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No. 57866-9

COURT OF APPEALS
THE STATE OF WASHINGTON
DIVISION I

MUTUAL OF ENUMCLAW INSURANCE COMPANY,

And

COMMERCIAL UNDERWRITERS INSURANCE COMPANY,

Appellants,

v.

USF INSURANCE COMPANY,

Respondent.

BRIEF OF APPELLANTS

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A. ASSIGNMENTS OF ERROR

1. Assignments of Error

1.1. The trial court erred in entering its Orders of 1-31-06 and 2-10-06 granting Summary Judgment for the defendant, USF Insurance Co.

1.2. The trial court erred in entering its Order of 11-10-05 denying the plaintiffs' Motion for Partial Summary Judgment.

2. Issues Pertaining to Assignments of Error

2.1. Is an insurer's duty to pay for its insured's defense and indemnity excused by delayed tender without the insurer proving it was prejudiced by the delay? (Assignment of Error 1.1)

2.2. Is an insurer's duty to share the obligation to pay for its insured's defense and indemnity through equitable contribution to other insurers who paid the entire amount excused by delayed tender? (Assignment of Error 1.1)

2.3. A lawyer who occasionally advised a builder, Dally Homes, on insurance and who "kept his ear to the ground" for rumors about Dally's projects, but was not representing Dally on any ongoing matter, learned the buyers of one condominium had hired an expert to determine if their buildings were defective and would consider suing Dally if defects were found. The lawyer had

no role in procuring Dally's insurance. The lawyer was unable to tell Dally about the potential claim until after Dally's USF policy became effective. Should the lawyer's knowledge be imputed to Dally to establish the known loss defense for USF? (Assignment of Error 1.2)

2.4. The lawyer learned of the potential claim from a condominium board member who was looking for a lawyer to advise the board if defects were found. The lawyer cannot remember what he was told, but remembers fearing there would be a suit against Dally if no action was taken. In the absence of the factual content of the conversation are the lawyer's conclusions sufficient to create an issue of fact to defeat a summary judgment to eliminate the known loss defense? (Assignment of Error 1.2)

B. STATEMENT OF THE CASE

Dally Homes, Inc. was the contractor and developer who built the Windsong Arbor Condominiums in the mid-1990's. CP 34. Dally was insured by Commercial Underwriters Insurance Company (CUIC) until it switched to USF Insurance Company (USF) on January 18, 2000. CP 34, 46. USF's policy is at CP 41, 44 – 87. Mutual of Enumclaw (MOE) also insured Dally for a time

through an additional insured endorsement obtained by one of Dally's subcontractors on the project. CP 35.

The Windsong Arbor Homeowners' Board of Directors became concerned that the Condominium Act statute of limitations might run leaving them without a remedy if construction defects were later discovered. CP 91 – 92. In December of 1999 the Board hired Mark Jobe, a construction expert, to determine whether the project was defective. CP 91, 93. Mr. Jobe reported back to the Board at its January 20, 2000 meeting. CP 91. At that meeting the Board learned for the first time that there were significant defects that required repairs. CP 91 – 92. This was two days after Dally's USF policy became effective. CP 46.

The Board also sought a lawyer to advise them if significant defects were found and selected James Skeen to find lawyers to interview. CP 90 – 92. Sometime in December 1999, Mr. Skeen called Richard Beal and asked whether he might be available to represent the Board. CP 327 – 328. Skeen was careful to say it was uncertain whether significant defects existed. CP 345. Although Mr. Beal cannot remember what was said, he concluded there was a risk his sometime client Dally Homes would be sued and obtained permission to warn Don Dally, the Company's

President. CP 345. Beal suggested Skeen contact Bo Barker, a lawyer specializing in condominium defect cases, and the Board hired Mr. Barker in March of 2000, about a month after learning from their expert, Mr. Jobe, that significant defects existed. CP 328, 91 – 93.

Mr. Beal had represented Dally Homes in an earlier action by another condominium owner's association. CP 331, 364 – 365. Since that time Dally looked to him from time to time for advice on insurance issues. CP 364 – 365. In addition, Beal "kept his ear to the ground" for rumors implicating Dally's projects. CP 331. After receiving permission to warn Dally, Beal tried to contact him. CP 331 – 332.

Because of the attenuated nature of their contact Beal could not remember Dally's telephone number. CP 332. He believes he called from his office. CP 332. Although when first asked Beal thought he reached Dally before the January 18, 2000 inception of USF's policy, he later determined, based on Mr. Dally's phone log, their contact occurred on January 20th, two days after the policy bound. CP 331 – 332. This was confirmed by Mr. Dally. CP 359 – 361.

Several months later Windsong sued Dally. Dally tendered its defense to MOE and CUIC, but did not tender to USF. CP 35. MOE and CUIC defended Dally through months of litigation. CP 35. When push came to shove it was apparent that a very substantial recovery was possible. CP 35. CUIC and MOE provided the money to settle the case at approximately half the total risk. CP 35. As part of the settlement they received an assignment of Dally's rights to pursue other insurance companies and the subcontractors. CP 35.

