, the insurer’s interference in the insured’s defense impairs the insured’s “right to a conflict-free defense.” *Lloyd’s & Inst. Of London Underwriters v. Fulton*, 2 P.3d 1199, 1205, 1208 (Alaska 2000). See, *Tank, supra*, 105 Wn.2d at 388 (RPC 5.4 prohibits assigned counsel from allowing insurer to influence the attorney’s professional judgment); *Mazon v. Krafchick*, 158 Wn.2d 440, 446-450, 144 P.3d 1168 (2006); WSBA Formal Ethics Op., no. 195. See further, *Barefield v. DPIC Co.*, 600 S.E.2d 256, 270-71 and nn. 18-19 (W. Va. 2004); *Givens v. Mullikin*, 75 S.W.3d 383, 395 (Tenn. 2002).

This Court has recognized that where coverage is disputed, an insurer may protect its own interests by filing a declaratory judgment action against

its insured in some circumstances,<sup>1</sup> even while defending its insured under a reservation of rights. See, *Trinity Universal Ins. Co. v. Willrich*, 13 Wn.2d 263, 267-72, 124 P.2d 950 (1942); *Tank, supra*, 105 Wn.2d at 391 (insurer “may sue for a declaratory judgment *before* they undertake a defense”); *Truck Ins. Exch. v. VanPort Homes*, 147 Wn.2d 751, 761, 58 P.3d 276 (2002)(insurer “may defend under a reservation of rights while seeking a declaratory judgment that it has no duty to defend”). But filing a parallel declaratory judgment action does not immunize an insurer’s bad faith conduct and, as the trial court properly concluded here, does not provide insurers with an unfettered license to interfere in the insured’s liability defense through “unreasonable, frivolous, or unfounded” conduct within the meaning of *Smith v. Safeco Ins. Co.*, 150 Wn.2d 478, 484-86, 78 P.3d 1274 (2003). See, *Willis*

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<sup>1</sup> See, 1 A. Windt, *Insurance Claims and Disputes*, §8.3 (4th Ed. Updated March, 2007)(declaratory judgment actions *may* be appropriate to determine which claims are covered if “truly necessary to allow the insurer properly to fulfill its duty to settle,” but insurer’s actions in the declaratory judgment action can also constitute bad faith). No bright line rule other than the standard prohibition against “unreasonable, frivolous, or unfounded” conduct governs use of declaratory judgment proceedings by Washington insurers prior to judgment in of the underlying liability case. See, M. Sweeney, *Tank v. State Farm: Conducting a Reservation of Rights Defense in Washington*, 11 U. Puget Sound L. Rev., 139, 144 and n. 30 (1987)(where “a policyholder’s liability to a third party claimant and the issue of coverage both depend on the same facts, the courts will not preempt the underlying tort action with a declaratory judgment”); *Holland America Ins. Co. v. National Indemnity Co.*, 75 Wn.2d 909, 911-14, 454 P.2d 383 (1969) (disapproving of the duplication an insurer’s declaratory judgment action would impose on injured victims); *Western National Assurance Co. v. Hecker*, 43 Wn. App. 816, 821 n. 1, 719 P.2d 954 (1986) (noting alternative of stay).

*Corroon Corp. v. The Home Ins. Co.*, 203 F.3d 449, 453 (7<sup>th</sup> Cir. 2000)(bad faith based upon insurer's "blatant manipulation" and "worst possible behavior" (including late-filed declaratory judgment complaint) that "completely undermined the defense which it had provided."); *Brown v. Patel*, \_\_P.3d\_\_, 2007 Okla. 16 ¶32, 2007 WL 915157 (Okla.) (rejecting summary judgment on bad faith claim arising out of UIM insurer's intervention in tort case because "[a]n insurer may engage in certain litigation conduct pursuant to a procedural right and yet by that act violate its duty to an insured"); *Lloyd's & Institute of London Underwriting Companies*, *supra*, 2 P.3d at 1205-6 (insurer's interviews of insured's witnesses, after it discovered possible coverage defense but without notice to the insured's assigned counsel, constituted bad faith); *Tucson Airport Authority v. Certain Underwriters at Lloyd's*, 186 Ariz. 45, 918 P.2d 1063, 1065-6 (1996)("Conduct by the insurer [in coverage action] which does destroy the security or impair the protection purchased breaches the implied covenant of good faith and fair dealing implied in the contract").

