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THE COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON,
AT SEATTLE

MUTUAL OF ENUMCLAW
INSURANCE COMPANY,

No. 57820-1-I

Appellant / Cross-Respondent

v.

MacPHERSON CONSTRUCTION &
DESIGN, LLC,

Respondent / Cross-Appellant.

REPLY BRIEF OF APPELLANT/ CROSS- RESPONDENT

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APPELLANT'S REPLY

I. MACPHERSON'S POLICY WAS NOT LIBERALIZED

In its opening brief, Enumclaw argued that MacPherson had the burden of proving each element of the Liberalization Clause, because it was a contractual condition precedent. Those elements are: the Filing was “approved to be effective” while MacPherson’s policy was in force; second, the Filing includes forms or other provisions that would extend or broaden MacPherson’s insurance coverage; and third, the Filing was available to MacPherson without additional premium. MacPherson made no response to the burden argument, so the Court can safely assume that MacPherson agrees that the burden of proof on each element lies with it.

A. The Nature of the Rates Filing

It bears noting that the Rates Filing relied upon by MacPherson was written by actuaries, to be read by actuaries. It is a cumbersome read for lawyers. When asked to wade through an actuarial composition, one court noted:

[T]he subject matter therein treated is so abstruse, technical, or scientific that it can be understood or used solely by actuaries . . . useful to and used by the technician and student but Sanskrit to the ordinary reader and student of high attainments. *United States v. Tice & Lynch*, 10 Ct. Cust. 198, 201 (Ct. Cust. App. 1920).

The Rates Filing is *not* a text to be interpreted according to the understanding of the average lay insured, with perceived ambiguities

resolved in the insured's favor, as is the case with policy interpretation. *See eg. Boeing Co. v. Aetna Casualty & Sur. Co.*, 113 Wn.2d 869, 881, 784 P.2d 507 (1990). In fact, it is not a contract at all. If MacPherson believes that the Rates Filing is sufficient to satisfy the requirements of the Liberalization Clause, it must prove that the Filing was to take effect during MacPherson's policy period, that the Filing broadens MacPherson's coverage, and that the Filing mandates MacPherson's premium could not increase under the Simplified Program. MacPherson may indeed find the filing "confusing¹," but that does not lessen MacPherson's obligation to prove its case. MacPherson did not and cannot do so, and the Court should rule that the policy was not liberalized.

B. None of the Prerequisites of the Liberalization Clause Occurred.

a. The Rates Filing was Not Effective during MacPherson's Policy.

The Filing on which MacPherson relies is not a Forms Filing; it is a Rates Filing. Rates Filings are not even *allowed* to contain requests for approval of forms. WAC 284.58.250(6). The *forms* MacPherson wants had been in use by Enumclaw since 1994. CP 1216. In the Rates Filing, Enumclaw was making a proposal regarding its computation of premiums in relation to published actuarial tables that provide statistical evidence of how much it costs to pay claims on various units of risk (known as "loss

¹ The undersigned admits without shame to having read it several times himself.

costs”). Premiums for a particular insured are set only at inception of a policy, and on yearly renewal. CP 1092. *See also* CP 1225.

The first requirement is that the “filing is approved or accepted by the insurance authorities to be effective while this policy is in force. . .” CP 1057. The filing must be approved to *be effective* during the policy period; the date on which the *filing was approved* is irrelevant. *Gerrish Corp. v. Aetna Cas. & Sur. Co.*, 949 F. Supp. 236 (D. Vt. 1996) is instructive. In *Gerrish*, there was a Form Filing, in which the OIC approved the use of an endorsement that removed the pollution exclusion from the policies of all insureds. The proposal was filed on April 30, 1984. The commissioner approved the form for use on May 2, 1984. The filing correspondence, however, stated, “[T]hese changes are applicable to all policies written on or after July 1, 1984.” *Gerrish Corp. v. Universal Underwriters Ins. Co. of Kansas*, 754 F. Supp. 358, 363 (D. Vt. 1990). Even though the commissioner had approved the filing in May, the court held that the date on which the “filing was approved to be effective” was July 1, 1984. *Gerrish Corp. v. Aetna Cas. & Sur. Co.*, 949 F. Supp. at 240.

In the case at bar, the Commissioner’s *approval* was “effective” on September 15, 2001². CP 1223. The application of the rates in the Rates

² In its opening brief, Enumclaw pointed out that the Rates Filing was effective on September 15, 2001 for new policies, and December 15 for renewals. CP 1223. The

Filing to renewing policies was to begin on December 15, 2001, *as the policies renewed*. CP 1223. The new rates were to be applied to renewing policies pursuant to the “Transition Program.” CP 1221. The Transition Program was an integral part of this filing, and was presented to the Commissioner in the initial correspondence relating to the filing.³ CP 981. In contrast to the Forms Filing in *Gerrish*, applicable to “all policies written on or after July 1, 1984,” the Transition Plan in the Enumclaw Filing was applicable *only* to policies that were “renewed or rewritten during the period that starts with the implementation date of this rule. . .” CP 1221. Unlike a *Gerrish*-style Filing, the date on which this Rates Filing becomes “effective” varies by policyholder according to renewal date. The new rates were approved to be effective for renewing policies beginning on December 15, 2001. CP 1223. The new rates would have been effective for MacPherson’s renewal in October, 2002, but MacPherson did not renew. Because the new rates were not approved to be effective with respect to MacPherson *during any* of MacPherson’s policy periods, the Liberalization Clause was not triggered.

C. The Rates Filing did Not Expand or Broaden Coverage.

It would be inaccurate to describe the Simplified Program as providing

initial August approval date, relied on by MacPherson, was postponed by the Commissioner at Enumclaw’s request. *Id.*

³ The Transition Plan will be discussed in more detail below.

“broader” coverage than the Pre-Simplified Program. Enumclaw presented several reasons why such a comparison is empty of meaning:

1. Neither the “Simplified Program” nor the “Pre-Simplified Program” point to any particular kind of coverage. As discussed above, the Rates Filing on which MacPherson relies contains no policy forms, and it addresses rates applicable to an entire program of insurance, consisting of a panoply of forms and endorsements, not just the particular CGL form MacPherson wants. A Pre-Simplified policy could be assembled with broader coverage than a Simplified policy, and vice-versa. *Appellant’s Brief at 21-25*

2. The Simplified CGL form had been in use by Enumclaw since 1994. Where a form is available when the coverage was written, but not chosen between the insurer and the insured, it cannot be the subject of liberalization. *Appellant’s Brief at 21.*

3. The Pre-Simplified CGL contained only a per-project policy limit, not a general aggregate policy limit. Where the insured worked at multiple jobsites, the coverage available under a Pre-Simplified CGL could far exceed the coverage available under the Simplified CGL. *Appellant’s Brief at 23.*

Because the “Simplified Program” does not represent “broader coverage” than the “Pre-Simplified Program,” the Liberalization Clause in MacPherson’s policy was not triggered.

MacPherson seeks to avoid these arguments by suggesting that Enumclaw “admitted” that the Simplified Program provided broader coverage, through the testimony of its “corporate designee,” Debbi Sellers. The primary problem with MacPherson’s assertion is that Ms. Sellers said

no such thing. She stated that *one exclusion* (the “your work” exclusion) in the Simplified CGL excluded less than the “your work” exclusion in the Pre-Simplified CGL. CP 1014-1019. She was not even asked if the Simplified Program was “broader” than the Pre-Simplified Program.

Ms. Sellers was not speaking for Enumclaw when she discussed coverage under the Simplified CGL. She was designated only on the issue of Enumclaw’s investigation of MacPherson’s claim, not what coverage could have been available under the Simplified CGL. CP 687. Enumclaw objected continuously during her deposition that questions regarding the Simplified CGL were outside the scope of the 30(b)(6) Notice. CP 1014-1018. MacPherson deleted these objections in its quotes, covering them with “objection posed.” *Respondent’s Brief at 9*. CP 1014-1018.

A corporation is not bound by testimony of a 30(b)(6) witness that is beyond that scope of the 30(b)(6) notice. In addition to the authority presented by Enumclaw’s Appeal Brief, the case of *Detoy v. City & County of San Francisco*, 196 F.R.D. 362 (D. Cal. 2000) is instructive. In *Detoy*, the corporation was not bound by testimony given by a 30(b)(6) witness that was beyond the scope of the Notice. Because it can neither distinguish that authority, nor offer any other reason why Enumclaw should be “bound.” MacPherson ignored the argument.