MOE and CUIC brought actions against other insurers and the subcontractors recovering back a significant portion of their outlay to settle the case. CP 36. After all of this was done it was discovered that USF also insured Dally for this risk with a policy that became effective two days before the Windsong Arbor Board learned of their condominium's defects at the January 20, 2000 meeting. CP 36. After USF rejected an invitation to contribute CUIC and MOE brought this action against it. CP 36.

USF argued the known loss defense prevented any liability to Dally. CP 168 - 183. MOE and CUIC tried to deprive USF of its known loss defense by Summary Judgment, however, the motion was defeated, both in the first instance and upon reconsideration.

CP 34 – 40, 281 – 283, 377 – 378. Later, USF obtained dismissal of the action by its own Summary Judgment Motion. CP 576 – 579. USF successfully defended its Summary Judgment on reconsideration. CP 598 – 599.

C. ARGUMENT

1. USF's Summary Judgment Should Be Reversed

USF's Summary Judgment was based on three arguments. First, it argued that because of the late tender its policy was not triggered. Second, USF argued that it was prejudiced as a matter of law by the delayed tender. Third, it argued that Dally intentionally waived USF's coverage by failing to tender. As a result USF says it is released from any obligation to contribute its share of the cost to defend and indemnify Dally. None of these arguments is correct.

An appeal from an order of summary judgment is considered *de novo*. *Kelsey Lane Home Owners Assn. v. Kelsey Lane Co., Inc.*, 125 Wn. App. 227, 232, 103 P.3d 1256 (2005).

a. USF's policy was triggered

USF argued that its policy was not triggered because tender was never made. To support this argument it cited cases from

other jurisdictions which are at dramatic variance with Washington cases. A Montana case was cited for the proposition that failure to tender to the insurer from whom contribution was sought relieved that insurer of the duty to pay. *Casualty Indemnity Exchange Ins. Co., v. Liberty Nat'l Fire Ins. Co.,* 902 F.Supp. 1235, 1239 (MT. Dist. 1995). That holding was based on the idea that "the right of an insurer to contribution from a co-insurer exists when both insurers are liable for the loss; a situation which can only arise when the obligations of both insurers under their respective policies are 'triggered'." *Ibid.* In Montana a policy is not triggered until tender is made. *Id.* at 1238. A Minnesota case was also relied upon. *Cellex Biosciences, Inc. v. St. Paul Fire & Marine Ins. Co.*, 537 N.W. 2d 621 (MN 1995). That case held that tender is a condition precedent to both the duty to indemnify and the duty to defend. *Id.* at 623.

Washington law is dramatically different than the law of Montana and Minnesota. In continuing damage cases like the *Windsong Arbor* case in which defects create continuing interior dampness and rot, the policies are triggered in the first instance by the occurrence of damage, even without the filing of the lawsuit. *Gruol Construction, v. Insurance Co. of N. America,* 11 Wn. App.

632, 636, 524 P.2d 427 (1974). Under this approach the policies of all insurers on the risk from the time the construction was completed until the damage is discovered are triggered. *Id.* at 633-635. This idea has come to be called the continuous trigger theory, or sometimes the triple trigger theory, characterized by our courts this way: "In other words, when damage occurs during a policy period, that policy is triggered." *American Nat'l Fire Ins. Co., v. B&L Trucking & Construction Co.,* 134 Wn. 2d 413, 425, 951 P.2d 250 (1998). As a result, even before the action was brought against Dally all three policies were triggered by continuing damage at the Windsong Arbor Condominiums. Both *B&L Trucking* and *Gruol* stand for the proposition that this triggering event requires the insurer to indemnify, not just defend. *Gruol* at 637-638 and *B&L Trucking* at 424.

b. <u>USF must prove it was actually and substantially prejudiced</u>

1. <u>Failure to tender does not automatically forgive the insurer's duty to pay for defense</u>

Even though the policy is triggered by the occurrence of potentially covered damage, the duty to defend itself is specifically activated when "a complaint against the insured, construed liberally, alleges facts which could, if proven, impose liability upon

the insured within the policy's coverage." *Uniguard Ins. Co. v. Leven*, 97 Wn. App. 417, 425, 983 P.2d 1155 (1999). An insurer does not actually have to take up the cudgel to defend until a defense is requested, however. "An insurer cannot be expected to anticipate when or if an insured will make a claim for coverage; the insured must affirmatively inform the insurer that its participation is desired." *Id.* at 427. Tender does not mark the onset of the insurer's duty. That begins with the triggering of the policy.