An insurer thus engages in bad faith whenever it engages in "unreasonable, frivolous, or unfounded" conduct that directly or indirectly

interferes in the reservation of rights defense of its insured, regardless of whether that conduct occurs under the pretext of a parallel declaratory judgment action, because “[t]he insurer who accepts that duty [*i.e.*, defense of the insured] under a reservation of rights, but then performs the duty in bad faith, is no less liable than the insurer who accepts but later rejects the duty.” *Safeco Ins. Co. of Am. v. Butler*, 118 Wn.2d 383, 392, 823 P.2d 499 (1992). Accord, *Tank, supra*, 105 Wn.2d at 387 (“reservation of rights agreement is not a license for an insurer to conduct the defense of an action in a manner other than [the manner in which] it would normally be required to defend”), quoting *Weber v. Biddle*, 4 Wn. App. 519, 524, 483 P.2d 155 (1971).

Both lower courts correctly found Mutual of Enumclaw’s *specific* conduct “improper,” *i.e.*, no legitimate legal or practical justification supported Mutual of Enumclaw’s actions. See, Pet. for Rev., p. 14. The Court of Appeals nevertheless held that “if MOE had litigated the coverage issues prior to the...arbitration ...Paulson could establish a bad faith claim against MOE.” *Mut. of Enumclaw, supra*, 132 Wn. App. at 813. That, of course, is *not* what Mutual of Enumclaw did. Moreover, *Trinity Universal, Tank* and *VanPort Homes* hold that merely litigating a declaratory judgment

action does *not* constitute bad faith--unless the insurer engages in “unreasonable, frivolous or unfounded” interference in the assigned defense. The Petition for Review thus explained that the Court of Appeals posited a false choice between (what the Court called) the “unreasonable options” of whether “to stand by and do nothing” or interfere in the insured’s underlying arbitration. Pet. for Rev., pp. 11-14 and Appendix D, p. 6.

Mutual of Enumclaw also had other available means to ameliorate the conflict between the enhanced obligations it owed to its insured and its financial self-interest in pursuing the declaratory judgment complaint. For example, it could have sought to stay the underlying liability litigation. RCW 7.24.190. *See, Western Nat’l Assurance, supra*, 43 Wn. App. at 821 n. 1. Mutual of Enumclaw did not seek a stay; instead, it waited more than a year before it filed the declaratory judgment action. Even then, Mutual of Enumclaw chose to *not* proceed expeditiously with the declaratory judgment action. CP 121. *Mutual of Enumclaw’s self-imposed delays* meant that it could not possibly complete the declaratory judgment action prior to the insured’s underlying arbitration proceeding and *destroyed any conceivable justification for its resort to declaratory judgment procedures*. *See, Windt,*

*supra*, §8.3 (explaining “three reasons why an insurance company might file a declaratory judgment action against its insured”).<sup>2</sup>

No Hobson’s choice confronted Mutual of Enumclaw.<sup>3</sup> It had ample means to protect its interests without interfering in its insured’s underlying liability defense. Mutual of Enumclaw instead directly interfered with the conduct of the arbitration, issuing a subpoena to the arbitrator and demanding (*ex parte* and without any notice to its insured) that the factfinder explain his arbitration decision based upon its self-serving representations as to its coverage. As a result, Mutual of Enumclaw created needless risk and uncertainty for its insured, as a means to undo the effects of its own imprudent choices. The Court should therefore hold that a Washington insurer acts in bad faith when it engages in “unreasonable, frivolous, or