Finally, Ms. Sellers’ statements were nothing more than her opinion on

the legal meaning of the Pre-Simplified and Simplified CGLs. Courts interpret insurance language as a matter of law. *Schwindt v. Underwriters at Lloyds of London*, 81 Wn. App. 293, 914 P.2d 119 (1996) rev. den. 130 Wn.2d 1003 (1996). Testimony on pure legal issues is inadmissible. *Stenger v. Washington*, 104 Wn. App. 393, 407-409 16 P.3d 655 (2001).

D. The Rates Filings did Not Make the Simplified Program Available to MacPherson for “No Additional Premium.”

The Fallacy of MacPherson’s Premium Logic. MacPherson must prove that the simplified program was available to it for “no additional premium.” Unlike Enumclaw, MacPherson presents no evidence of what its renewing premium would have been under the simplified program.

Instead, MacPherson relies on the following syllogism:

1. All insureds would experience a decrease in premium under the simplified program.
2. MacPherson was an insured.

THEREFORE:

3. MacPherson’s premium would have decreased under the simplified program.

The quality of the conclusion is only as good as the quality of the premises. The problem is with the first premise - “all insureds would experience a decrease in premium under the simplified program.” In an infirm attempt to establish this proposition, MacPherson relies exclusively

on correspondence between Enumclaw and the OIC relating to the Rates Filing. MacPherson cites several examples of what it characterizes as representations that “the transition would not result in an increase in premiums to its CGL policyholders.” *Respondent’s Brief at 10.* MacPherson mischaracterizes this correspondence, insisting that Enumclaw meant that every policy holder would experience a decreased premium. However, the “premium decrease” refers only to the aggregate premium received from all policyholders, not premiums paid by individual insureds. Nothing in the filing precludes Enumclaw from increasing MacPherson’s premium. As will be explained, Enumclaw expressly told the Commissioner, mathematically, that the premiums for some insureds *would* increase. Enumclaw was entitled to charge MacPherson a higher premium under the Simplified Program, and the policy was not liberalized.

The Rate Transition Program. There is nothing easy about understanding the Filing. MacPherson entreats the Court to brush aside any real understanding of it because it is “confusing.” But if MacPherson wants to use the Filing to “prove” its premium would have decreased, it must demonstrate to the Court why that Filing precludes its premium from increasing. MacPherson cannot, because while the Rate Filing describes a decrease in the aggregate premium level, it is mathematically founded on premium increases for a number of policyholders.

Premiums under the Simplified Program were tied to different exposure bases than they had been under the pre-simplified program. For example, premiums that were set as a multiple of the number of an insured's employees could now be set as a multiple of the insured's payroll. CP 787. If Enumclaw had directly applied the new bases, some insureds would have experienced large increases or decreases in their renewing premiums⁴. CP 932.

It was exactly these large swings that Enumclaw prevented with the Transition Plan⁵. In its first letter to the Commissioner in this filing, Enumclaw stated,

Accordingly, we have enclosed for your review and consideration a Transition Rule *that was developed to mitigate the impact of premium fluctuations* that are related to changes in rating bases in conjunction with base rate changes and changes to increased limits factors. CP 982 (emphasis added).

⁴ Imagine Insured A is a painting contractor that has 20 employees, each of which it pays \$10 per hour. Insured B is an electrical contractor with 5 employees, each of which it pays \$100 per hour. If an insurer calculated a premium by using a multiple of ten times the number of an insured's employees, Insured A would pay \$200 and Insured B would pay \$50; the insurer would collect \$250. The insurer might then change the rating basis to the insured's payroll. The premium could be calculated as 0.0022 times an insured's monthly payroll. Insured A would pay $(0.0022) \times 160$ (work hours per month) \times \$10 (per hour) \times 20 (workers), or \$71.43. Insured B would pay $(0.0022) \times 160$ (work hours per month) \times \$100 (per hour) \times 5 (workers), or \$178.57. Notice that the aggregate premium remains \$250, but Insured A's premium decreased by \$128.57 (a 64% decrease), while Insured B's premium increased by \$128.57 (a 357% increase.)

⁵ MacPherson's protest that "Any claim by MOE that the transition would resulted in 'wild fluctuations' in premiums is unsupported" (*Respondent's Brief at 20*) is nothing more than a confused rant. As discussed in this Brief, the Rates Filing itself make clear that there *would have been* wild fluctuations in premiums had Enumclaw not applied its Transition Plan, Rule 2. CP 982. With the application of Rule 2, there were only moderate fluctuations.

The Transition Plan, also referred to as Rule 2, is *not* the formula by which premiums are calculated under the Simplified Program. Those premiums are calculated based on ISO published loss costs (with modification factors approved by the Commissioner), and other modification factors that apply at the individual policy level such as loss experience. CP 996-1007. The Transition Plan simply caps the renewal premium (based on the new exposure bases) to a maximum of 125% of the expiring pre-Simplified premium, and a minimum of 75% of the expiring premium. Thus, even though there would be fluctuations at the individual policy level, they would be mitigated by the Transition Plan. Enumclaw explained, and the Commissioner understood, that some premiums would go down as a result of the conversion, and some premiums would go *up*.

Enumclaw provided the Commissioner with a thorough explanation of the effect of the new rating bases, in combination with the loss cost modification factors, on its aggregate premium receipt. CP 881. In an attachment to that submission, Enumclaw provided three important data points: first, the company's existing aggregate general liability premium receipt; second, the range of what the aggregate premium receipt would be, strictly applying the new rating bases; and third, a range of what the

aggregate premium would be, applying the new rating bases, but capping premiums with the Transition Rule. These “ranges” were presented as the minimum, mean, and maximum levels of potential aggregate premium receipt. *Id.* at 881-883. Here is how those numbers came out:

Existing Premium: \$1,096,172

Strict Conversion Minimum Premium: \$1,202,811
(Increase of 9.73%)

Strict Conversion Mean Premium: \$1,272,281
(Increase of 16.07%)

Strict Conversion Maximum Premium: \$1,341,751
(Increase of 22.40%)

Capped Conversion Minimum Premium: \$999,442
(Decrease of 8.82%)

Capped Conversion Mean Premium: \$1,008,993
(Decrease of 7.95%)

Capped Conversion Maximum Premium: \$1,015,449
(Decrease of 7.36%) CP 883.

If Enumclaw applied the new rating bases without the Transition Plan’s capping, the aggregate premium would have increased. The Transition plan changed that. “Note that under all scenarios, Capped Minimum Transition, Capped Maximum Transition and Capped Mean Transition, modest decreases are expected.”⁶ CP 881.

⁶ MacPherson cites a statement by Enumclaw that “No scenario results in a rate increase. All scenarios present an anticipated decrease.” CP 882, *Respondent’s Brief at 1, 12*. MacPherson seems to be attempting to convince the Court that MacPherson’s policy is a “scenario.” As is evident from even a casual reading of this letter (CP 881), the “scenarios” are the Capped Minimum Transition, Capped Maximum Transition, and Capped Mean Transition - all aggregate premium figures, not individual policy premiums.

The math logic that underlies these projections is fundamentally based on, and impossible without, a significant number of insureds experiencing a 25% premium increase at renewal⁷.

The logic of the tax analogy applies equally to the premiums under the Simplified Program. When the new rating bases were applied without the Transition Plan's caps, the aggregate premium would have increased significantly. Then, when the Transition Plan's caps were applied, the

⁷ The mathematics of the premium changes lend themselves to a taxation analogy. Imagine that the Federal Government is instituting a new tax code. In this new code, the "rating" basis will no longer be income, but net worth. Because of this change, some individuals of high net worth but little income will experience a large increase in their taxes, while others, who have high incomes, but spend it traveling and eating out, will owe far less. In order to ameliorate the political fallout from the immediate shock to the system, the government decides to cap the maximum changes in any individual's tax bill for the first two years to a maximum fluctuation of 25%.

Imagine that the gross tax receipt before the new system was implemented was \$10 trillion. When the government projects the gross receipts under the new system, it first considers tax revenue based on taxing net worth, without applying the cap; the projected revenue is \$12 trillion. Then the caps are applied, and the projected revenue decreases to \$8 trillion. Joe Citizen taxes increased, and cries foul at the government that denominated the change a "two trillion dollar tax cut." He charges that the government never contemplated that anyone's tax bill would increase, so his bill must be wrong. Joe has not grasped the mechanics of the new code.