The scope of the duty to defend is both broad and durable, capable of surviving the insured's breach unless the insurer is actually and substantially prejudiced. *Griffin v. Allstate*, 108 Wn. App. 133, 141, 29 P.3d 777 (2001). As a result, an insurer will have to pay pre-tender defense costs unless late tender has actually prejudiced the insurer. *Id.* at 142. The Griffins were sued in an action that was dismissed without prejudice by agreement. Id. at 136. A second identical suit was later brought. *Id.* at 136-137. After the second action began the Griffins tendered to Allstate. *Id.* at 137. Without a showing of prejudice Allstate was required to pay, not only for defending the second action, but for defending the first action which had been dismissed before tender. *Id.* at 141-

142. Unless USF can show it was prejudiced by the late notice it must pay its share.

2. Since policy conditions protect insurers from prejudice, insurers must show a breach of conditions caused actual prejudice to avoid policy duties

The *Griffin* rule stems from an earlier Washington case requiring the insurer to prove actual prejudice from the insured's breach of policy conditions before it would be forgiven its duties under the policy. *Oregon Automobile Ins. Co. v. Salzberg*, 85 Wn. 2d 372, 376-377, 535 P.2d 816 (1975). Since the policy provisions setting up conditions (cooperation, notice, voluntary payment, and the like) which must be met by the insured were placed in the policy to avoid prejudice to the insurer, relieving the insurer of its duties without a showing of actual prejudice would provide a windfall to the insurer at the expense, not only of the insured itself but potentially to innocent third party claimants as well. *Salzberg,* 85 Wn. 2d 376-377 and *PUD No. 1 v. International Ins. Co.,* 124 Wn.2d 789, 803, 881 P.2d 1020 (1994). This is because the policies represent a societal mechanism for risk spreading and are not only a simple contract between the insurer and the insured. *Salzberg*, 85 Wn.2d at 376 – 377. As a result of the *Salzberg* case

Washington courts have required a showing of actual prejudice as a prerequisite to avoiding obligations under a policy after a breach by the insured.

A ten-year-old Washington case put teeth into the *Salzberg* actual prejudice requirement for delayed notice cases. *Canron, Inc. v. Federal Ins. Co.*, 82 Wn. App. 480, 918 P.2d 937 (1996). *Canron* held the insurer must prove a "concrete detriment resulting from the delay which harms the insurer's preparation or presentation of defenses to coverage or liability." *Id.* at 486. General testimony that records were destroyed and conditions changed which hampered the insurer's investigation was inadequate. The court held that the insurer had to show specifically what records were destroyed and what changes were made, and more than that, precisely how the investigation was prejudiced. *Id.* at 488-492. In most cases this is the burden the insurer must bear.

3. Prejudice to an insurer can be presumed only in the most extreme cases

Despite the rules set out in *Salzberg* and *Canron,* the courts have presumed prejudice in some extreme policy condition breaches. A 50-year-old case sets the stage for presumed prejudice. *Sears Robuck & Co. v. Hartford Accident & Indemnity*

Co., 50 Wn.2d 443, 313 P.2d 347 (1957). Sears discovered coverage and gave notice to an insurer on November 25, 1953. The trial began December 1, 1953 and was settled during the third day of trial. The opinion states: "to be deprived of [that right to investigate] constitutes prejudice, however imponderable the damages, and however efficient and competent the attorneys retained by the insured." *Sears* at 454. Sears asked the court to require the insurer to prove prejudice. The court said "the mere fact that, if they had been handling it, they might have reached the very same result that was reached, is really no defense." *Sears* at 453. Despite the fact that these statements and apparent holdings were confessed by the opinion itself to be dicta, some later cases, including cases after the *Salzberg* opinion, have relied upon its reasoning. *Id.* at 454 (dicta); *Northwest Prosthetic & Orthotic Clinic, Inc. v. Centennial Ins. Co.,* 100 Wn. App. 546, 552-553, 997 P.2d 972 (2000) (reliance on *Sears* after *Salzberg*).

The determination of whether to presume prejudice from a tender so late it deprives an insurer of the ability to investigate and participate in the defense is dependent upon an analysis of a variety of factors. In general, if it appears from the facts that the insured has pulled a fast one prejudice is likely to be presumed.

On the other hand, if the resolution of the case appears to have been reasonable and the delayed tender not calculated to hamper the insurer, the insurer is unlikely to have suffered presumable prejudice.

This approach is illustrated by a state Supreme Court case involving settlement without consent rather than late notice. *PUD No. 1 v. International Ins. Co.,* 124 Wn.2d 789, 881 P.2d 1020 (1994). Citing the rule requiring proof of prejudice and the fact that the settlement without consent was done with court approval, the Supreme Court held that the insurer's failure to prove prejudice prevented its recovery. *Id.* at 803-805. In response to the insurer's argument that prejudice should have been presumed the court noted prejudice should be presumed only in extreme cases and said the issue had been properly determined as an issue of fact. *Id.* at 805.

The most obvious cases in which presuming prejudice seems appropriate are those reeking of evidence suggestive of fraud by the insured. See, *Pilgrim v. State Farm,* 89 Wn. App. 712, 950 P.2d 479 (1997) and *Tran v. State Farm,* 136 Wn.2d 214, 961 P.2d 358 (1998). Both of these cases involved, not the notice provision, but rather the cooperation clause of the policy. *Pilgrim,*

89 Wn. App. at 714; *Tran,* 136 Wn.2d at 228. In both cases the evidence suggestive of fraud was almost overwhelming and in both cases the insured refused a request for documents that might have been used to establish whether a motive for fraud existed. *Pilgrim,* 89 Wn. App. at 717-718, and *Tran,* 136 Wn.2d at 218-222 (evidence); *Pilgrim,* 89 Wn. App. at 714 and *Tran,* 136 Wn.2d at 217 (refused). In both cases the requested documents would have displayed the financial condition of the insured in an effort to determine whether financial hardship could have supplied a motive to present a fraudulent claim. Although that exercise may seem dubious, that is the motivation to commit fraud may exist with or without financial hardship, the evidence suggesting fraud was so strong it must have made the insurers roll their eyes and plug their noses.