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2 Insurers may seek to intervene in the insured’s underlying liability case. CP 445 (AAA Rule R-24). See, Resp. Br., pp. 25-6 and n. 15 (recognizing threats posed to the insured’s interests by insurer intervention); *Calif. Dept. of Toxic Substances Control v. City of Chico*, 297 F. Supp.2d 1227, 1237 (E.D. Cal. 2004). Mutual of Enumclaw, however, did not seek permission to intervene in or attend its insured’s underlying arbitration proceeding. CP 75 (104:8-13). The Court of Appeals nevertheless presumed the arbitrator would not have granted a motion to intervene. *Mut. of Enumclaw v. Dan Paulson Constr. Co.*, 132 Wn. App. 803, 812, 134 P.3d 240 (2006).

3 Mutual of Enumclaw should not be heard to complain about its “unreasonable options” because its policy language requires such choices. See, *American Nat’l Fire Ins. Co. v. B & L Trucking*, 134 Wn.2d 413, 430, 951 P.2d 250 (1998)(the insurer “drafted the policy language; it cannot now argue its own drafting is unfair.”). Every insurer has the option, indeed the duty under WAC 284-30, to promptly adjust the claim and settle undisputed, covered amounts. See discussion, *infra*, pp. 14-15.

unfounded” conduct that interferes in the insured’s underlying liability defense, regardless whether the insurer has also commenced a declaratory judgment action.<sup>4</sup>

**III. The Court Should Affirm The Bright-Line Rule Of *Butler* And Reject The Lower Courts’ Outcome-Based Analysis Of Harm**

Insurer bad faith, like other torts, requires proof of harm. *Butler*, *supra*, 118 Wn.2d at 388-9.<sup>5</sup> However, the *Butler* Court recognized that an insured who has been deprived of a key benefit of the insurance contract faces an “almost impossible burden of proving that he or she is demonstrably worse off because of [the insurer’s actions].” *Id.*, at 390, *quoting*, A. Windt, *Insurance Claims and Disputes: Representation of Insurance Companies and Insureds* §2.09, at 40-41 (2d ed. 1988). Accordingly, *Butler* established a presumption of harm because “shifting the burden ameliorates the difficulty insureds have in showing that a particular act resulted in prejudice” and

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4 The Court should reverse the Court of Appeals apparent grant of summary judgment in favor of Mutual of Enumclaw for the reasons explained in the Pet. for Rev., pp.7-8 and n.2.

5 *Butler* also differentiated insurers from “true fiduciaries” (*id.*, 118 Wn.2d at 389) because the remedy for a true fiduciary’s breach of duty frequently does *not* require proof of harm. *Eriks v. Denver*, 118 Wn.2d 451, 462, 824 P.2d 1207 (1992); *Mersky v. MLS Bureau*, 73 Wn.2d 225, 231, 437 P.2d 897 (1968).

“relieves the insured of that ‘almost impossible burden.’” *Id.* at 392, 390.

Coverage by estoppel thus developed *not* as an “equitable” remedy, as the Court of Appeals mistakenly held<sup>6</sup>, but as a substitute measure for (the “almost impossible” to prove) damages arising out of uncertainty and risk unreasonably imposed on the insured by its insurer’s tort of bad faith while under a duty to defend. *Besel v. Viking Ins. Co.*, 146 Wn.2d 730, 738, 49 P.3d 887 (2002)(“the amount of the covenant judgment is the presumptive measure of an insured’s harm caused by an insurer’s tortious bad faith”); *Truck Ins. Exch. v. VanPort Homes*, 147 Wn.2d 751, 765, 58 P.3d 1080 (2002) (“An insurer refusing to defend exposes its insured to business failure and bankruptcy”); *Hamilton v. State Farm*, 83 Wn.2d 787, 793, 523 P.2d 193 (1974)(“risk of verdict substantially in excess of policy limits”); *Transamerica Ins. Group v. Chubb & Son, Inc.*, 16 Wn. App. 247, 250-52, 554 P.2d 1080 (1976)(loss of control over defense and possibility of conflict of interest; “[t]he course cannot be rerun”); *R.A. Hansen Co v. Aetna Cas. Co.*, 15 Wn. App. 608, 611, 550 P.2d 701 (1976)(“loss of a favorable settlement,...inability to produce all testimony..., inability to produce any

