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BY C.J. HERRITT

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

Court of Appeals No. 55342-9-I

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.

REPLY TO PETITION FOR CROSS-REVIEW
AND NEW ISSUE RAISED IN ANSWER

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This reply responds to Mutual of Enumclaw's Cross-Petition for Review and, as authorized by RAP 13.4(d), MOE's new argument concerning "harm" raised in its Answer, p. 16.

I. STATEMENT OF THE CASE RE: CROSS-PETITION

A. REBUTTAL STATEMENT OF ISSUE PRESENTED BY CROSS-PETITION.

Rejoinder Re: Respondents' §B, Issue 1 (p. 1): The trial court granted summary judgment holding that no genuine issue of material fact exists concerning the reasonableness of the Stipulated Arbitration Award between the Martinellis and Mutual of Enumclaw's insured, Paulson Construction. Mutual of Enumclaw appealed the reasonableness issue to the Court of Appeals, Division I, which generally left the trial court determination of reasonableness intact, except to mention in a footnote that "[w]e agree, however, that MOE never had a meaningful opportunity to contest the arbitrator's reasonableness finding." *Mutual of Enumclaw v. Martinelli*, 132 Wn. App. 803, 818 n. 29, 134 P.3d 240 (2006).

The issue thus presented by MOE's Cross-Petition is whether the Court of Appeals erred when it upheld the trial court's determination that no genuine issue of material fact existed as to the reasonableness of the

Stipulated Arbitration Award between the Martinellis and MOE's insured, Paulson Construction.

Related Issue no. 1: If the Court reinstates the trial court determination that MOE acted in bad faith, is the issue raised by MOE's Cross-Petition moot because a presumption of reasonableness applies to the Stipulated Arbitration Award pursuant to *Truck Ins. Exch. v. Vanport Homes*, 147 Wn.2d 751, 764-66, 58 P.3d 276 (2002) and MOE did not rebut that presumption as a matter of law? CP 690.

Related Issue no. 2: If the Court grants review of the Cross-Petition, did the Court of Appeals err when it held that MOE did not have an adequate opportunity to dispute the arbitrator's finding of reasonableness?

B. REBUTTAL STATEMENT OF FACTS RE: CROSS-PETITION.

The Petition for Review explains that the Martinellis and Respondent's insured, Paulson Construction, entered into a stipulated settlement after MOE interfered in the underlying arbitration. Pet. for Review, pp. 6-7, 8. The Arbitrator approved the stipulated arbitration award and found it reasonable. *Id.*, referencing CP 179. After notice and

hearing, the Superior Court (to which the arbitration proceeding had been previously appealed) confirmed the arbitration award, including the determination of reasonableness. CP 182-87. Respondent MOE had actual notice of the Superior Court hearing, but did not try to intervene or otherwise object. CP 30 ¶5.

When the parties later filed cross-motions for summary judgment in the declaratory judgment action initiated by Mutual of Enumclaw, the Martinellis' motion for summary judgment asked, *inter alia*, for summary judgment as to the reasonableness of the Stipulated Arbitration Award. CP 256-57. The trial court: (1) denied MOE's affirmative defense of fraud or collusion because MOE had "not supported its affirmative defense...with competent evidence;" (2) held that "no genuine issue of fact exists as to the reasonableness of the Stipulated Arbitration Award," and; (3) "the Stipulated Arbitration Award...is reasonable as a matter of law." CP 690.

In the Court of Appeals, MOE argued that the trial court's determination of reasonableness violated its due process rights and that the "record in this proceeding is insufficient to uphold such [a] conclusion." MOE Opening Br. in Div. I, pp. 37-44. In response, the Martinellis

explained that the trial court determination of reasonableness could be affirmed on any one of three (3) independent grounds, including: “(1) MOE failed to carry its burden under *Vanport Homes* to prove fraud or collusion, thus reasonableness is presumed and not rebutted; (2) sufficient evidence supported the trial court’s reasonableness determination (on summary judgment), and; (3) MOE waived any objection to reasonableness in the underlying proceedings of which it had notice but chose to ignore.” Martinelli Opening Br. in Div. I, pp. 33-39.