More directly on point are two cases, one involving tender intentionally withheld and the other involving delayed discovery of coverage. *Felice v. St. Paul Fire & Marine Ins. Co.*, 42 Wn. App. 352, 711 P.2d 1066 (1985); *Pulse v. Northwest Farm Bureau Ins. Co.,* 18 Wn. App. 59, 566 P.2d 577 (1977). The Pulses defended an action by a neighbor at their own expense. After judgment they discovered a policy that covered the claim and tendered to the

insurer. The court noted that the insurer conceded that it was unlikely it could have done a better job of defending. Observing the *Sears* presumed prejudice ruling had been undercut by the *Salzberg* proof of actual prejudice requirement, the court overturned a summary judgment for the insurer and sent the case back for trial.

Mr. Felice, a lawyer, decided to defend a claim against himself rather than notify his malpractice insurer. *Felice* 42 Wn. App. at 355. After defending, losing the trial, and filing Notice of Appeal, Mr. Felice notified the insurer with one day left at the end of the 30-day appeal period. *Id.* at 359-360. Summary Judgment for the insurer based on presumed prejudice was upheld because the insurer was precluded from making its own investigation. *Id.* at 360. The *Pulse* case was distinguished by the court because the Pulses, unlike Mr. Felice, defended themselves without knowing the claim was covered. *Id.* at 360.

4. <u>This is not an extreme case because the value of the claim was accurately set in negotiation</u>

An interesting more recent case attempts to explain how to distinguish the two types of cases, those extreme cases in which prejudice is presumed and those not so extreme cases in which

prejudice must be proved by the insurer to avoid coverage. *Northwest Prosthetic & Orthotic Clinic, Inc. v. Centennial Ins. Co.*, 100 Wn. App. 546, 997 P.2d 972 (2000). *Northwest Prosthetic* involved facts highly suggestive of a design to set-up the insurer.

Two of three equal owners of the Northwest Prosthetic business terminated the third owner who brought a contract action against them alleging they did not have the contractually required reasonable cause for his termination. *Id.* at 548. About two months before trial the plaintiff amended his complaint to add a claim of defamation, which unlike the contract claim could have been covered by Northwest's policy. *Ibid.* Northwest's lawyer delayed a month, half the time remaining before trial, before sending the insurer a letter notifying it of the defamation claim but failing to describe the claim itself, the status of the case, or the fact that trial and a settlement conference were imminent. *Ibid.* On the day of the settlement conference, the lawyer's paralegal called the insurer's claim handler to request some information but failed to mention either the imminent trial date or the fact that a settlement conference was scheduled that day. *Id.* at 549. Three days later, ten days before trial, the parties settled for $325,000.00, all of which was characterized as damages for personal injuries resulting

from the potentially covered defamation, and none characterized as contract damages, even though the complainant's salary at the time of termination was $25,000 a month and even though about five months had gone by. *Id.* at 549 (settlement) and 555 (salary claim). In the meantime, the insurer hired a lawyer to defend Northwest who on the day he was hired called Northwest's lawyer and learned that the case had been settled almost three weeks before. *Id.* at 549. Until that moment the insurer had no hint that time was short, that a settlement was in the mill and that a quick decision was required.

The court held prejudice was presumed from this set of facts. *Id.* at 547. In doing so it distinguished the case from both *Canron* and *Pulse.* It noted that unlike the insurer in *Canron,* because of Northwest's intentional and calculated delay its insurer had no opportunity to investigate. *Id.* at 551. In addition to having time to actually investigate, Canron's insurer had available "extensive documentation" of the investigations by the EPA, the Department of Ecology, and other potentially responsible parties for the pollution in that case. *Ibid.* The court also distinguished *Northwest* from *Pulse.* It characterized *Pulse* as a case in which a clear-cut result was achieved that was essentially beyond dispute.

Id. at 554. In *Pulse* the insured defended before discovering coverage and there was no basis to believe the insurer could have improved the result. *Ibid.* It pointed out that in *Pulse* the damages were concrete as opposed to the nebulous damages caused by the alleged defamation in *Northwest*. *Ibid.* In *Pulse* the action was actually tried to a court. *Ibid.* The *Northwest* court was obviously leery of the $325,000 *Northwest* settlement in which the entire amount was dumped into the potentially covered defamation claim rather than the apparently more substantial, but non-covered, termination claim. *Id* at 554-555. After pointing out these factors the court concluded: "under these circumstances, unlike *Pulse*, one cannot be confident that the litigation accurately established the value of the claim." *Id.* at 555.