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<sup>6</sup> The Court of Appeals justified its balancing test, stating “[w]here the damages greatly outweigh the relatively minor economic harm, the remedy becomes more punitive than equitable.” *Mut. of Enumclaw, supra*, 132 Wn. App. at 817.

material witness, loss of the benefit of any defense..., withdrawal so near in time to trial that insured is unable to prepare his defense”).

The presumption of harm thus developed *not as a measure of damage* but as a substitute for traditional concepts of proximate cause. *Butler, supra*, 118 Wn.2d at 392; *Kirk v. Mt. Airy Ins. Co.*, 134 Wn.2d 558, 563, 951 P.2d 1124 (1998)(“The rebuttable presumption 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”). Indeed, the insureds in *Besel, Kirk, VanPort Homes, Hamilton, or Transamerica Ins.* could never establish prejudice under the balancing test adopted by the Court of Appeals here because the insurer’s potential liability will always substantially exceed the insured’s provable “economic harm” (especially if a court ultimately finds *no* coverage). The Court of Appeals erred in transforming the presumption of harm into an “equitable” remedy designed to balance the insured’s provable “economic harm” against the insurer’s potential liability exposure, rather than a substitute for the “almost impossible burden” of proving damage and proximate cause intended by *Butler*. See, Pet. for Rev., pp. 17-18.

To rebut the *Butler* presumption of harm, Mutual of Enumclaw had to

show that its bad faith interference in the insured's reservation of rights defense did *not* increase the uncertainty or risk for its insured. In the trial court and in the Court of Appeals, Mutual of Enumclaw specifically disclaimed any ability to rebut the presumption of harm, conceding instead that "proving such a negative is well near impossible" and "[u]ltimately, at least in the context of this case, the presumption of harm adds little or nothing to the analysis." CP 479. Mutual of Enumclaw also admitted that estoppel to deny coverage would flow ("identical impact") from a trial court finding of bad faith in this case. *Id.* Instead, as here, Mutual of Enumclaw urged an extraordinarily narrow, outcome-based application of the presumption of harm limited to those situations in which the insurer's bad faith "increased the insured's economic exposure to the tort claimant." Ans. to Pet. for Rev., pp. 13-14; App. Br., pp. 30-37. Washington courts have repeatedly rejected Mutual of Enumclaw's narrow definition of harm because it effectively limits the insurer's bad faith liability to contract damages, in direct contravention of *Tank and Butler*. See discussion, *supra*, pp. 8-9; App. Br., pp. 29-31.

In any event, Mutual of Enumclaw's argument is also flawed in this particular case because the uncontroverted evidence established precisely the

type of harm recognized by the Washington courts. CP 142-44 (identifying four specific areas of harm: interference in the insured's final trial preparation, interjection of insurance into the arbitration, uncertainty concerning potential prejudicing of the arbitrator, and uncertainty concerning effect of interference on confirmability of the arbitration award); CP 139-41, 155, 512-3 (26:15-27:22); 527-28 (24:21-25:10); 531 ¶¶4, 5. See further, CP 246-8, 252. The Court of Appeals disregarded evidence of the substantial threat of harm to the insured's interest because it did not in fact "lead to a different financial outcome for Paulson." *Mut. of Enumclaw, supra*, 132 Wn. App. at 814. The lower courts' *outcome-based* analysis negates the compelling policies that have led this Court, as well as others, to adopt a presumption of harm for insurance bad faith, as the Alaska Supreme Court explained in *Lloyd's & Inst. Of London Underwriters, supra*, 2 P.3d at 1208:

Impropriety of the kind that PacMar committed is intolerable if it has *any adverse effect* on the insured party. The need to discourage such overreaching is particularly compelling in insurance cases because of the special fiduciary relationship that exists between an insurer and its insureds, the insurer's peculiar ability to take advantage of its insured's trust, and the typical insured's vulnerability to overreaching conduct. **Given the bright-line, easily established test of prejudice also promotes efficiency and fairness. A strict, outcome-based definition of prejudice** would require case-by-case litigation to determine actual coverage—a requirement that would pit the insurer against its own insured on a playing field where the

insurer almost always enjoys tremendous financial and institutional advantages.

Moreover, by punishing misconduct only if the insured can show that the misconduct defeated otherwise available coverage, an outcome based prejudice test would effectively reward successful misconduct. It would encourage insurers to dispute coverage and to overreach in the process to ensure that their efforts succeed. **The strict prejudice requirement thus would functionally convert the remedy of coverage by estoppel into a remedy of coverage by proof of coverage;** by requiring the insured to prove that the insurer's misconduct actually changed the outcome, it would effectively force the insured to shoulder the affirmative burden of proving coverage.

The dissent suggests that when an insurer's breach makes no difference in the ultimate outcome, or when it is not a fundamental breach, the remedy of coverage by estoppel should be abandoned in favor of some lesser punishment—one more suitable to the crime. **But applied to insurance contracts, a "punishment-fits-the-crime" approach would retain all of the drawbacks of an outcome-based prejudice rule without offering any offsetting advantages.** It would continue to encourage case-by-case litigation of coverage, to reward successful misconduct (albeit partially rather than fully), and to saddle the insured with the duty of proving either loss of coverage or some unspecified alternative form of actual damage. Moreover, the dissent proposes no specific sanction to replace estoppel. And we can think of none that would be workable—that is, easy to apply yet still capable of effectively deterring misconduct. [Emphasis added; footnotes omitted].

The *Butler* presumption of harm has fulfilled its salutary promise of discouraging insurer misconduct toward insureds, without imposing an undue burden on insurers or the courts. Everyone knows the rules, which only come

into play in those infrequent, extreme situations when an insurer engages in such “unreasonable, frivolous, or unfounded” conduct as to warrant a finding of bad faith. See, *Butler, supra*, 118 Wn.2d at 391 (“Any case in which the insurer actually acted in bad faith is an ‘extreme case’”). The Court should therefore re-affirm its bright-line, easily established presumption of harm enunciated in *Butler* (and reiterated in *Besel* and *Vanport Homes*), and reject the lower courts’ outcome-based, strict prejudice analysis.

**IV. The *Butler* Presumption Of Harm And Coverage By Estoppel Should Apply To Insurers That Fail To Protect Their Insureds Through Prompt Adjustment And Payment Of Undisputed, Covered Claims After Liability Has Become Clear**

Regardless of whether the insuring agreement consists of a commercial CGL policy (as here) or other types of policies,<sup>7</sup> the insurer’s duty to indemnify (or “duty to pay”) arises pursuant to the express terms of the insurance contract [CP 518], the insurer’s general duty of good faith under RCW 48.01.030, and the Washington Administrative Code §284-30-300, *et seq.* *Tank, supra*, 105 Wn.2d at 386-7; see further, A. Windt, *supra*, §§2.22, 6.05 (March 2007). In the specific context of third-party claims, the insurer’s duty to indemnify also follows naturally from the insurer’s related

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<sup>7</sup> UIM policies, for example, are also contracts of indemnity that include a duty to pay. *Lenzi v. Redland Ins. Co.*, 140 Wn.2d 267, 280-1, 996 P.2d 603 (2000). See n. 8, *infra*.

