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NO. 57820-1-I

**COURT OF APPEALS
DIVISION I
OF THE STATE OF WASHINGTON**

MUTUAL OF ENUMCLAW INSURANCE COMPANY,

Appellant/Cross-Respondent,

v.

MACPHERSON CONSTRUCTION & DESIGN, LLC

Respondent/Cross-Appellant.

RESPONDENT/CROSS-APPELLANT'S REPLY BRIEF

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I. SUMMARY OF REPLY ARGUMENT

As discussed in MacPherson Construction & Design, LLC's ("MacPherson") earlier briefing, the trial court erred when it failed to find the MoE Policy afforded coverage for property damage arising out of the work of MacPherson's subcontractors. The authorities cited by MacPherson in its earlier briefing, and most notably the authority of the ISO Circular, establish that MoE's position is without merit.

First, MoE's denial of MacPherson's claim under the "work performed" exclusion relies on a dubious legal concept whereby the subcontractor's work "merges" into MacPherson's work upon completion. There is no valid, legal support for this concept. As earlier briefed by MacPherson, MoE relies on cases which have absolutely nothing to do with the "work performed" exclusion stated in the UMB 3011 endorsement at issue. Moreover, this strained application ignores the simple language of the exclusion, highly persuasive evidence regarding ISO intent, guidelines for the proper interpretation of insurance policies, and expert commentary on how the exclusion operates. Simply put, the great weight of authority belies MoE's position.

Second, MoE's denial of MacPherson's claim under the "faulty workmanship" exclusion also fails, as that exclusion is meant to address ongoing operations losses, not completed operations losses. The "faulty workmanship" exclusion applies only to the particular part upon which operations are being performed. The arbitration award at issue in this appeal does not include the cost to repair or replace the particular part worked on, but instead addresses the cost to investigate and repair consequential damages occurring after construction was complete. Therefore the exclusion does not apply.

II. ARGUMENT

MacPherson is entitled to a ruling that the trial court erred in ruling the "work performed" and "faulty workmanship" exclusions bar MacPherson's claim. MacPherson is entitled to an award for the entire amount of the arbitration award, prejudgment interest and attorney's fees and other costs of litigation, including the cost of this appeal.

A. **THE "WORK PERFORMED" EXCLUSION APPLIES ONLY TO MACPHERSON'S WORK, NOT TO WORK PERFORMED BY A SUBCONTRACTOR**

When examining exclusionary clauses in insurance contracts certain basic principals apply. Chief among them is that

exclusionary clauses are to be strictly construed against the insurer.¹ “The purpose of insurance is to insure, and that construction should be taken which will render the contract operative, rather than inoperative.”²

MoE supports its argument by citing the hackneyed proposition that commercial liability policies are not performance bonds. This is a generalized statement and does not serve as an analysis of the MoE Policy and its exclusions. MacPherson does not seek to convert the policy into a performance bond, but instead seeks coverage for a fortuitous completed operations property damage loss – the exact risk MoE underwrote and insured.

1. The Plain Language Of “Work Performed” Exclusion Excludes Only Damage Caused By The Named Insured, Not Damage Caused By A Subcontractor

The liability policy issued to MacPherson covers property damage to which MacPherson is legally obligated to pay – unless an exclusion applies. The MoE umbrella policy contains an exclusion for property damage “to work performed by *or on behalf*

¹ S.L. Rowland Constr. v. St. Paul Fire & Marine Ins. Co., 72 Wn.2d 682, 688, 434 P.2d 725 (1967).

² Scales v. Skagit Cy. Med. Bur., 6 Wn. App. 68, 70, 491 P.2d 1338 (1971).

of the named insured.”³ This exclusion is replaced by an endorsement contained in the UMB 3011 endorsement without the “or on behalf of” language and which excludes only property damage “to work performed by the Named Insured arising out of the work or any portion thereof, or out of material, parts or equipment furnished in connection therewith.”⁴

The deletion of the “or on behalf of” language is not superfluous. As myriad authority establishes, the result is that the policy only excludes completed operations damage claims for damage to, or arising out of, the named insured’s work. MacPherson’s claim is for completed operations property damage resulting from the work performed by a subcontractor - not by itself as named insured. The plain reading of the policy should end the analysis of this exclusion. To this end, MacPherson presents evidence the entire arbitration award is for damage caused by a subcontractor; evidence which has never been challenged by MoE. Based on the unambiguous language in the policy, the “work performed” exclusion does not apply and MacPherson’s claim is covered.