The circumstances of construction defect litigation, like the case against Dally which underlies this case against USF, show the claim's value was accurately established. First construction defect cases feature concrete, ascertainable physical damage unlike the ethereal defamation claim in *Northwest*. Second, when both the insured and its insurers are involved in resolving construction defect cases the settlements are hammered out in tough negotiations. Both the insured and the insurers are motivated to

minimize the cost of settlement. The insured needs to preserve insurance coverage for other potential claims and the insurers, who must actually pay, need assurance the amount is not inflated. Third, when insurers are involved, the case cannot be resolved by dumping the entire claim into a covered category, ignoring exclusions which would lower the cost. The insurers would not accept such a ruse. Fourth, absent evidence from USF showing mistakes, or the failure to raise appropriate defenses for Dally, there is no basis to suggest USF would have produced a better result had it participated in the defense of Dally. Fifth, during the eighteen months this case was litigated USF has had an opportunity to obtain in discovery documentation of the damages in the underlying case against Dally. These factors assure the claim was accurately determined despite USF's absence from the defense. As a result USF is unable to claim it was prejudiced as a matter of law.

c. <u>Dally didn't waive its USF policy rights</u>

USF argued that Dally Homes waived coverage under its policy by deciding not to tender. This argument is incorrect because Dally did not know it had coverage under that policy. See argument against the known loss defense C.2. below. Waiver is

"the voluntary and intentional relinquishment of a known right." *Ross v. Harding,* 64 Wn. 2d 231, 240, 391 P.2d 526 (1964). In the *Ross* case a party who relied on the existence of a lease was claimed to have waived the leases' existence. The court held, however, the party asserting waiver failed to prove the other party had known there was no valid lease, and thus failed to prove waiver. *Ross,* 64 Wn. 2d at 240. See also, *Mid-Century Ins. Co. v. Brown,* 33 Wn. App. 291, 296, 654 P.2d 716 (1982) ("one cannot waive that which he does not know or where he has acted under a misapprehension of facts").

That is exactly the situation we face in this case. USF is unable to show that Dally knew it had coverage under the policy. It can only show Dally's occasional lawyer thought the information he had constituted a known loss for Dally. Because USF has the burden to prove waiver and has failed to do so this argument fails. *Jones v. Best*, 134 Wn. 2d 232, 241-242, 950 P.2d 1 (1998).

d. <u>MOE and CUIC are entitled to contribution from USF regardless of Dally's failure to tender</u>

Even if USF is correct in its other arguments, MOE and CUIC are entitled to contribution. Unlike subrogation, equitable contribution does not rest upon the rights of the insured, but rather

independently arises from the common obligation shared by the co-obligors. *Fireman's Fund Ins. Co. v. Maryland Casualty Co.,* 65 Cal. App. 4th 1279, 1292-1302, 77 Cal. Rptr. 2d 296 (1998). In that case, the rights of equitable contribution among co-insurers survived the insured's settlement with the non-paying insurer, even though that settlement affected subrogation rights. *Fireman's Fund*, 65 Cal. App. 4th at 1289. As a result, even if Dally's actions impaired subrogation rights, the right of contribution survives for MOE and CUIC.

The Doctrine of Contribution requires that persons under a common burden share that burden equitably. 18 Am. Jur. Contribution §1, p. 7 (1985). In the insurance context equitable contribution comes into play when fewer than all of the insurers on the risk pay more than their share of the obligation and then must seek compensation from the insurers who did not pay their share. *Fireman's Fund Ins. Co., v. Maryland Casualty Co.,* 65 Cal. App. 4th at 1293. Equitable contribution permits the paying insurers to recover the excess they paid over their proportional share of the obligation. *Ibid.* The purpose of the rule is to allocate appropriately the common burden among the insurers in proportion to their respective coverage of the risk. *Ibid.* The principle is the same

whether the insurers owe equal or different amounts. *Ibid;* 18 Am. Jur. 2d Contribution §10, p. 17-18 (1985).

Equitable contribution is firmly established in Washington. See, *eg., Sound Built Homes, Inc. v. Windemere Real Estate/South, Inc.*, 118 Wn. App. 617, 633-635, 72 P.3d 788 (2003). Although the *Sound Built Homes* case speaks of dividing the obligation equally among the co-obligors, that idea appears to be based on a series of cases, including *Sound Built Homes* itself, in which the co-obligation happened to be equal. See, the cases listed at *Sound Built Homes,* 118 Wn. App. at 634 n. 38.[1] Because equitable contribution is inherently equitable in nature requiring a precisely equal allocation among the several insurers would be unduly rigid unless they happened to owe equal amounts. 18 Am. Jur. 2d Contribution §23, p. 31 (1985).

This issue was addressed in the *Fireman's Fund* case in which the court used a time on the risk analysis to allocate the responsibility of the insurers. As it happened, the insurers had equal time on the risk and as a result equal liability. *Fireman's*

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[1] *Sound Built Homes'* footnote 38 also cites 9 Corbin on Contracts §924 at 620 (interim ed. 2002). This refers to an example of two joint makers of a promissory note for $1000 each of whom would be owed $500 contribution from the other upon paying the entire debt. Although correct, the example does not require contribution in equal amounts, unless the contributors actually owe equal amounts.

Fund, 69 Cal. App. 4th at 1303 and 1307. However, the case makes it clear that the responsibility of co-obligors under equitable contribution is for each obligor's proportional responsibility arising from each company's coverage. *Fireman's Fund*, 65 Cal. App. 4th at 1293 and 1307.