enhanced obligation to protect its insured through good faith efforts to settle the third-party claim. *Tank, supra*, 105 Wn.2d at 387; see further, *Smith v. Safeco Ins. Co.*, 112 Wn. App. 645, 650-51 and n. 20, 50 P.3d 277 (2002), *rev'd on other grounds, Smith, supra*, 150 Wn.2d 478. Absent timely adjustment and payment or settlement by its insurer, the insured risks lost settlement opportunities, business disruption, and the potentially devastating effects of judgment, execution, and/or bankruptcy. These extraordinary risks illustrate the critical importance of prompt adjustment and settlement of third-party claims. See, *Vanport Homes, supra*, 147 Wn.2d at 764-65 (“unconscionable delay”; defense “must be prompt and timely”).

Washington Administrative Code §§284-30-370 and 330(6) clarifies the insurer’s twin, *affirmative* duties of prompt adjustment and good faith settlement efforts in third-party claims, including a duty “to effectuate prompt **payment** of property damage claims to innocent third parties.”<sup>8</sup> (Emphasis added). See further, WAC 284-30-330(12)(insurers may not delay settlement of undisputed amounts as a means to influence settlements of disputed amounts). An insurer’s violation of these

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<sup>8</sup> The enhanced obligation of good faith that flows from a third-party insurer’s reservation of rights defense generally does not apply to first-party claims. *Coventry v. American States Ins. Co.*, 136 Wn.2d 269, 284-5, 961 P.2d 933 (1998).

standards constitutes bad faith, *i.e.*, “unreasonable, frivolous, or unfounded” conduct, *as a matter of law*. *Tank, supra*, 105 Wn.2d at 386; *Besel v. Viking Ins. Co.*, 105 Wn. App. 463, 476-77, 21 P.3d 293 (2001), *rev’d on other grounds, supra*, 146 Wn.2d 730.

The Petition for Review explained Mutual of Enumclaw’s bad faith, and the fundamental error in the lower court’s analysis. Pet. for Rev., pp. 18-20. See, Resp. Br., pp. 45-48; Cross-Appellants’ Reply Br., pp. 6-10. Mutual of Enumclaw does not seriously dispute violation of its duty to promptly adjust and settle undisputed, covered damages. App. Reply Br., pp. 40-45. Mutual of Enumclaw instead argues that the covenant judgment immunizes it from application of the *Butler* presumption of harm because harm no longer exists after the insured enters into the covenant judgment. Ans. to Pet. for Rev., p. 16.

Mutual of Enumclaw is wrong for three reasons. Most obviously, the *Butler* presumption of harm applies where, as here, Mutual of Enumclaw defended its insured under a reservation of rights. See, *Coventry, supra*, 136 Wn.2d at 277. Moreover, delay in adjustment and settlement of claims causes precisely the kind of uncertainty and risk that the Washington courts

have repeatedly recognized as “harm” within the meaning of *Butler*. See discussion, *supra*, pp.8-9. Third, the insurer may not rely on the covenant judgment to protect it from the consequences of its bad faith because the insurer “is in no position to argue that the steps the insured took to protect himself should inure to the insurer’s benefit.” *Greer v. Northwestern Nat’l Ins.*, 109 Wn.2d 191, 204-5, 743 P.2d 1244 (1987); *Besel, supra*, 146 Wn.2d at 735-37. Mutual of Enumclaw, therefore, did not (and cannot) rebut the presumption of harm resulting from its failure to promptly adjust and pay the undisputed, covered claims against its insured.