Despite having reversed the trial court’s determination of bad faith and harm, the Court of Appeals left the trial court determination of reasonableness intact except to the limited extent shown in footnote 29. *Mutual of Enumclaw v. Martinelli*, 132 Wn. App. 803, 818 n. 29, 134 P.3d 240 (2006).

II. RESPONSE TO CROSS-PETITION

A. THE CROSS-PETITION SUPPORTS REVIEW OF THE MARTINELLIS’ PETITION FOR REVIEW.

Respondent Mutual of Enumclaw cross-petitions for review concerning the nature of a liability insurer’s procedural rights related to reasonableness hearings involving settlement by its insured. Petitioners do

not agree with Respondent's conclusion that "[i]f this Court accepts review and thereafter concludes that Martinellis have established coverage by estoppel, then this Court must concurrently examine the issue of whether there has yet been a proper determination that the settlement between the Martinellis was reasonable, and thus binding upon MOE." Answer, p. 20. See discussion, *infra*, pp. 6-8.

Petitioners nevertheless acknowledge that a second, currently-pending Petition for Review raises very similar issues to those raised by Respondent's Cross-Petition concerning insurer participation in reasonableness hearings (Answer, pp. 18-20), as well as those concerning the presumption of harm raised by the Martinellis' Petition for Review, pp. 15-18 and Respondent's Answer, pp. 16-17. *Corta Madera Homeowners Association v. USF Insurance Co.*, Supreme Court, Case no. 78904-5, Pet. for Review, pp.16-20. Indeed, the Petition for Review in Case no. 78904-5 urges review specifically because the Court of Appeals' decision in that case "conflicts with *Mutual of Enumclaw v. Dan Paulson Constr.*" *Id.*, Pet. for Review, p. 14.

The Martinellis' Petition for Review, together with Cross-Petition, thus provide the Court with a rare opportunity to issue a seminal opinion

covering the fundamental premises of Washington insurance bad faith law, including: (1) the nature of what constitutes bad faith and, more specifically, whether the insurer's interference in the insured's underlying liability case represents bad faith; (2) the nature of the presumption of harm, including the nature of proof sufficient to rebut the presumption of harm and whether Division I's balancing test applies to that determination; (3) the circumstances, if any, under which Washington insurers must unconditionally tender reasonable amounts of undisputed, covered damages, and; (4) the procedures governing insurers' participation in the determination of reasonableness.

Petitioners therefore do not oppose review of the Cross-Petition *if* review of the Cross-Petition is conditioned upon review of the Martinellis' Petition for Review, as Respondent Mutual of Enumclaw suggests.

Answer, p. 1 §B, Issue no. 1.

B. THE COURT OF APPEALS LEFT INTACT THE TRIAL COURT DETERMINATION OF REASONABLENESS.

When the parties filed cross-motions for summary judgment in the declaratory judgment action initiated by Mutual of Enumclaw, the Martinellis' motion asked, *inter alia*, for summary judgment establishing

the reasonableness of the Stipulated Arbitration Award and cited substantial evidence to support that conclusion. CP 256-57. The trial court: (1) denied MOE's affirmative defense of fraud or collusion because MOE had "not supported its affirmative defense...with competent evidence;" (2) held that "no genuine issue of fact exists as to the reasonableness of the Stipulated Arbitration Award," and; (3) "the Stipulated Arbitration Award...is reasonable as a matter of law." CP 690.

In the Court of Appeals, MOE argued that the trial court's determination of reasonableness violated its due process rights and that the "record in this proceeding is insufficient to uphold such [a] conclusion." MOE Opening Br. in Div. I, pp. 37-44. In response, the Martinellis explained that the trial court's determination of reasonableness could be affirmed on any one of three (3) independent grounds, including: "(1) MOE failed to carry its burden under *Vanport Homes* to prove fraud or collusion, thus reasonableness is presumed and not rebutted; (2) sufficient evidence supported the trial court's reasonableness determination, and; (3) MOE waived any objection to reasonableness in the underlying proceedings of which it had notice but chose to ignore." Martinelli Opening Br. in Div. I, pp. 33-39. Despite having reversed the trial court's

determination of bad faith and harm, the Court of Appeals left the trial court's determination of reasonableness intact except to the limited extent shown in footnote 29. *Mutual of Enumclaw v. Martinelli*, 132 Wn. App. 803, 818 n. 29, 134 P.3d 240 (2006).