To explain Joe's error, the effect of the capping mechanism merits a careful exposition. Suppose that there are ten taxpayers that each paid \$100 under the old system. These people have high income, but low net worth, and their uncapped tax liability would have decreased to \$40 apiece. In this scenario, the lower cap would apply, and that cap would bump their liability up to \$75. Without the cap, the government would have received \$400 from this group; with the cap, it will receive \$750. **Thus, the application of the lower cap *always* causes tax revenue to increase. Conversely, in the opposite situation, the upper cap *always* causes tax revenue to decrease.**

The only way that the caps could cause a decrease in gross revenue is if the effect of the upper cap outweighed the effect of the lower cap. This situation is impossible unless a significant portion of the taxpayers' tax bills were reduced as a result of the upper cap. The application of upper cap leaves this group of taxpayers with a tax liability of *125% of their previous tax bill*.

aggregate projected premium decreased. As was true in the tax example, that decrease is logically possible *only* if some policy holders' renewing premium is 125% of their expiring premium. MacPherson argues the Rates Filing was a commitment by Enumclaw not to raise the premium of any insured. The Rates Filing really shows policy holders' premiums would fluctuate both up and down, but not more than 25%.

MacPherson's final effort to prove that the Rates Filing mandated a "decreased" premium for MacPherson is a "1.0" multiplier for contractors. CP 957. MacPherson concludes that there would be "no premium difference" for contractors renewing under the Simplified Program. *Respondent's Brief at 17-18.* MacPherson miscomprehends the Filing. The "1.0" for contractors is a deviation from Enumclaw's proposed loss cost modification factor of 1.563. CP 957. That "1.0" multiplier for contractors has nothing to do with a comparison between MacPherson's premium under the Pre-Simplified versus Simplified Programs. A brief explanation of loss cost modification factors is necessary to lift MacPherson's fog from the meaning of these numbers.

1. **Prospective Loss Costs** means that portion of a rate that provides only for losses and loss adjustment expenses and does not include provisions for expenses (other than loss adjustment expenses) or profit, and is based on historical aggregate losses and loss adjustment expenses adjusted through development to their ultimate value and projected through trending to a future point in time.

2. **Loss Cost Adjustment** means a factor by which prospective loss costs are multiplied to obtain final rates. It takes into account:

- (i) Operating expenses;
- (ii) Underwriting profit (or loss) and contingencies;
- (iii) Investment income;
- (iv) Dividends, savings, or unabsorbed premium deposits allowed or returned to policyholders, members, or subscribers;
- (v) Variations in loss experience unique to the insurer making the filing; and
- (vi) Other relevant factors, if any.

3. **Rate** means the cost of insurance per exposure unit, whether expressed as a single number or separately as prospective loss cost and loss cost adjustment, prior to any application of individual risk variations as permitted by WAC 284-24-100, and does not include minimum premiums or supplementary rating information. WAC § 284-24-062.

Prospective Loss Costs are published by advisory organizations such as the ISO. CP 919-924. In adopting the new **rates**, Enumclaw was required to obtain approval for its proposed **Loss Cost Adjustment** (referred to as a **Loss Cost Modification Factor**); the insurer proposed 1.563. CP 957. This means that if ISO specified that one unit of a particular risk had a loss cost of \$10, Enumclaw would generate its **rate** by multiplying that cost by the modification factor: \$15.63.

Enumclaw also proposed additional modification factors for each insurable industry, including contractors. The additional modification factor for contractors was "1.0" - there was no modification for that group. No part of this calculation is related to the expiring premium under the

Pre-Simplified Program. The “1.0” factor for contractors does not express any sort of relationship between MacPherson’s old premium and what would have been its new premium.

Enumclaw also submitted the declaration of Cori Medrano, a manager of commercial underwriting⁸. She testified that MacPherson’s expiring premium under the pre-simplified program for the subcontractor risk was \$473.00. CP 1856-1857. Had MacPherson been rated under the simplified program, its premium for subcontractor coverage would have been \$6,294.00. *Id.* Ultimately, the decision of whether to renew MacPherson’s policy, and what premium to charge for the entire package, would have been based on the re-application form and contractor’s supplemental application. CP 1227-1229. MacPherson never applied, and allowed its policy to lapse without transitioning. MacPherson cannot show that coverage under the Simplified Program would have been available without additional premium.

II. THE SIMPLIFIED CGL EXCLUSION

In its opening Brief, Enumclaw explained that, even if MacPherson’s

⁸ MacPherson dismisses Ms. Medrano’s testimony, alleging that her “only connection with the issue is as the current custodian of MacPherson, LLC’s underwriting file.” *Respondent’s Brief at 1*. Ms. Medrano, however, is a manager of commercial underwriting who testified that she had personal knowledge of the application of Enumclaw’s rates to MacPherson’s exposure bases sufficient to generate a premium for the subcontractor risk. CP 1856. MacPherson gives no reason why a manager of commercial underwriting is “incompetent” (*Respondent’s Brief at 18*) to testify as to an insured’s expected premium with the company.

CGL had been replaced with a Simplified CGL, the Withdrawal from Use exclusion in the Simplified version would have prevented coverage for a large portion of the award against MacPherson. There is no coverage for:

n. Recall of Products, Work or Impaired Property

Damages claimed for any loss, cost or expense incurred by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of:

- (1) "Your product";
- (2) "Your work"; or
- (3) "Impaired property";

if such product, work, or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy or or dangerous condition in it. CP 1486.

This exclusion prevents coverage for the cost of removing and replacing the defective EIFS (siding) and the economic loss suffered by the Hedges. The scope of the exclusion remains a factual question. MacPherson did not respond to Enumclaw's arguments on this issue, and there is thus no Reply to make. Suffice to say that if MacPherson had even a colorable argument, it would have made it. At the very least, the Court should remand this case to the trial court for a determination of what damages would have been excluded by the Withdrawal from Use exclusion.

CROSS-RESPONDENT'S RESPONSE

I. STATEMENT OF THE CASE

The underlying facts of this case were briefed by Enumclaw in the Appellant's Brief in this case. At the trial court, Enumclaw proved that MacPherson was not entitled to coverage because of policy exclusions. MacPherson argued that it was entitled to coverage because of the policy's Liberalization Clause. On this point, the trial court (wrongly) agreed with MacPherson, and entered judgment in MacPherson's favor. That ruling is the subject of Enumclaw's appeal. MacPherson cross-appealed the coverage determination against it with respect to the Umbrella policy, and this Brief is Enumclaw's Response. For the following reasons, the ruling of the trial court with respect to coverage under the umbrella should be affirmed.

II. ARGUMENT

1. Standard of Review

A trial court's resolution of questions of law is reviewed *de novo*. *Huff v. Budbill*, 141 Wn.2d 1, 7, 1 P.3d 1138 (2000). MacPherson also seeks review of the trial court's award of attorney fees. Such a discretionary ruling will not be reversed on appeal absent an abuse of discretion. *Bank of Am. v. David W. Hubert, P.C.*, 153 Wn.2d 102, 101 P.3d 409 (2004).

2. Liability Policies Are Not Performance Bonds

Commercial liability policies are created to protect a commercial enterprise from “the possibility that the goods, products or work of the insured, once relinquished or completed, will cause bodily injury or damage to property other than to the product or completed work itself, and for which the insured may be found liable.” *Henderson, Insurance Protection for Products Liability and Completed Operations – What Every Lawyer Should Know*, 50 Neb. L. Rev 415, 441 (1971). Although the contractor may become contractually liable for the failure to provide an appropriate level of quality, repairing or replacing a faulty product is a business expense to be borne by the contractor to satisfy customers. *Id.* at 239. This cost is finite, within the control of the insured, and not normally the subject of liability insurance. The risk that the contractor’s faulty work or product will injure other property or persons is another matter, however, because the potential liability is almost limitless. *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. at 239 - 240. It is this risk that is addressed by commercial liability policies.

Washington recognizes and enforces the distinction between uninsured business risks like the quality of a contractor’s work, and insured liability to third parties caused by the contractor’s negligently constructed product, often holding that a CGL is not a performance bond. *Eg, Harrison*

Plumbing & Heating, Inc., v. New Hampshire Insurance Group, 37 Wn. App. 621, 625-626, 628, 681 P.2d 875, (1984). The differentiation between these two types of potential liability is known as the Business Risk principle. While it is a useful term to describe the coverage provided by certain CGL policies, it is not a “doctrine” that even theoretically could change unambiguous policy terms. It is nothing more than a description of how the exclusions in the policy relating to the insured’s work and products operate. In this case, MacPherson’s liability to the Hedges was a Business Risk, which was excluded from coverage.