³ CP 520 (emphasis added).

⁴ CP 531.

2. The Plain Language of the UMB 3011 Endorsement Demonstrates Intent To Cover Property Damage Caused By A Subcontractor

In addition to the simple language of specific exclusion, evidence from the four corners of the UMB 3011 endorsement, as well as industry commentary, indicates the deletion of the “on your behalf” language was deliberate, meaningful, and supports the conclusion that MacPherson’s claim is covered.

First, the main umbrella form excluded coverage for damage “to work performed by *or on behalf of* the named insured.” The replacement UMB 3011 form only excludes work performed “by the named insured.” The actual endorsement form uses the broader “on behalf of” language in three previous paragraphs.⁵ This deliberate use, and subsequent non-use, of the “on behalf of” language in the policy indicates these terms are not superfluous, inconsequential or irrelevant.

Many courts have found this simple logic persuasive. In Fireguard Sprinkler Systems, Inc. v. Scottsdale Ins. Co.,⁶ the court held that in an identical situation “**[w]e cannot conclude that omission of the phrase “or on behalf of” in sections VI(A)(3) of**

⁵ CP 531 (exclusions A.2.(a); A.2.(d)(1) and A.2.(d)(3)).

⁶ 864 F.2d 648, 651 (9th Cir. 1988) (emphasis added).

the endorsement has no significance.” This is especially true in the instant case where MoE fails to submit any evidence that its use or non-use of this language was irrelevant or inconsequential. The trial court should have recognized, as the court in Fireguard did, that “[b]ecause this phrase was deliberately deleted in one paragraph and retained in the immediately preceding paragraphs, we are persuaded that the exclusion in the endorsement applies only to work performed by the named insured.”⁷

Moreover, in McKellar Development of Nevada Inc. v. Northern Ins. Co. of New York,⁸ the court also found intent from the face of the document and held that “the elimination of the phrase or ‘on behalf of’ indicates that the work of subcontractors was intended to be covered by the policies.”

Therefore, even without need to resort to extrinsic ISO intent regarding this exclusion, because the “work performed” exclusion does not use the language that would exclude damage arising from the subcontractor’s work for the named insured, the exclusion does not apply to MacPherson’s claim.

⁷ Id.

⁸ 108 Nev. 729, 837 P.2d 858 (1992).

3. **Evidence Of Industry Usage And Intent Indicates Coverage For Property Damage Caused By Subcontractors**

MoE claims it is improper to rely on ISO intent, or other sources, when the language of the policy is clear and unambiguous. Given the authority MacPherson submits, MoE's characterization of "clear and ambiguous" is disingenuous. Correctly, the Court should rely on all evidence, including the forms available to MoE, the history of changes to the language of the form, industry circulars relating to the language changes, and expert commentary to conclude that the UMB 3011 affords coverage for property damage to, and arising out of, subcontractor work.

Insurance commentator Scott Turner notes the removal of this key language is a **major, deliberate, and intentional broadening of coverage** [by weakening the exclusion] by insurers in exchange for a significant premium.⁹ MoE argues that it did not charge MacPherson an additional premium, which somehow is negative evidence it did not intend to broaden coverage. Whether

⁹ Scott C. Turner, Insurance Coverage of Construction Disputes Vol. 1 § 33.3 (2nd Ed. 2005) (emphasis added).

MoE failed to collect this premium, or relied on the umbrella status of the exclusion as actuarial justification for not charging an additional premium - it would have no effect on the reasonable interpretation of the exclusion. As stated by the Fireguard court, “[w]ords deleted from a contract may be the strongest evidence of the intention of the parties.”¹⁰

4. Cases Applying The Merger Rule Are Distinguishable And Do Not Follow Washington Law

MoE relies heavily on Schwindt v. Underwriters at Lloyd’s of London,¹¹ to support its denial of MacPherson’s claim. The Schwindt court held that in the absence of any evidence of intent, the deletion of the “on behalf of” language did not indicate the insurer intended to cover property damage caused by a subcontractor. In Schwindt, the court found no evidence of ISO intent. In this case, and unlike Schwindt, there is strong and unequivocal evidence of ISO intent contained in the record. First, MoE’s CR 30(b)(6) designee admitted the company abides by ISO intent. Second, the ISO Circular is clear in its statements regarding the effect of the deletion of the “or on behalf of” language.