The trial court correctly upheld the reasonableness of the Stipulated Arbitration Award between Paulson and the Martinellis as a matter of law. Ample evidence supported that conclusion. The Court of Appeals left the trial court determination of reasonableness intact on appeal. Therefore, the trial court's determination of reasonableness *does* bind MOE as this case is currently postured. Respondent's implicit argument to the contrary (Answer, pp. 19-20) is in error.

C. DELAY IN PAYMENT REPRESENTS HARM.

MOE argues that "the Martinellis do not allege nor explain how Paulson, the insured, has been harmed by the failure of MOE to currently pay." Answer, p. 16. MOE argues, in essence, that the Petition for Review was deficient on this narrow issue. It is not. Petitioners thus respond briefly to this new issue, in conformity with RAP 13.4(d).

Pursuant to the authority granted by the Legislature in RCW 48.30.010, the Commissioner of Insurance established "minimum

standards” of conduct for Washington insurers. WAC 284-30-300, *et seq.*

Violation of these standards represents bad faith as a matter of law.

Industrial Indem. Co. v. Kallevig, 114 Wn.2d 907, 920-23, 792 P.2d 520 (1990)(violation of insurance regulations constitutes “a *per se* unfair trade practice”). Once the insured proves bad faith, a presumption of harm arises consistent with *Safeco Ins. Co. v. Butler*, 118 Wn.2d 383, 390-92, 823 P.2d 499 (1992). The burden then falls on the insurer to rebut the presumption of harm. *Id.*

The Martinellis’ Petition for Review expressly and properly discussed the presumption of harm applicable to insurer bad faith. Pet. for Review, pp. 16-17, *citing*, *Truck Ins. Exch. v. Vanport Homes*, 147 Wn.2d 751, 765, 58 P.3d 1080 (2002) and *R.A. Hansen Co. v. Aetna Cas. Co.*, 15 Wn. App. 608, 611, 550 P.2d 701 (1976). Nothing required the Martinellis to re-argue the presumption of harm a second time in the same Petition for Review.

Moreover, Respondent does not, and cannot, seriously suggest that harm does not flow from an insurer’s delay in adjusting claims and paying undisputed, covered damages. The Commissioner of Insurance established the inherent harm caused by delay in payment of claims by

Washington insurers when WAC 284-30-310, 284-30-370, and 284-30-330(6) were adopted. Furthermore, an insurer's delay in payment of sums due and owing represents "harm," as a matter of law. *E.g., Banuelos v. TSA Washington, Inc.*, __ Wn. App. __, __ P.3d __, 2006 WL 2372254 at *4-5 (Div. III, 8/17/06). See, *Vanport Homes, supra*, 147 Wn.2d at 765; *R.A. Hansen Co., supra*, 15 Wn. App. at 611.

The Martinellis' Petition for Review was therefore entirely proper. Furthermore, no serious dispute can exist but that an insurer's delay in adjusting and paying undisputed, covered claims results in harm.

III. CONCLUSION

For these reasons, petitioners/cross-respondents Karen and Joseph Martinelli do not oppose review of MOE's cross-petition for review *if* such review is conditioned on the Court's review of the Martinelli's Petition for Review. Nevertheless, the trial court and Court of Appeals correctly decided the reasonableness issue in favor of the Martinellis and their determinations should be affirmed on the merits.

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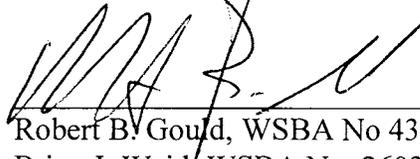
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Respectfully submitted this 22 day of August, 2006.

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