3. MacPherson’s Policies Contain Business Risk Exclusions.

MacPherson purchased two policies from Enumclaw: a CGL policy and an Umbrella Policy. CP 500, 517. The coverage provided by the Umbrella is the only subject of this appeal, as MacPherson agrees that the CGL policy does not cover its claim. *Cross-Appellant’s Brief at 6, Note 5*. The Umbrella is made up of a “base” policy (UP2), which is modified by endorsements to that base. CP 517. The UMB 3011 Umbrella endorsement (“UMB”) adds two exclusions to that policy that prevent coverage in favor of MacPherson as a matter of law. The first exclusion is the Work exclusion. The policy does not apply:

With respect to the COMPLETED OPERATIONS HAZARD to Property Damage to work performed by the Named Insured arising out of the work or any portion

thereof, or out of materials, parts or equipment furnished in connection therewith. (CP 532)

The second exclusion is the Faulty Workmanship exclusion which excludes property damage to:

That particular part of any property . . . the restoration, repair or replacement of which has been made or is necessary by reason of Faulty Workmanship thereon by or on behalf of the Insured. (CP 532)

Both the Work exclusion and the Faulty Workmanship exclusion bar MacPherson's claim in this case; however, they operate independently and must be analyzed separately. *Harrison Plumbing*, 37 Wn. App. at 627.

4. The Work Exclusion Prevents Coverage For MacPherson's Claims.

The parties agree that the damage in this case was included in the Completed Operations Hazard. Because the Hedges' house was the "work" of MacPherson, there is no coverage under the Umbrella Policy for damage to this "work."

In this case, the Hedges' entire house was MacPherson's "work." There is no dispute that the alleged property damage took place after MacPherson's operations had been completed, so the exclusion logically reads, This policy does not apply to:

Property Damage to MacPherson's work (the Hedges' house) arising out of that work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.

Because the entire award against MacPherson arises out of “property damage” to the Hedges’ house, there is no coverage for that award.

The only part of this analysis with which MacPherson disagrees is whether the Hedges’ house, as a whole, counts as MacPherson’s “work.” MacPherson argues that because it hired subcontractors to complete much of the project, the house is not its “work,” and property damage to the house is not excluded. MacPherson misunderstands Washington law regarding what constitutes the “work” of a general contractor.

MacPherson’s argument is not new. It was rejected in the case of *Schwindt v. Underwriters at Lloyds of London*, 81 Wn. App. 293, 914 P.2d 119 (1996) *rev. den.* 130 Wn.2d 1003 (1996). In *Schwindt*, the insured was a general contractor that constructed a medical center. Once it was completed, the owners discovered a number of serious defects and property damage. The owners sued the contractor, which tendered the claim to Lloyds. In the coverage action, Lloyds asserted several Business Risk exclusions, including its “work” exclusion:

[No coverage] for damage to that particular part of property upon which the Assured is or has been working caused by the faulty manner in which the work has been performed *Id.* at 295.

Schwindt resisted the application of the Work exclusion, making the same argument that MacPherson now makes - that the work was

performed by subcontractors, so the entire building should not count as the insured's work. *Id.* at 305. Division One of this Court noted that "exclusions for faulty construction and defective material are unambiguous," and rejected Schwindt's argument. *Id.* at 304 n. 24. The Court ruled that, in Washington, the work of subcontractors merges into the work of the general contractor upon completion. *Id.* at 305-307. Because the general contractor was responsible for the entire project, the entire project is the general contractor's "work" for purposes of Business Risk work-product exclusions. *Id.*

In so ruling, the Court was unconvinced by Schwindt's reliance on the case of *Fireguard Sprinkler Sys., Inc. v. Scottsdale Ins. Co.*, a Ninth Circuit case interpreting Oregon law, holding that the Work exclusion did not apply to the work of subcontractors. 864 F.2d 648 (1988). In *Fireguard*, the insured was a contractor making the same argument that the Work exclusion did not preclude coverage for damage arising from the work of its subcontractors. As will be discussed in more detail below, the court held that there was subcontractor coverage, but its decision was *not* based on the actual language of the exclusion itself; the court departed from that language based on what it perceived to be the insurer's "intent." *Id.* at 651. The *Fireguard* court determined the insurer's "intent" based on two pieces of proffered evidence: first, the insured's basic coverage form

excluded work performed “by or on behalf of” the named insured, but an endorsement excluded work performed “by” the insured; second, an ISO circular contained commentary to the effect that the different language in the endorsement was meant to provide coverage for the work of subcontractors. *Id at 651-652.*

In opposition to the *Fireguard* holding, the insurer in *Schwindt* relied primarily on the Minnesota case of *Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 396 N.W. 2d 229 (Minn. 1986). The court in *Knutson* addressed the identical issue that faced the court in *Fireguard*, but came to the opposite conclusion. The *Knutson* court reasoned as follows:

[W]hether the work was “done by” or “on behalf of” the general contractor is irrelevant to the analysis. The completed product is to be viewed as a whole, not as a “grouping” of component parts.

...

Knutson, by contract, undertook to furnish all materials and labor. It had responsibility for all construction work -- its own as well as its subcontractors’. It had “effective control” over all project work and materials, including those provided by subcontractors. When the completed project is turned over to the owner by the general contractor, all of the work performed and materials furnished by subcontractors merges into the general contractor's product--a product it has contracted to complete in a good workmanlike manner. *Id. at 237.*

In *Schwindt*, this Court found that the *Fireguard* “interpretation does not reflect the realities of the commercial construction process” and endorsed the *Knutson* approach. *Schwindt at 306.*

a. The Minnesota - Oregon Split of Authority

The different approaches taken by the *Knutson* case and the *Fireguard* case represent a split of authority with respect to how courts construe work exclusions. For ease of reference, the first line of cases will be referred to as the Minnesota Rule. (The seminal case adopting this rule is *Knutson Construction Co., v. St. Paul Fire & Marine Ins. Co.*, 396 N.W.2d 229 (Minn. 1986).)

⇒ **Minnesota Rule** – The general contractor is ultimately responsible for the quality of the work of the subcontractors, so the subcontractors’ “work” merges into the general contractor’s “work” in the context of completed operations. The exclusion for liability arising from the insured’s work also, by definition, excludes liability arising from the work of the insured’s subcontractors.

When the completed project is turned over to the owner by the general contractor, all of the work performed and materials furnished by subcontractors **merges into** the general contractor’s product--a product it has contracted to complete in a good workmanlike manner. *Id.* at 236 (emphasis added).

The second line of cases will be referred to as the Oregon Rule. (The seminal case adopting this rule was *Fireguard Sprinkler Sys., v. Scottsdale Ins. Co.* 864 F.2d 648 (9th Cir. 1988), applying Oregon law).

⇒ **Oregon Rule** - When the policy excludes liability arising from the “insured’s work”, that exclusion does *not* exclude liability arising from the work of the insured’s subcontractors. In this case, MacPherson argues that all of the damage to the Hedges’ house arose from the work of subcontractors, and thus the entire claim would be covered.

In [cases applying the Minnesota Rule] court[s] decided that the work of subcontractors is part of the completed operations

exclusion, because it is merely a component of the general contractor's work. **Again, we reject this idea.** *Id.* at 654 (emphasis added).

The way in which courts cognize the relationship between the work of a general contractor and its subcontractors drives their interpretation of insurance policy Work exclusions. Enumclaw will demonstrate that Washington follows the Minnesota approach, and that the Oregon Rule is incompatible with Washington law. There is no coverage for MacPherson's claim.

i. Washington Follows the Minnesota Merger Rule.

Despite MacPherson's protestations to the contrary, this Court has already adopted the Minnesota Rule. "We find persuasive the *Minnesota court's* approach to interpreting liability insurance policies issued to contractors and hold that *work of subcontractors is necessarily included in exclusions pertaining to faulty work or defective products of the contractor.*" *Schwindt, v. Underwriters at Lloyds of London*, 81 Wn. App. at 305-306. (Emphasis added.) *See also Mutual of Enumclaw Ins. Co. v. Patrick Archer Construction, Inc.*, 123 Wn. App. 728, 735 –736, 97 P.3d 751 (2004). Once a construction project is completed, the work of the subcontractors merges into the work of the general contractor, and the Work exclusion applies to bar coverage for damage to the entire structure. *Id.* MacPherson advances the same argument used by the general

contractors in *Schwindt*, *Archer*, and *Knutson*. As a matter of law in this State, that argument fails.

ii. The Oregon Rule is Contrary to Established Washington Law.