Mutual of Enumclaw also argues that the Court should not impose coverage by estoppel based upon “events occurring after resolution of the claims against the insured.” Ans. to Pet. for Rev., p. 16. Mutual of Enumclaw is wrong for two reasons. First, Mutual of Enumclaw completed its adjusting work in October, 2003 and filed its declaratory judgment complaint admitting its liability for “some” of the Martinellis’ claims in November, 2003—several months prior to the covenant judgment. CP 97-8, 100-03; Pet. for Rev., Appendix D, p. 6. More importantly, “coverage by estoppel is an appropriate remedy [when] the insurer contributes to the

insured's loss by failing to fulfill its obligation in some way." *Coventry, supra*, 136 Wn.2d at 284. Mutual of Enumclaw achieved that dubious distinction here, by failing to timely adjust and either settle or pay the undisputed, covered claims against the insured. Coverage by estoppel is, accordingly, the appropriate remedy in this particular case.

**V. No Dispute Exists Concerning The Reasonableness Of The Insured's Covenant Judgment**

Both sides *agree* that the reasonableness issue raised by Mutual of Enumclaw is moot if the Court reinstates the trial court conclusion that Mutual of Enumclaw acted in bad faith. Ans. to Pet. for Rev., p. 18; Resp. Br., pp. 33-4 and n. 18; CP 690. Accord, *VanPort Homes, supra*, 147 Wn.2d at 765; *Besel, supra*, 146 Wn.2d at 734.

Mutual of Enumclaw had the opportunity to challenge the settlement's reasonableness *in this case*, but did not. The trial court found the settlement reasonable based on the substantial evidence submitted at the summary judgment hearing. CP 690; App. Br., p. 34 n. 18. The Court of Appeals left this trial court conclusion intact. See, Reply to Pet. for Cross-Rev., pp. 2-4, 7-8. This Court has specifically approved summary proceedings to make the reasonableness determination, much like those

employed by the trial court here. *Clark v. Pacificorp*, 118 Wn.2d 167, 182, 822 P.2d 162 (1991)(affirming trial court's discretion as to procedure); *Wilson v. Steinbach*, 98 Wn.2d 434, 438, 656 P.2d 1030 (1982) (use of attorney declarations). Accord, *Pickett v. Stephens-Nielsen, Inc.*, 43 Wn. App. 326, 333 and n. 2, 717 P.2d 277 (1986)(*prima facie* showing shifts burden to party opposing reasonableness to prove "specific facts" controverting reasonableness). Mutual of Enumclaw, after receiving ample notice under CR 56, did not identify any "specific facts" that controvert reasonableness.

This leaves Mutual of Enumclaw's skeletal, technical complaint that "its right to challenge the reasonableness of the settlement has not been fulfilled" *in the arbitration proceeding*. Ans. to Pet. for Rev., p. 19. Mutual of Enumclaw knew of the arbitration proceeding and the Superior Court hearing that confirmed the arbitrator's reasonableness determination, but excuses its inaction because "there was no valid basis for MOE to intervene." *Id.* See discussion, *supra*, p.6. *Red Oaks Condominiums v. Mut. of Enumclaw*, 128 Wn. App. 317, 326, 116 P.3d 404 (2005)("not a stranger" to the underlying case). An insurer that stands on the sidelines of its insured's

underlying litigation should not be later heard to complain that its own dilatory behavior denied it “due process.” *Id.*

For each of these reasons, the Court should affirm the trial court summary judgment order on the reasonableness issue.

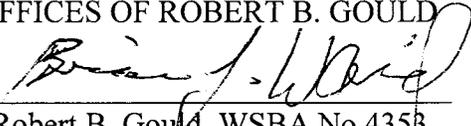
### CONCLUSION

Mutual of Enumclaw’s self-serving conduct created unnecessary risk and uncertainty for its insured. The Court should not condone Mutual of Enumclaw’s conduct, but reinstate the judgment of the trial court. The Court should also hold that once the liability of an insured has been established the insured’s liability insurer may not withhold payment of undisputed, covered amounts while it litigates disputed amounts. The Court should also award Mr. and Mrs. Martinelli their reasonable attorney fees. See, RAP 18.1(a) and Resp. Br., pp. 44-45.

Respectfully submitted this 3<sup>rd</sup> day of May, 2007.

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