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NO. 79027-2

THE SUPREME COURT
OF THE STATE OF WASHINGTON

MUTUAL OF ENUMCLAW INSURANCE COMPANY,
Respondent and Cross-Petitioner,

v.

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

Petitioners.

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**RESPONSE OF RESPONDENT/CROSS-PETITIONER,
MUTUAL OF ENUMCLAW INSURANCE COMPANY
TO AMICUS CURIAE BRIEFS OF
WASHINGTON STATE TRIAL LAWYERS ASSOCIATION FOUNDATION
AND BUILDING INDUSTRY ASSOCIATION OF WASHINGTON**

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I. LEGAL DISCUSSION

A. MOE's request that the arbitrator delineate the components of any arbitration award did not constitute a "bad faith" interference with the arbitration process.

Like the Martinellis, WSTLA makes contradictory arguments. On the one hand, WSTLA contends that the written questions addressed to the arbitrator constituted an unreasonable interference with the AAA Arbitration process. On that subject, WSTLA does not share with us how the communication with the arbitrator in any way interfered with the vigorous defense against the construction defect claims put forth by Paulson's attorneys and experts hired by MOE. On that basis alone, this case is distinguishable from the various coverage by estoppel cases cited by WSTLA and the Martinellis, each of which involved scenarios in which the insured's ability to defend against the claims was compromised.

After making its initial statement that the contact with the arbitrator interfered with the defenses presented by Paulson and the AAA Arbitration, WSTLA then turns its hat in the opposite direction by contending that MOE "never made a formal motion to intervene or appear

as a person with a direct interest in the arbitration by virtue of the unresolved coverage issues.” (WSTLA p. 16).¹

Let us hypothetically assume that MOE had requested permission to intervene. Naturally, at that point the existence of the insurance coverage issues would have been brought to the attention of the AAA Arbitrator. By contending that MOE should have moved to intervene, WSTLA necessarily concedes that bringing to the attention to the arbitrator the insurance coverage issues would not be an act of bad faith in this case. Next, let us hypothetically assume that MOE had been permitted to intervene. We must ask ourselves what would MOE logically request at the arbitration proceeding, once it was permitted to intervene as an additional party. Naturally, MOE would request that the arbitrator segregate the components of any arbitration award entered, so that MOE and Paulson could hopefully ascertain the insured and uninsured aspects of the arbitration award. Such procedure has been condoned by courts, without any suggestion that such procedure improperly interfered with the

¹ Unlike the Civil Court rules, the AAA Arbitration rules do not provide any mechanism for intervention by one who is not a party to the arbitration agreement. At most, a non-party may be permitted to attend. Specifically:

R-24 Attendance at Hearings

The arbitrator and the AAA shall maintain the privacy of the hearings unless the law provides to the contrary. Any person having a direct interest in the arbitration is entitled to attend hearings. The arbitrator shall otherwise have the power to require the exclusion of any witness, other than a party or other essential person, during the testimony of any other witness. It shall be discretionary with the arbitrator to determine the propriety of the attendance of any person other than a party and its representative.

Construction Industry Arbitration Rules (2005). CP445.

ability of the insured to fully defend against the claims. *Thomas vs. Henderson*, 297 F. Supp. 2nd 1311 (S.D. Ala. 2003); *Briggs and Stratton Corp., vs. Concrete Sales and Service, Inc.*, 166 F.R.D. 43 (M.D. Georgia 1996). *Accord, Knapp vs. Hankins*, 106 F. Supp. 43 (E.D. Illinois 1952).²

No reported Washington decision has dealt with the issue of the right of an insurer to intervene in the underlying damage lawsuit against its insured. However, to now hold that an insurance company's request that the trier of fact delineate the basis of its award, verdict or judgment, constitutes bad faith as a matter of law, would be a quantum expansion of bad faith law in this state. No such holding can be found in any state or federal court decision.

Here, the trial court found that MOE's contact with the arbitrator had not harmed Paulson regarding his defense against the Martinelli's claims. In this appeal, no one disputes that conclusion. Likewise, no one disputes that MOE did not interfere with assigned defense counsel expressing Paulson's position that MOE should withdraw its request that the arbitrator delineate the basis of any arbitration award which might be entered. MOE in no way interfered with assigned defense counsel's

² In addition to allowing an insurer to intervene for purposes of segregating insured and uninsured awards, other courts have allowed intervention when the insured defendant has directed its defense counsel to concede issues of liability and/or damages in a manner which arguably prejudices the insurance company's position. *Ross vs. Marshall*, 426 F. 3rd 745 (Fifth Cir. 2005); *Su Duck Kim vs. HV Corp.*, 5 Haw.App. 298, 688 P.2d. 1158 (1984).

obligation to assert any and all defenses and/or positions requested by Paulson.