MacPherson argues that Enumclaw's citation to *Schwindt*, and *Knutson* is "inapposite," and that these cases are based on "archaic" rationale, which this Court should abandon in favor of the "modern" intent-based *Fireguard* rule. There is no support for the *Fireguard* Oregon Rule in any case in Washington. When it created the Oregon Rule, the court in *Fireguard* rejected the Merger Rule, and based its decision on what it perceived to be the insurer's intent. *Fireguard Sprinkler Systems, Inc. v. Scottsdale Ins. Co.* 864 F.2d 648. The policy language in *Fireguard* was the same as in the case at bar: the base policy contained an exclusion that prevented coverage for work performed by or on behalf of the insured. An endorsement replaced the exclusion with one that prevented coverage, in the context of completed operations, for property damage to work performed by the insured. *Id.* The insured sought coverage for property damage arising out of the work of a subcontractor. The insured presented "evidence" that the endorsement's removal of the "or on behalf of" language in the base policy was an indication that the insurer had a private intention to cover liability for property damage caused by subcontractors. *Id.* The court ruled that this unilateral "intent" was binding

on the insurer, which could not deny coverage it “intended” to provide when it “drafted” the policy. *Id.* However, the insurer in *Fireguard* did not draft the policy – ISO did, and the only evidence of the defending insurer’s “intent” was the same evidence of ISO’s post-hoc commentary as MacPherson presents in this case. As will be discussed below, an insurer’s unexpressed unilateral intent has no place in insurance policy interpretation in Washington.

MacPherson offers three reasons why *Schwindt* is not controlling, none of which is compelling: first, that the policy language and history is different; second, that *Schwindt* did not consider ISO “intent;” third, that the Minnesota underpinnings of *Schwindt* have been “dispensed with.” MacPherson is wrong about Washington law, wrong about Minnesota law, and wrong about the effect of the Work exclusion.

b. The Language of the Lloyds and Enumclaw Exclusions is Not Distinguishable; Neither Covers Property Damage to the Work of Subcontractors.

An analysis of the *actual language* of the exclusion in MacPherson’s policy can yield but one conclusion; the *Schwindt* case conclusively establishes that there is no coverage for the work of subcontractors. Neither the Lloyds exclusion in *Schwindt* nor the Enumclaw exclusion even mentions subcontractors. Here are the actual exclusions:

Lloyds. [No coverage] for damage to that particular part of property upon which the Assured is or has been working caused by the faulty manner in which the work has been performed (*Schwindt*, 81 Wn. App. at 295)

Enumclaw. [The policy does not apply] In the context of Completed Operations, to property damage to work performed by the Named Insured arising out of the work or any portion thereof. . . (CP 532)

In *Schwindt*, the Court held that the work of subcontractors necessarily merges into the work of the general contractor upon completion of the project, and the exclusion for the “Assured’s work” excluded coverage for work performed by the Assured’s subcontractors. In the case at bar, the exclusion applies to the work of the “Named Insured.” As a matter of law, there is no distinguishing factor based on the *actual language* of the exclusions, and the ruling in *Schwindt* establishes that the Enumclaw exclusion *unambiguously* excludes the subcontractor coverage.

c. Alleged Unilateral Intent Cannot Alter the Meaning of an Unambiguous Policy Exclusion.

Unable to distinguish the actual language of the Enumclaw exclusion from the *Schwindt* Lloyds exclusion, MacPherson asserts that the Court should interpret *the same language* in a *different way* because Enumclaw allegedly “intended” to provide subcontractor coverage. In an odd logical juxtaposition to this argument, MacPherson then (correctly) points out that “It is the duty of the court to declare the meaning of what was written and

not what is intended to be written,” citing *J.W. Seavery Hop Corp. v. Pollock*, 20 Wn.2d 337, 349, 147 P.2d 310 (1944) (*Cross-Appellant’s Brief at 51*). The Court should remain acutely aware that it is *MacPherson*, not *Enumclaw*, that seeks to change the unambiguous meaning of the Work exclusion with “intent evidence.” There are two primary flaws in *MacPherson’s* analysis. First, *Enumclaw’s* intent is irrelevant to the interpretation of unambiguous policy exclusions. Second, there is no evidence that *Enumclaw* had *any* intent to provide subcontractor coverage in the UMB.

i. Intent is irrelevant where an exclusion is unambiguous; this exclusion is unambiguous.

In an attempt to distinguish *Schwindt*, *MacPherson* cites the *Fireguard* case and its progeny from other jurisdictions. The signature logic of the *Fireguard* case, however, is that the perceived intent of the insurer can override the plain language of an unambiguous exclusion; this proposition is in direct conflict with Washington law.

The *Fireguard* court relied on the fact that an endorsement contained a different version of the Work exclusion from that in the main policy form. One of the differences was that the primary form excluded coverage for work performed *by or on behalf of* the insured, while the endorsement’s version excluded coverage, *in the context of completed operations*, for

work performed *by* the insured. As will be addressed, this change in language does not provide subcontractor coverage under Washington law. But in any event, the operative exclusion contained in the endorsement unambiguously prevents coverage for MacPherson's claim; all evidence of "intent" that MacPherson relies upon is irrelevant because the UMB exclusion is clear on its face. As the Washington Supreme Court recently held in *Quadrant Corp. v. Am. States Ins. Co.*, 154 Wn.2d 165, 110 P.3d 733 (2005) (emphasis added):

Washington law clearly requires this court to look first to the plain language of an insurance policy exclusion. If the exclusionary language is unambiguous, then the court cannot create an ambiguity where none exists. **If the language is plain there is no need to consider extrinsic evidence of the parties' intent.** The language of the absolute pollution exclusion is unambiguous when applied to the facts of this case. The deck sealant at issue here is clearly a pollutant as defined in the policy and Kaczor's injury falls squarely within the exclusionary language. **Thus, there is no need to turn to evidence regarding the history and purpose of the standard pollution exclusion.** *Id. at 186.*

Because the UMB exclusion is unambiguous as a matter of law, MacPherson's alleged "evidence of intent" cannot alter its meaning.

ii. Enumclaw Had No Intent to Cover the Work of Subcontractors.

"Intent evidence" is irrelevant in this case, but MacPherson did not and cannot prove that Enumclaw intended to provide coverage for subcontractor work. MacPherson points to two alleged indicia of intent,

but neither establishes that Enumclaw intended to provide such coverage. First, MacPherson argues that different language in the UMB Work exclusion represents an intent to cover subcontractor work. Second, MacPherson argues that Enumclaw is “bound” by a legal analysis of a similar form in an ISO circular. MacPherson’s arguments fail.

iii. The Difference Between the Umbrella’s Basic Work Exclusion and the Endorsement’s Work Exclusion is Irrelevant to the Coverage Issue in this Case.

MacPherson puts substantial weight on the fact that the Work exclusion in the UMB is phrased differently than the Work exclusion in the basic Umbrella policy. MacPherson argues that the trial court “failed to give meaning to the deletion ‘or on behalf of’” in the UMB. The difference in language does not show that Enumclaw intended to cover the work of subcontractors. As a matter of law in Washington, both versions of the Work exclusion unambiguously exclude coverage for subcontractor work. *Schwindt*. Thus a Washington insurer using one version of the exclusion in place of the other does not transmit an intention to cover the work of subcontractors. Furthermore, MacPherson entirely ignores the *addition* of the capitalized, boldfaced language that indicates the UMB exclusion applies to property damage in the **COMPLETED OPERATIONS HAZARD**.

This change in the timeframe in which the exclusion operates explains

the omission of the “or on behalf of” language. The Work exclusion in the unendorsed Umbrella applies with equal force to ongoing and completed operations. In that context, it applies to work done “by or on behalf of” the insured. The UMB Work exclusion, however, applies only with respect to the completed operations hazard. Once the operation is completed, the work of the subcontractors has merged with the work of the general contractor - the “or on behalf of” language becomes superfluous and was omitted. *Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 396 N.W. 2d at 237. Because the exclusionary language denied coverage for property damage arising out of the insured’s work, and *all* of the work was the insured’s work upon completion, there was no coverage for damage to that work. *Id.* at 236 – 237.

iv. The Circular does Not Establish Enumclaw’s “Intent.”