MOE, CUIC and USF shared a common liability to defend and indemnify Dally Homes, because they all had coverage during the period damage was occurring at Windsong Arbor. In Washington, all insurers on the risk of a gradually developing occurrence are jointly and severally liable. *Gruol Construction v. Insurance Company of N. America,* 11 Wn. App. 632, 637-638, 524 P.2d 427 (1974); *American Nat'l Fire Ins. Co., v. B&L Trucking & Construction Co.,* 134 Wn. 2d 413, 424,951 P.2d 250 (1998). All of the jointly and severally liable insurers must defend and indemnify.

As a result of sharing this common obligation the right of contribution exists for MOE and CUIC. Having paid the entire obligation they are entitled to receive from USF the amount they paid over their proportional share of the obligation. USF must pay its share of the obligation in order to prevent it from profiting at the expense of the paying companies, MOE and CUIC.

2. MOE's and CUIC's Summary Judgment Motion On The Known Loss Defense Should Have Been Granted

a. The message was not delivered until after USF's policy became effective

USF argued Dally knew of the claim before the USF policy became effective, removing that loss from coverage under the USF policy. Citing evidence showing the Windsong Arbor Condominium Owners Association board itself didn't know it had a basis to sue until it met with its expert two days after USF's policy bound, MOE and CUIC moved for a summary judgment to deprive USF of the known loss defense. The trial court denied the motion saying Mr. Beal's deposition testimony raised issues of fact whether Dally knew of the claim before the policy bound.

USF argued Mr. Beal delivered sufficient information to Dally to put him on notice of a claim before the USF policy became effective. Under the evidence this argument fails. Mr. Beal testified that he received some information from Jim Skeen, a Windsong board member, probably in late December "and certainly . . . before December 31st." CP 327. Straining to recall minute details from five years before Mr. Beal was "fuzzy" about when he talked to Mr. Dally to convey the message. CP 331. Although he thought he had a memory of having made the call "significantly before the time

frame of January 18," Mr. Dally's records and memory are at variance. CP 331 – 332. Dally's testimony and phone log show Mr. Beal called him on January 20, 2000, two days after the USF policy bound. CP 331 – 332, 359 – 361. Upon learning this Mr. Beal testified "so it is entirely possible that the reason my memory is fuzzy is because I didn't actually talk to Don but instead talked to his voice mail. I don't know." CP 331 – 332. If Mr. Beal left a voice message it would only have said to return the call. CP 332. As a result, the evidence shows that any substantive information Mr. Beal gave Mr. Dally would have occurred on January 20th at the earliest. There is no evidence to show Dally knew of the claim before USF's policy bound.

b. <u>The rumors of a lawsuit were too vague to create a known loss</u>

1. <u>A known loss is actual subjective knowledge</u>

Insurance is only available to cover an uncertain risk. If an insurance purchaser knows a loss has already occurred insurance is not available and the insurer can avoid payment by raising the known loss defense. In Washington the known loss defense requires the insured have actual subjective knowledge rather than mere notice of the loss. See, *Overton, v. Consolidated Insurance*

Co., 145 Wn.2d 417, 425, 38 P.3d 322 (2002). The subjective knowledge must be sufficient for the insured to know there is a substantial probability of a claim or property damage that will produce a claim. *Ibid* (subjective knowledge); *Hillhaven Property Ltd., v. Sellen Construction Co.,* 133 Wn.2d 751, 767-768, 948 P.2d 796 (1997) (substantial probability). Evidence that is merely suggestive is inadequate. For example, evidence of annoying water leaks was insufficient to provide knowledge of significant hidden damage in *Hillhaven.*

Evidence of hints or rumors that a claim might be brought or that damage was occurring would be insufficient to establish the known loss defense. See, *PUD No. 1,* 124 Wn. 2d at 805-808. The level of evidence required to establish the affirmative of an issue is "substantial evidence." In addition to direct evidence, substantial evidence may be indirect, however to prove a disputed fact it "must have in its support that character of evidence which would convince an unprejudiced thinking mind of the truth of the fact, before it can be said it be established." *Hillhaven,* 133 Wn.2d at 766, quoting *Smith v. Yamashita,* 12 Wn.2d 580, 582-83, 123 P.2d 340 (1942). Evidence that Windsong would consider an action if significant damage were found does not pass this test.

2. USF's endorsement requires actual subjective knowledge

USF added an endorsement to its policy that bears on this issue. The "PREEXISTING DAMAGES AND/OR DEFECTS EXCLUSION" prevents coverage if a claim is based upon "preexisting damages and/or defects known to any insured before the effective date of this policy." (emphasis added). CP 78. This exclusion also requires actual subjective knowledge of the preexisting damages or defects. Webster's Third New International Dictionary defines "known" as "...that is apprehended or perceived by the mind or senses: that has become a part of knowledge. . . ." (Unabridged 1971). Mr. Beal could not have supplied this level of information to Dally.