Contrary to the position of WSTLA, MOE's request that the arbitrator delineate the basis of any award is not equivalent to interfering with assigned defense counsel's duty of loyalty to Paulson. Assigned defense counsel opposed MOE's request to obtain information from the arbitrator, and MOE withdrew its request.

B. The attorney fees incurred by Paulson in opposing MOE's request for information is not the type of "harm" which will invoke coverage by estoppel.

Having determined that MOE's conduct did not constitute bad faith, the Court of Appeals decision then went on to discuss whether the attorney fees incurred by Paulson, through his personal coverage counsel, to oppose the subpoena duces tecum and written interrogatories issued in the declaratory judgment action constituted the type of harm which would justify invoking coverage by estoppel. WSTLA correctly notes that such discussion by the court constitutes dicta, in light of the finding that MOE's conduct did not constitute bad faith.

WSTLA then takes issue with some of the terminology of the Court of Appeals decision regarding the issue of "harm." Specifically,

WSTLA objects to the court discussing the degree of harm sustained by the insured. In the abstract, WSTLA has a point. However, that misses the context of the actual holding by the Court of Appeals. Specifically, the Court of Appeals stated:

But here, the alleged harm rests solely on minor attorney fees incurred in the declaratory judgment action to challenge a subpoena. The same or greater fees would have been incurred if MOE had formally moved to intervene in the arbitration proceeding, which the Martinellis assert MOE should have done. Furthermore, unlike *Butler*, the alleged harm stemmed from MOE's attempt to determine coverage issues rather than from bad faith in defending the underlying tort lawsuit.

Mutual Enumclaw Insurance Company vs. Dan Paulson Construction, Inc., 132 Wn.App. 803, 816, 134 P.3d. 240 (2006).

We believe both of the alternative grounds for the finding of a lack of "harm" justifying coverage by estoppel are correct statements by the Court of Appeals.

C. An insurer is entitled to contest the reasonableness of a covenant judgment.

In the final portion of its brief, WSTLA asserts that, when an insurance company is determined to have acted in bad faith, it should be precluded from contesting the reasonableness of a covenant judgment entered into by the insured and claimant. No Washington decision has so held. This court should not adopt that approach.

Anyone who will be impacted by a covenant judgment has a due process right to contest the reasonableness of such judgment. *Brewer vs. Fibreboard Corp.*, 127 Wn.2d. 512, 524 – 528, 531, 901 P.2d. 297 (1995). See, *Howard vs. Royal Specialty Underwriting Inc.*, 121 Wn.App. 372, 379 – 380, 89 P.3d. 265 (2004). WSTLA fails to explain why an insurer who is found to have acted in bad faith, is precluded from its due process right to contest the amount of damages it will be obligated to pay. There would be no justification for such approach, and would directly contradict the universally noted problem that arises from the fact that insureds who enter into covenant judgments, which they will not be required to pay, have no incentive to settle for a reasonable sum. *Bessel vs. Viking Insurance Co. of Wisconsin*, 146 Wn.2d. 730, 737 – 738, 49 P.3d. 887 (2002).

To accept WSTLA's position, would be akin to holding that the driver of a car who was unquestionably negligent, or even intentionally caused harm, is precluded from contesting the amount of damages which should be awarded to the opposing party. Such holding would hardly pass constitutional muster.

D. Insurers should not pay for uninsured claims.

The essential addition by Amicus Curiae Building Industry Association of Washington is its position that the Court of Appeals decision exposes builders to greater liability to their customers. Amicus Curiae, p. 7. Our response is that it is insured contractors should and must pay for uninsured claims against them. There is nothing MOE did which exposed Paulson to liability to the Martinellis for uninsured claims. To the contrary, MOE provided defense counsel, who in turn provided a vigorous defense, to both the insured and uninsured claims. Paulson received the full benefit of his insurance contract.

II. CONCLUSION

Like the Martinellis, WSTLA and Building Industry Association seek to expand the parameters of coverage by estoppel. The requested expansions are not justified.

DATED this 1st day of June, 2007.

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