MacPherson presents an ISO circular that opines that the language in an endorsement similar to the UMB is intended to cover property damage to subcontractor work, and that this was the reason for the “or on behalf of” omission in the endorsement. This circular is nothing more than an interpretation of the legal effect of policy terms, which conflicts with Washington Law. Interpretation of an insurance contract is the province of the Court, not a commentator. *Schwindt v. Underwriters at Lloyds of London*, 81 Wn. App. 293. Furthermore, as hard as MacPherson tries to

engraft the “intent” described by an ISO commentator in the circular onto Enumclaw, Enumclaw and the ISO are two distinct entities. Because the UMB is not an ISO form, and there is no evidence that Enumclaw intended to depart from the unambiguous meaning of the exclusion, MacPherson’s “intent evidence” is irrelevant.

The UMB is Not an ISO Form. Enumclaw’s UMB was written on an Enumclaw form, made to fit with the Enumclaw Umbrella policy, and there is no evidence at all that Enumclaw thereby intended to provide coverage for property damage to subcontractor work. ISO adopts and disseminates standardized policy language and forms, which are either used on an ISO copyright form, or which are incorporated by insurers into their policy coverage programs. CP 240. The ISO copyright forms bear the ISO copyright notation, an example of which can be found at CP 1087. The UMB uses some language from the ISO, but it is not an ISO copyright form, and its header indicates that it was specific to Enumclaw. CP 1132. The fact some ISO language was included in the UMB is no reason to engraft an ISO commentator’s understanding of the legal effect of several of those words onto Enumclaw.

There is No Evidence that Enumclaw Agreed with, Much Less Adopted, ISO’s Analysis. MacPherson attempts to bind Enumclaw to ISO’s legal interpretation of the Work exclusion by citing the testimony of

Debbi Sellers, an Enumclaw claims adjuster. MacPherson tells the Court that Ms. Sellers “admitted” in her deposition that Enumclaw “follows ISO intent.” *Cross-Appellant’s Brief at 50-51*. Ms. Sellers did no such thing. She was asked if she had knowledge of whether Enumclaw underwriters intended something other than what ISO intended. CP 407. She confirmed that she had *no knowledge* of whether the underwriters intended “the endorsement to be interpreted in the same fashion.” *Id.* Here is how MacPherson analyses Ms. Sellers’ testimony:

1. I do not know if Enumclaw intended something other than the ISO.
2. I did not find any literature indicating that Enumclaw intended something other than the ISO.

THEREFORE:

3. Enumclaw “intended what ISO intended.”

It is not difficult to spot the flawed logic. Nevertheless, this is the *only* link MacPherson points to which allegedly connects Enumclaw’s intent to the ISO. The link is defective, and MacPherson’s arguments that rely on Enumclaw “intending what ISO intended” should be rejected.

Additionally, there is evidence that Enumclaw intended *not* to cover the work of subcontractors. MacPherson cites Scott C. Turner, *Insurance Coverage of Construction Disputes, Vol. 1 § 33.3* (2nd Ed. 2005) for the proposition that insurance companies’ intent to provide such coverage in the endorsement is reflected in “significant additional premium.” *Id.* If an

enhanced premium is the bellwether of insurer's intent, Enumclaw intended not to provide coverage for subcontractor work; *there was no additional charge* for the UMB. This can be seen in the declarations of the Umbrella, which lists the premium of the Umbrella, and the various endorsements. CP 1117. No additional charge is recorded for the UMB, either in the declarations or on the UMB itself. CP 1117, CP 1132. Where an endorsement garners additional premium, the additional premium is reflected. *See, eg.* CP 1038 (Broad Form Endorsement attached to the base liability policy, reflecting an additional premium of 30 percent of the basic premium.) MacPherson cannot ascribe to Enumclaw an intent to provide coverage for subcontractor work based on an increased premium.

MacPherson has offered nothing to show that Enumclaw intended to provide coverage for subcontractor work in the UMB, and the Court should enforce the unambiguous Work exclusion as it is written.

d. The Merger Rule is alive and well in Washington and in Minnesota.

It is not surprising that MacPherson attempts to devalue the *Schwindt* Merger rationale. But MacPherson should be forthright about what it seeks; MacPherson wants the Court to overrule *Schwindt*. The *Schwindt* Court was clear: “[W]ork of subcontractors is necessarily included in exclusions pertaining to faulty work or defective products of the

contractor.” The *Fireguard* court considered this Merger Rule, and made its position similarly clear: “Again, we reject this idea.” *Fireguard Sprinkler Systems, Inc. v. Scottsdale Ins. Co.* 864 F.2d at 654. MacPherson urges the Court to follow *Fireguard*, and “reject” the holding of *Schwindt*. This rejection of Washington law is justified, MacPherson claims, because the Minnesota cases which the Court found persuasive in *Schwindt* allegedly have been “dispensed with” by the Minnesota court. *Cross-Appellant’s Brief at 50*. MacPherson fails to appreciate that it was the *Merger logic* of the Minnesota cases, not Minnesota jurisprudence wholesale, that was adopted by this Court and became the law of *this* State.

Further, MacPherson has misconstrued the current state of Minnesota law; the *Knutson* case would be decided in Minnesota today exactly as it was originally. Arguing otherwise, MacPherson cites the case of *Wanzek Const., Inc. v. Wausau*, 679 N.W.2d 322 (Minn. 2004). In *Wanzek*, the insured’s policy, unlike MacPherson’s, was written on the Simplified general liability form, which contained the following exception to the Work exclusion:

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor. Id.

The insurer in *Wanzek* argued that Business Risk and Merger doctrines

described in *Knutson* should apply, and that the insured was therefore not entitled to coverage for damage to subcontractor work. Not surprisingly, in light of the explicit subcontractor exception to the Work exclusion in the Simplified policy, the court held that the *Knutson* Business Risk and Merger principles could not override the plain meaning of the policy. *Id.* *Wanzek* does not overrule *Knutson*, it confirms it. Both *Wanzek* and *Knutson* stand for the proposition that courts enforce the unambiguous meaning of policy exclusions. The Business Risk principle cannot override their plain meaning. The policy in *Knutson* unambiguously excluded coverage for damage arising out of subcontractors' work; the policy in *Wanzek* unambiguously covered that risk. It is no accident that *Wanzek* fails to claim that it is overruling *Knutson*. What *Wanzek* notably did *not* say is that Minnesota was abandoning unambiguous language in the face of "insurance industry intent." Indeed, neither *Fireguard* nor intent were any part of the *Wanzek* decision.

In an attempt to bolster its claim that *Wanzek* overruled *Knutson*, MacPherson cites *Westfield Ins. Co. v. Weis Builders, Inc.* 2004 U.S. Dist. LEXIS 13658 (2004), an unpublished opinion from a federal court in Minnesota⁹. In construing a Simplified policy, with explicit subcontractor

⁹ Although this citation is legally innocuous, Enumclaw objects to it on the basis that it is unpublished. "[C]itation to unpublished opinions of other jurisdictions is also

work coverage, the court in *Westfield* claimed that *Wanzek* had “dispensed with” the *Knutson* interpretation of the Work exclusion. *Id.* This hasty characterization is only true to the extent that *Wanzek* addressed itself to entirely different policy language than *Knutson*. A careful reading of *Wanzek* demonstrates that the federal court overstated the significance of that case. *Wanzek* did not overrule *Knutson*.

Finally, MacPherson claims that “In fact, there is no case in any jurisdiction denying coverage for damage arising out of subcontractor work where ISO intent was considered by the deciding court, and where the insurer changed one of its own policy forms from “by or on behalf of” to “by. . .” *Cross-Appellant’s Brief at 50*. MacPherson’s purposefully broad and authoritative statement is simply wrong. MacPherson missed the case of *Blaylock and Brown Const. Co., Inc. v. AIU Ins. Co.*, 796 S.W.2d 146 (Tenn. App. 1990)¹⁰. The court in *Blaylock* did consider both the omission of the “or on behalf” language in the endorsement, and the ISO commentary in the circular:

inappropriate.” *Mendez v. Palm Harbor Homes, Inc.*, 111 Wn. App. 446 472, 45 P.3d 594 (2002). This case should not be considered by the Court.