3. No one knows what Mr. Beal learned

Mr. Beal testified that when he received the call from Mr. Skeen he asked a series of questions. Through these questions he learned the condominium projects name, the number of units, and the approximate date of its first sale. There was some conversation "about what they had going on out at Windsong Arbor" before he learned Dally Homes was the builder, presenting him with a conflict of interest. CP 328. When asked what Mr.

Skeen told him about the damage at the Windsong Arbor Condominiums Mr. Beal said "I don't remember exactly what he said. But I remember what went through my mind." CP 345. He also stated "I do remember that Skeen was careful not to exaggerate and not to say, I think I've got a lawsuit. It was very clear to me that he didn't know what he had." CP 345. Mr. Beal's testimony was primarily a description of his assumptions, his reasoning, his conclusions, and his opinions. For example, he stated: "I don't remember exactly what he said. But I remember what went through mind. And what went through my mind was water intrusion. I know how Oxford Park was built. I know that they are at the end of the four years. There is going to be a lawsuit if I don't do something. And I need to get permission from him if it's okay with him to alert Don." CP 345.

As a result of Mr. Beal's very candid testimony we don't have any of the facts he received from Mr. Skeen. Even if he had spoken to Mr. Dally before January 18th when the USF policy bound Mr. Beal lacked sufficient information to provide Mr. Dally knowledge of an impending claim. He could only report Windsong Arbor would consider a suit if significant defects were found. Mr. Beal's conclusions are not subjective knowledge of a substantial

probability of a claim or property damage that would produce a claim, the knowledge required for a known loss. USF would have us dilute the known loss defense to deprive Dally Homes of its insurance based on mere rumor or speculation.

c. **Mr. Beal's conclusions do not create an issue of fact**

In a summary judgment context testimony does not raise "a genuine issue for trial unless it sets forth facts evidentiary in nature, i.e., information as to 'what took place, an act, an incident, a reality as distinguished from supposition or opinion.' Ultimate facts, conclusions of fact, or conclusory statements of fact are insufficient to raise a question of fact." *Curran v. Marysville,* 53 Wn. App. 358, 367, 766 P.2d 1141 (1989) (citations omitted). This rule applies to lawyer witnesses and non-lawyer witnesses alike. *American Linen Supply Co., v. Nursing Home Building Corp.*, 15 Wn. App. 757, 763, 551 P.2d 1038 (1976). In the *American Linen* case the court ruled that it was proper for the trial court on summary judgment to consider the lawyer's affidavit to the extent it was based on testimonial knowledge as opposed to "conclusions and other surplusage." *Ibid.* The reason for this rule seems apparent. Only the court has discretion to evaluate whether there

is a dispute of fact. USF proposes to remove that discretion from the court and instead place it with a lawyer witness who is struggling to remember remote events. That would be an inappropriate transfer of the court's authority.

d. <u>Beal's knowledge cannot be imputed to Dally</u>

USF argues that because of the nature of the relationship Mr. Beal had with Dally Homes his knowledge was the knowledge of Dally Homes, whether delivered to Dally or not. This argument is based on the dubious premise Mr. Beal was Dally's agent. Even if he were Dally's agent his relationship was so narrow and remote imputation of his knowledge to Dally would be inappropriate. USF seeks to apply the information Mr. Beal received to a transaction with which he had no contact and no authority, the purchase and inception of the USF policy, also making imputation inappropriate. Even if imputation were appropriate it cannot be done here because we don't know what knowledge Mr. Beal received, we only know his conclusions.

Mr. Beal worked for Dally off and on after the conclusion of the *Oxford Park* case, the first case Mr. Beal helped Dally with. Mr. Dally testified that Mr. Beal occasionally advised him "when I have questions on insurance," but he had no duties "other than

insurance." CP 364 – 365. Mr. Beal remembered a second task. "The second thing he looked to me for was what I call ear to the ground." CP 331. Mr. Beal was to "let him know if I, you know, heard anything or found out anything that would implicate him or his company." CP 331. Mr. Beal's second task was to convey bits of information or rumors that might provide an early warning to Mr. Dally.

Mr. Beal's work for Dally was only occasional. He testified he didn't remember Mr. Dally's number and had to return to the office to call because it had been a long time since they had any dealings. CP 332.

When Mr. Skeen called Beal seeking a lawyer for the Windsong Homeowners, Mr. Beal was not Dally's agent. There is no evidence in the record to establish an agency –the mutual consent of Dally and Beal that Beal would act for Dally and under Dally's control. *Skagit State Bank v. Rasmussen,* 109 Wn. 2d 377, 387-388, 745 P.3d 37 (1987). It was USF's burden to show that evidence. *Kelsey Lane Home Owners Assn. v. Kelsey Lane Co., Inc.*, 125 Wn. App. 227, 236, 103 P.3d 1256 (2005). Without that evidence the court cannot find an agency. *Rasmussen,* 109 Wn.

2d at 387 – 388. Since Beal was not Dally's agent imputation is not possible. *Kelsey Lane,* 125 Wn. App. at 237.

Although Dally expected to hire Beal from time to time for insurance advice, he had not done so for some time. Mr. Beal's past engagements had ended, ending his authority to act for Dally. *Restatement 2d, Agency § 106*. As a result, Mr. Beal was not Dally's agent, and imputation is not possible. *Kelsey Lane*, 125 Wn. App. at 237.