¹⁰ Fireguard, at 651.

¹¹ 81 Wn. App. 293, 914 P.2d 119 (1996).

MoE also relies on both Knutson Construction Co. v. St. Paul Fire & Marine Ins. Co.,¹² and Blaylock and Brown Const. Co. Inc. v. AIU Ins. Co.,¹³ to support its denial of MacPherson's claim under the "work performed" exclusion. As discussed in MacPherson's earlier briefing in this matter, the underlying reasoning behind these two decisions is no longer the prevailing theory.

The decision in Wanzek Construction, Inc. v. Wausau,¹⁴ controls and invalidates the authority MoE relies on. Furthermore, Westfield Insurance Company v. Weis Builders, Inc.,¹⁵ in discussing Minnesota law, acknowledged that the Wanzek case "held that the extent to which a policy covers business risks must be governed by the specific terms of the contract, as opposed to the business risk doctrine." MoE's attempt to inject the business risk doctrine in place of a simple application of the unambiguous language of the exclusion violates Washington law and the wealth of authority supporting MacPherson's position.

In sum, the "work performed" exclusion does not apply, as the plain language of the UMB 3011 evidences MoE's intent to

¹² 396 N.W.2d 229, 231-33 (Minn. 1986).

¹³ 796 S.W.2d 146 (Tenn. App. 1990).

¹⁴ 679 N.W.2d 322, 2004 Minn. LEXIS 235 (2004).

¹⁵ 2004 U.S. Dist. LEXIS 13658 (2004).

provide completed operations coverage for property damage to, or arising out of, subcontractor work. Furthermore, this logical conclusion is supported by ample case law and expert commentary. MoE's efforts to argue otherwise fail.

B. THE "FAULTY WORKMANSHIP" EXCLUSION DOES NOT APPLY TO BAR MACPHERSON'S CLAIM

MoE's also claims the "faulty workmanship" exclusion bars coverage for this claim.¹⁶ The "faulty workmanship" exclusion excludes property damage to:

that **particular part** of any property . . .

- (3) **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.**¹⁷

The purpose of the "that particular part" language in the exclusion is to limit application to only the repair cost of the actual defect – not to any of the resulting damage. As recognized by authority submitted by MacPherson, "that particular part" is a narrow definition consisting of only the specific part of work that an insured is working on when a loss occurs.

¹⁶ Mutual of Enumclaw's Reply Brief of Appellant/Cross-Respondent [Opposition], p. 40.

¹⁷ CP 531.

The expert testimony in the record evidences that the framing and sheathing do not need replacement because it was faulty, or installed in a faulty fashion. The framing and sheathing were replaced only because the EIFS seams were improperly installed which allowed water to leak in and damage otherwise good materials. There is no basis to apply the “faulty workmanship” exclusion to bar coverage for MacPherson’s claim, as the claim does not contain any amounts for repair or replacement of “that particular part” of property upon which any faulty workmanship was performed.

MoE relies on Vandivort v. Seattle Tennis Club¹⁸ to support its denial under the “faulty workmanship” exclusion. Vandivort is inapplicable for two main reasons. First, the issue in Vandivort involved an **ongoing operations** loss - damage that occurs during the course of a construction project.¹⁹ The loss at issue in this case is a **completed operations** loss - damage that occurs after construction is complete. Therefore, on the facts alone, Vandivort does not apply to the instant claim.

¹⁸ 11 Wn. App. 303, 522 P.2d 198 (1974).

¹⁹ Id.

Second, as earlier briefed by MacPherson, Vandivort does not hold that “that particular part” of a construction project is the entirety of the completed job in the context of a completed operations loss. Here, there is undisputed evidence in the record that the “particular part” of the property which must be repaired was limited to the seams and flashing of the EIFS siding on the Hedges’ residence. This Court should reject MOE’s arguments in light of the examples in the ISO circular.

In sum, MoE’s improperly denied MacPherson’s claim under the “faulty workmanship” exclusion, as the exclusion is limited and only excludes the type of repair costs not present in MacPherson’s claim.

III. CONCLUSION

For the foregoing reasons, the trial court should be reversed on the coverage issue presented in this appeal.

DATED this 30th day of November, 2006.

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CERTIFICATE OF SERVICE

The undersigned certifies that on *Thursday, November 30, 2006*, I caused a true and correct copy of this document to be delivered in the manner indicated to the following parties:

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