¹⁰ It is not beyond the pale that moderately careful legal research could fail to uncover *Blaylock*, but it is surprising that MacPherson would make such a statement in light of the fact that it actually *cites and discusses Blaylock* just four pages later. *Cross-Appellant’s Brief at 54*. It is even more surprising that MacPherson would make such a statement seeing as Enumclaw pointed out its error when MacPherson made *exactly the same* blunder before the trial court. CP 762-763. Enumclaw is certain that MacPherson will concede its error.

After considering [the Oregon and Minnesota Rules and the ISO circular], we believe the better-reasoned interpretation of these provisions is that which is adopted by the Minnesota Supreme Court in *Knutson*, 396 N.W.2d 229. . . Exclusion (c) in the broad form property damage coverage excludes coverage “to property damage to work performed by the named insured arising out of such work” We must determine what is the “work performed by the named insured.” In the instant case, the named insured is the general contractor and work performed by the insured must necessarily be such work as the named insured is required to perform under the construction contract. How the insured performs the work is a matter for its decision in the exercise of sound business practice. The contractor can employ subcontractors or use employees to do the work, but in the end, when the work is completed, all the work called for by the contract on the part of the contractor must be deemed to be work performed by the contractor. *Id.* at 154.

Blaylock's importance is not only as a piece of persuasive authority. Its reasoning was cited with approval, along with Minnesota's, in *Schwindt*. MacPherson tries to brush *Blaylock* aside, claiming that it is obsolete because Minnesota “dispensed” with the *Knutson* rationale in the *Wanzek* case. Minnesota did *not* “dispense” with *Knutson*, and even if it had, *Blaylock* is a *Tennessee* case, whose reasoning was adopted in *Washington*. *Blaylock* affirms, and *Schwindt* recognizes, that the *Knutson* Merger doctrine survived *Fireguard*¹¹. As a matter of law, the work of MacPherson's subcontractors merged into MacPherson's work upon the

¹¹ MacPherson also suggests that the “rationale of *Knutson* is entirely misplaced in the context of this case” because *Knutson* addressed only the product exclusion, not the Work exclusion. *Cross-Appellant's Brief* at 47. It strains the imagination to believe that MacPherson entirely missed the Work analysis in *Knutson*.

completion of the Hedges' house, and the Work exclusion prevents coverage for damage to that structure.

5. The Faulty Workmanship Exclusion Independently Excludes Coverage in Favor of MacPherson.

The Work exclusion alone is sufficient to exclude the Hedges' claim, but there is a second Business Risk exclusion contained in MacPherson's policy that prevents coverage: the Faulty Workmanship exclusion. There is no coverage for property damage to:

that particular part of any property . . . the restoration, repair or replacement of which has been made or is necessary by reason of Faulty Workmanship thereon by or on behalf of the Insured¹². (CP 532)

Washington law has established that, "that particular part on which the insured worked" means a general contractor's entire structure. *Vandivort, v. Seattle Tennis Club* 11 Wn. App. 303, 522 P.2d 198 (1974). Vandivort was acting as a general contractor in constructing a large indoor tennis facility. During construction, the north wall collapsed in a landslide that was negligently caused by Vandivort. Vandivort's insurer denied coverage based on a "that particular part" exclusion. Vandivort argued that damage to the west side of the structure should be covered, because the slide had

¹² MacPherson's discussion of this exclusion is split into two parts, which makes it seem as though it is addressing two separate exclusions: the "That Particular Part" exclusion and the "Repair or Replacement" exclusion. *Cross-Appellant's Brief at 55 and 58, respectively*. These are two parts of the same exclusion, the Faulty Workmanship exclusion, cited above. It is unclear why MacPherson has bifurcated it.

occurred on the north side. *Id.* at 308. The court rejected that reasoning. *Id.* at 308. Similarly, the particular part of the property on which MacPherson or its subcontractors provided Faulty Workmanship was the entire house.

MacPherson attempts to distinguish *Vandivort* on the basis that the court analyzed the “that particular part” language in the context of ongoing operations. The operative exclusion in *Vandivort* excluded property damage to “that particular part of any property . . . upon which operations are being performed by the insured.” *Vandivort, v. Seattle Tennis Club*, 11 Wn. App. 303, 307 (1974). This exclusion is also contained in the MacPherson policies, but is not applicable because it addresses only ongoing operations. MacPherson’s operations were completed. But the holding of the case applies equally to the exclusion at issue here: where a general contractor is building a project, the entire project is the particular part on which the contractor performs operations. MacPherson acknowledges as much: “[T]he issue in *Vandivort* was the extent of a contractor’s operations.” *Cross-Appellant’s Brief at 56 (emphasis added)*. MacPherson is correct. Pursuant to *Vandivort*, the “extent of a contractor’s operations” is the entire project, when that contractor is the *general* contractor.

That point was expanded in *Schwindt, v. Underwriters at Lloyds of London*, 81 Wn. App. 293. In *Schwindt*, defects in the workmanship of the

general contractor and its subcontractors resulted in extensive *consequential* property damage to the building. *Id.* at 295 – 296. Lloyds relied upon the Work exclusion when it denied coverage for the claim. The Lloyds exclusion also contained the “that particular part” language that is crucial to an interpretation of Enumclaw’s Faulty Workmanship exclusion. The Lloyds exclusion prohibited coverage:

for damage **to that particular part** of any property upon which the Assured is or has been working caused by the faulty manner in which the work has been performed. . . *Id.* at 295 (Emphasis added).

In addition to the subcontractor argument previously addressed, the assured argued that this exclusion does not “extend to claims of bad work or bad use of material resulting in damage beyond the removal and replacement of the **particular item** of defective work.” *Id.* at 302. (Emphasis added.) This is the identical argument MacPherson now makes. This Court disagreed: “[B]ecause this damage is still a part of the defective building itself, it falls within the policy exclusions.” *Id.* at 303-04. Thus the faulty work exclusion eliminated not only coverage for the poor wiring and waterproofing, but also the resulting consequential damage to a chiller and floor tiles (respectively). *Id.* at 304. This was so because when the insured is a general contractor, the *entire structure* is “that particular part” of property upon which the insured is working. *Id.* at

304 – 305. The application of the Faulty Workmanship exclusion in the case at bar is nearly identical to the application of Lloyds’ faulty work exclusion in *Schwindt*. MacPherson was the general contractor, and poor workmanship allowed water to enter and caused other damage. Because the entire house was the “particular part” upon which MacPherson was working, the exclusion prevents coverage for property damage to the entire house.

MacPherson’s only response to the clear ruling of *Schwindt* is that there was no evidence of Lloyds’ intent, whereas Enumclaw “follows ISO’s intent.” *Cross-Appellant’s Brief at 57*. The merits of departing from the plain language of the policy in favor of ISO commentary, and binding Enumclaw to that commentary have been addressed. But the application of “ISO intent” to override the plain language of the Faulty Workmanship exclusion is even thinner than it is in the context of the Work exclusion. Here, MacPherson relies on examples ISO provides of what is and is not covered by this exclusion. None of these addresses what is the particular part of a construction project on which a general contractor performs operations. *Cross-Appellant’s Brief at 57-58*. To the extent that ISO’s analysis conflicts with Washington law, it is irrelevant. This exclusion independently prevents coverage in favor of MacPherson.

6. Enumclaw has Never Concluded that there was Coverage Under the Umbrella.

MacPherson mentions several times that Enumclaw concluded that there was coverage under the Umbrella, and then “inexplicably” denied coverage. *MacPherson, Inc.’s Motion for Summary Judgment at 13*. This argument comes within a hair-width of the concepts of waiver and estoppel, but never explicitly goes that far, because MacPherson lacks any proof to establish these theories. Enumclaw never concluded that there was coverage under MacPherson’s Umbrella Policy, and certainly never expressed such a conclusion to MacPherson. In order to show that Enumclaw had “conceded” that there was Umbrella coverage, MacPherson identifies the following alleged indicators:

File notes: There is a note in a Enumclaw Examiner’s log that there was no coverage under the CGL policy, so Umbrella coverage was ‘triggered’. *Cross-Appellant’s Brief at 33-34*. MacPherson suggests, although it does not explicitly state, that when a policy is “triggered,” that means that the claim is automatically payable, and no exclusions apply. What “triggered” really means is that no underlying insurance was available, and the Umbrella’s grant of coverage becomes effective, *subject to exclusions*. MacPherson understands this concept perfectly. In MacPherson, LLC’s Motion for Summary Judgment, CP 353, MacPherson stated “As such, the insuring agreements in the MoE Policy have been triggered. The burden then shifts to MoE to prove that exclusions apply.” An examiner’s note that the Umbrella had been triggered is absolutely not a concession of coverage under that policy.