Even if Mr. Beal had been Dally's agent his knowledge could not be imputed. In most circumstances notification of a fact by an agent to the principal occurs when the agent states the fact to the principal or delivers the information in writing either personally to the principal or to one of several locations calculated to insure the principal will receive it. *Restatement 2d,* Agency § 11. However, under some circumstances an agent receives information of which the principal remains ignorant. If formal notice is given to an agent authorized to conduct a particular transaction to which the notice relates, the law imputes this knowledge to the principal even though the principal has not received it. *Restatement 2d, Agency, § 268(1)(c).* Notice of information can result from an act of formal notice, or can result

from knowledge of a fact, or knowledge of information sufficient to create reason to know that the fact exists. *Restatement 2d, Agency, Introductory Note to Chapter 8.* The law distinguishes between information held as knowledge and that received by formal notification. This is because in some situations a legal effect is generated by delivery of a notice, whether the person receiving it is aware of it or not. However, in other circumstances, the principal's state of mind is, itself, a necessary element. *Restatement 2d, Agency, § 268, comment b, and comment d.* "If knowledge, as distinguished from reason to know, is the important element in a transaction, and the agent who has the knowledge is not one acting for the principal in the transaction, the principal is not affected by the fact that the agent has the knowledge. In many situations, in order for one to be responsible, it is necessary that the act should be done with knowledge in a subjective sense, and it is not sufficient that one has means of information." *Restatement 2d, Agency, § 275, comment b.* (Emphasis added). The known loss defense is a circumstance in which the principal's state of mind is a necessary element. It requires actual subjective knowledge sufficient for the insured to know there is a substantial probability of a claim or property damage that will produce a claim.

Overton, v. Consolidated Insurance Co., 145 Wn.2d 417, 425, 38 P.3d 322 (2002) (subjective knowledge); *Hillhaven Property Ltd., v. Sellen Construction Co.,* 133 Wn.2d 751, 767, 948 P.2d 796 (1997) (substantial probability). This requirement, coupled with the fact Mr. Beal had no connection of any sort with Dally's purchase of the USF policy, makes the imputation of his knowledge to Dally inappropriate.

The subjective knowledge of an agent is imputed to its principal only when the agent is acting for the principal in the transaction in which the knowledge arises, or when the principal has misled the person with whom the agent is dealing by creating apparent authority in the agent, causing mis-delivery of information to the agent. *Restatement 2d, Agency, § 273.* The rule states, "except where there is reliance upon the appearance of agency, a principal is not bound by knowledge of an agent concerning matters as to which he has only apparent authority." *Ibid.* Since Mr. Beal did not deal with either USF or Dally Homes' insurance agent for the procurement of the policy, he had neither actual nor apparent authority with respect to that transaction. As a result, any knowledge he had was not knowledge to Dally Homes

until he was able to actually deliver it. See, *Roderick Timber Co. v. Willapa Harbor Cedar Prods. Inc.,* 29 Wn. App. 311, 316-317, 627 P.2d 1352 (1981).

The USF policy may also affect this analysis. The "Preexisting Damages and/or Defects Exclusion" endorsement is a two-page document. CP 78 – 79. The second page states that for the purposes of the endorsement "insured shall mean any Named Insured, its officers, directors, partners, risk managers or any persons acting in similar capacities." CP 79. The endorsement requires the knowledge of the claim to be held by governing functionaries or high ranking employees of the company who are likely to have direct responsibility to and direct contact with its CEO and governing board and, thus likely to actually present the information to the company quickly. *Cf. Roderick Timber*, 29 Wn. App. at 317. Mr. Beal's relationship with Dally Homes was much more remote than this. Even if he had the requisite knowledge for a known loss at Windsong Arbor, it was not Dally's knowledge until actually delivered.

Even if the court holds that Mr. Beal's knowledge must be imputed to the corporation, it cannot be done in this case. We have insufficient information about what Mr. Beal knew. The state

of his knowledge is insufficiently factual to create either a known loss or a dispute of fact.

The knowledge of some agents can be imputed to their principals. However, Mr. Beal was not Dally Homes' agent. Even if he had been an agent the remoteness and narrow scope of the relationship and the fact that whatever knowledge he obtained related to the purchase and inception of the USF policy, a transaction with which he had no contact and thus no authority, would prevent imputation. In any case, Mr. Beal has forgotten the message he received. We cannot impute it to Dally now because we don't know what it was.

D. CONCLUSION

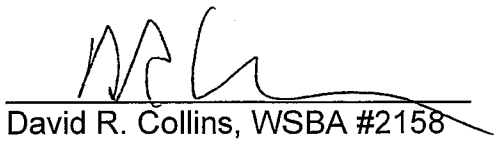
The appellants, MOE and CUIC ask:

(1) The Trial Court's Order Granting Summary Judgment for USF be reversed, reinstating this case for trial; and

(2) The Order denying CUIC and MOE's Partial Summary Judgment Motion be reversed to grant the motion, forbidding USF to raise the known loss defense at trial.

Dated this 12th day of July, 2006.

HACKET, BEECHER & HART



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