Reservation of Rights Letter: Counsel for Enumclaw sent a letter to counsel for MacPherson stating, “[I]t is my understanding that

sufficient insurance money was made available to fully cover the cost of repair of any damage to tangible property.” *Cross-Appellant’s Brief at 34*, CP 556. While this statement may reflect that insurers of MacPherson and multiple subcontractors had made various, inadmissible offers of settlement that could combine to pay for the injury to tangible property, it is absolutely not a concession that MacPherson’s Umbrella provides coverage for the loss. The letter does not mention the Umbrella.

File note: This activity log note states: “Discussed pre-judgment interest on repair costs – compensable/payable under umbrella.” *Cross-Appellant’s Brief at 34*, CP 559. Discussions about what coverage may or may not be available under the Umbrella do not amount to “recognizing that [Enumclaw] had found coverage for the Hedges’ claim under the umbrella supplement.” *Id.*

Examiner Email: An email written by Examiner Erin Weatherspoon, discussed at her deposition, states, “Portions of this amount is economic loss and is not covered even if we have some coverage under the umbrella” (for repair costs). *Cross-Appellant’s Brief at 34*, CP 545. MacPherson tells the Court that this is a “recogni[tion of] coverage under the umbrella supplement” and an “admission” of coverage.

Examiner Deposition: Examiner Erin Weatherspoon was asked if the “umbrella policy would provide coverage for liability that the policyholder assumed under a contract.” *Cross-Appellant’s Brief at 33*, CP 547. In its brief, MacPherson reports that she answers, “It should.” *Id.* Ms. Weatherspoon’s real answer was, “It should. And I’ll qualify that because there are always exceptions and little blurbs here and (end of transcript in Clerk’s Papers).” Aside from this embarrassing, intentionally misleading truncation of testimony, this appeal has nothing to do with whether the policy provides coverage for “liability assumed under a contract.” It has to do with whether there is coverage for damage arising from the work of MacPherson’s subcontractors.

These startling distortions of Enumclaw’s position is the fabric out of which MacPherson’s briefs are made. There was *never* a “concession” that

the Umbrella policy covered MacPherson's liability to the Hedges. Enumclaw respectfully suggests frequent reference to the primary sources.

7. Even if MacPherson is Entitled to Attorney Fees, it is Not Entitled to More than the Trial Court Awarded.

MacPherson is not entitled to its attorney fees under *Olympic Steamship v. Centennial*, 117 Wn.2d 37, 811 P.2d 673 (1991) unless it prevails in obtaining coverage in this lawsuit. On appeal, MacPherson complains that the trial court awarded less in *Olympic Steamship* fees than it should have¹³. An award of attorney fees is discretionary, and will not be disturbed on appeal absent an abuse of that discretion. *Bank of Am. v. David W. Hubert, P.C.*, 153 Wn.2d 102, 101 P.3d 673 (2004).

a. Procedural History of the Fee Award

Given the history of MacPherson's fee demand, its complaints that the trial court did not award enough fees should fall on deaf ears. There is no dispute that MacPherson could only be entitled to fees spent on successful claims. CP 1289. MacPherson brought and litigated the following claims (CP 802-808):

1. Enumclaw violated the Consumer Protection Act;
2. Enumclaw was estopped from asserting coverage defenses because of alleged inadequacies in Enumclaw's reservation of rights;

¹³ This fee award was based solely on the finding of coverage under the Liberalization Clause.

3. Enumclaw was estopped from asserting coverage defenses because it allegedly acted in bad faith;
4. Enumclaw was vicariously liable for the failure of MacPherson's insurance agents to sell it insurance that covered this claim;
5. Enumclaw acted in bad faith by not "investigating" thoroughly enough whether MacPherson was entitled to the benefit of the Liberalization Clause;
6. MacPherson, LLC was entitled to coverage, even if MacPherson, Inc.'s claims were excluded, because the Hedge's house was not the "work" or "product" of the LLC;
7. Enumclaw's counsel violated CR 11 by making an argument based on an exclusion that MacPherson did not believe was relevant (CP 793);
8. Enumclaw owed MacPherson coverage under the terms of its policy (the argument in this cross appeal); and
9. Enumclaw owed MacPherson coverage as a result of the Liberalization Clause (the argument in Enumclaw's appeal).

In pursuing those claims, MacPherson, LLC and MacPherson, Inc. concurrently employed four law firms. CP 1290. They filed two motions for summary judgment (one granted, one denied), a imprudent motion for CR 11 sanctions (denied), a motion to amend the Answer (granted, but all new claims made in the amendment were either dismissed or abandoned), and a Motion for Entry of Final Judgment. CP 1280. Out of all nine of these claims, MacPherson, LLC ultimately prevailed on only one: the

liberalization argument. MacPherson, Inc. prevailed on none¹⁴. MacPherson asserts that legal work on all nine of these claims was necessary in order to obtain coverage, but neither makes an argument nor cites authority to explain why this is so. Washington law is clear that a prevailing party is only entitled to fees for pursuing the claims on which it prevailed. *Mahler v. Szucs*, 135 Wn. 2d 398, 957 P.2d 632 (1998).

Despite its acknowledgement that “Washington law does not allow recovery of fees and costs spent pursuing unsuccessful legal theories (CP 1289),” MacPherson refused to make any attempt to segregate or elucidate fee line items with unclear descriptions of work (*See, eg*, CP 1303 - *impossible to determine what claims the work relates to.*). Enumclaw correctly responded that segregating fees is the burden of the party demanding them (*Mahler*, 135 Wn. 2d at 433-434), and there should be no award until MacPherson did so. CP 1503-1505. In Reply, MacPherson again refused to make any attempt to segregate its attorney fees, despite its burden. CP 1515. Enumclaw, by way of surreply, proposed a segregation the only way it could - by identifying entries with descriptions that were even peripherally related to the liberalization claim¹⁵. CP 1516

¹⁴ MacPherson claims that the only fees it incurred on an unsuccessful theory were related to the one summary judgment motion regarding policy exclusions. MacPherson has overlook these several other unsuccessful theories.

¹⁵ Enumclaw noted: “It is possible that the attorneys at Stanislaw Ashbaugh and the Harper firm that performed the work recounted in these invoices will be able to flesh out

Despite the invitation, MacPherson continued to refuse to make any fee allocation of its own, and refused to provide a more thorough description. The trial court accepted Enumclaw's allocation, based on Enumclaw's briefing, and entered the final judgment. CP 1620. MacPherson then drafted, and the trial court signed, findings of fact and conclusions of law to support the fee award. CP 1624.

MacPherson had multiple opportunities to present the Court with a fee allocation, but it refused to. It then drafted findings of fact and conclusions of law supporting that fee award. Now MacPherson *appeals that* fee award, arguing that the findings and conclusions it drafted were insufficient, the trial court was overly stingy in its allocation, and that the trial court did its math in the wrong order.

b. If there was Error in the Fee Award, it was Invited by MacPherson.

MacPherson did not just have the *opportunity* to present the court with a fee allocation, it *refused* to make such an allocation when invited to do so. Because MacPherson obstinately failed to allocate, and drafted the findings of fact and conclusions of law that supported the fee award, any error that may be present in that award was invited by MacPherson, and

some of their entries, and show that some which do not appear to be related to the liberalization claim, in fact, are. At the Court's discretion, Enumclaw invites those firms to provide a more detailed account of the time spent pursuing the successful claim." CP 1519.

not subject to appeal.

Under the doctrine of invited error, a party “cannot set up an error at trial and then complain about it on appeal.” *Estate of Stevens*, 94 Wn. App. 20, 971 P.2d 58 (1999). That is exactly what MacPherson has done, and the Court should not countenance it. In the event that MacPherson prevails in this appeal, the Court should affirm the trial court’s determination of attorney fees.

CONCLUSION

For the above reasons, Enumclaw respectfully requests that the Court affirm the ruling that there is no coverage under the Umbrella policy. Enumclaw respectfully requests that the Court reverse the judgment of the trial court based on Liberalization, and direct the trial court to enter judgment in favor of Enumclaw. In the alternative, Enumclaw respectfully requests that the Court reverse the judgment of the trial court, and remand this case for a determination of how coverage is limited by the Withdrawal from Use exclusion.

RESPECTFULLY SUBMITTED this 30th day of October, 2006.

HACKETT, BEECHER & HART



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