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No. 56591-5-1

80937-2

COURT OF APPEALS
THE STATE OF WASHINGTON
DIVISION I

RED OAKS CONDOMINIUM OWNERS ASSOCIATION, a
Washington non-profit corporation

Appellant,

v.

MUTUAL OF ENUMCLAW INSURANCE COMPANY

Respondent.

BRIEF OF RESPONDENT

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I. STATEMENT OF THE CASE

Sundquist is a developer and general contractor for housing, including condominiums in Western Washington. CP 185. At the times relevant to this lawsuit Sundquist was insured by Mutual of Enumclaw (hereinafter "MOE") under CGL and Umbrella Liability Policies. CP 186. In the first half of 2003 Sundquist submitted to MOE five separate claims Sundquist was concerned could result in liability. Each of these claims, Red Oaks, Wethersfield, Mill Creek Court, Barrington, and Gold Leaf, was identical for purposes of determining coverage under the MOE policies. CP 44-49, 1091. Each of these projects was suffering from construction defects causing water intrusion. CP 213-215, 1091.

The claims against Sundquist were at varying levels of maturity when Sundquist notified MOE of their existence. Sundquist had engaged in negotiations with each of the claimants hoping to avoid lawsuits. CP 811, 1091. Even though several of the claims, including Red Oaks, had not yet resulted in an action, MOE accepted Sundquist's tender of defense and appointed Sundquist's choice of lawyer, Jeff Frank, of Bullivant, Houser, Bailey to provide Sundquist's defense and represent it in the negotiations. CP 44-49, 936 p.10 l. 17 - p. 11 l. 20. MOE reserved its rights, first in a letter relating to the Barrington claim in August, 2003, and later in a letter encompassing all five claims in November, 2003. These

letters informed Sundquist of several exclusions, among them exclusions for Sundquist's work, products, and faulty workmanship. CP 1119-1121, 44-49.

Having received the reservation of rights letter for the Barrington claim, and thus fully aware of MOE's position on coverage under the policy presently before the Court, Sundquist voluntarily sought and obtained MOE's approval to enter into an ER 408 Discovery and Tolling Agreement. CP 811, 819-822, 936 p.13 l. 7 – p. 15 l. 16. Sundquist believed the Discovery Agreement was a good defense strategy to minimize its liability and MOE agreed. CP 937, p. 14 l. 2 – p. 15 l. 10. The agreement was executed by Sundquist and Red Oaks, who were the only two parties to the agreement, on September 29, 2003. CP 822. Under the agreement Sundquist agreed to fund a joint discovery exercise including the appointment of a neutral expert to determine an appropriate scope of repairs for the Red Oaks buildings. CP 819-822, 937, p. 14 l. 13 – p. 15 l. 7. Bids would then be submitted to construction companies. CP 820. The parties agreed to mediate differences, and failing that to litigate them in arbitration or in court. CP 820-821. Because MOE agreed with Sundquist that the Discovery Agreement was a good tool to limit Sundquist's exposure as part of its defense, MOE agreed to pay the cost of the neutral expert and up to \$25,000 of Red Oaks' attorneys fees incurred

during the pendency of the Discovery Agreement. CP 821, 937 p. 14 l. 2 – p. 15 l. 10.

On October 29, 2003, Dave Michlitsch of MOE met with Larry Sundquist, Jeff Leghorn (Sundquist's in-house counsel), and Richard Beal (Sundquist's coverage counsel) to discuss the claims against Sundquist. Mr. Michlitsch told Mr. Sundquist and his lawyers that MOE believed there was no coverage for the claims and, as a result, no money was likely to be available to settle them. CP 938, p. 20 l. 17 – p. 22 l. 12.

Apparently as a result of that meeting and the reservation of rights Sundquist immediately sued MOE in a Declaratory Judgment action on the Barrington claim, which was the most immediate claim at the time. CP 1094, 1132. MOE originally filed an Answer and Counterclaims relating solely to the Barrington project but subsequently amended the Counterclaim to cover all of the claims against Sundquist, including Red Oaks. CP 1081-1087, 1133.

Sundquist and Red Oaks scheduled a mediation on March 4, 2004. Three days before the mediation, Mr. Michlitsch reiterated MOE's position that the Red Oaks claim was not covered under the policy, and no insurance money would be available to fund a settlement. CP 940, p. 26 l. 5 – p. 27 l. 22. Red Oaks filed its action against Sundquist on March 31st and settled with Sundquist two days later, by exchanging a covenant not to

execute on its Stipulated Judgment of \$1,948,000 against Sundquist for an assignment of any rights Sundquist may have had against MOE for the Red Oaks claim. *Red Oaks COA v. Sundquist Homes, Inc.*, 128 Wn. App. 317, 320, 116 P.3d 404 (2005).

Red Oaks then brought this action against MOE alleging coverage under the policies and bad faith. CP 1-13. In two Summary Judgment Motions MOE obtained rulings there was no coverage under the policies for the Red Oaks' claims. CP 700-702, 898-900. Without having earlier raised its bad faith estoppel defenses to resist the previous summary judgment motions, Red Oaks brought a Summary Judgment Motion based on bad faith. CP 170-183, 795-809, 901-929. Red Oaks' Motion was denied and a Summary Judgment of Dismissal granted to MOE. CP 1316-1318.

Red Oaks bases some of its arguments on Sundquist's relationship with its insurance agent. For a number of years Sundquist had engaged the Brunni-Colbath Insurance Agency to provide it advice and help it select insurers and policies to cover its risks. CP 188. Brunni-Colbath also had a relationship with more than one hundred insurance companies, including MOE, who had provided it limited authority to collect premiums and bind coverage. CP 680-684, 668-676. Sundquist met with Brunni-Colbath regularly to review its insurance status and obtain advice. CP

188. When construction defect litigation began to appear in Washington Bruni-Colbath advised Sundquist that insurance policies would not cover a contractor's own work. CP 190.

II. ARGUMENT

Red Oaks makes two arguments on appeal. The first is that there is coverage for this claim under Sundquist's MOE insurance policies. The second is that MOE acted in bad faith, and is estopped to deny coverage regardless of what the policies say. Red Oaks is mistaken. MOE will show that exclusions in Sundquist's policy prevent coverage for this claim, and MOE handled the claim properly.

A. **There Is No Coverage Under Sundquist's Policy For Liability To Red Oaks.**

Because the exclusions in Sundquist's policy apply to Red Oaks' claim, Sundquist had no insurance coverage to assign to Red Oaks. The trial court ruled correctly on this issue, and should be affirmed.

1. **Red Oaks Rights Are No Greater Than Sundquist's.**

It is axiomatic in contract law that assignors can only pass the rights they possess to their assignees — nothing magical happens to expand rights in the process of assignment. *Restatement, 2nd, Contracts*, 336(1) (1981). In addition, assignees are subject to any defenses that would have been effective against the assignor when notice of the

assignment was made. *Id.* at 336(2). Washington courts apply these principles. See, e.g., *Pacific NW Life Insurance Co., v. Turnbull*, 51 Wn. App. 692, 700-701, 754 P.2d 1262 (1988) (assignment taken subject to fraud defense). They apply to insurance policies which, of course, are contracts. *Allstate Ins. Co., v. A.A. McNamara & Sons, Inc.*, 1 F3d. 133 (2nd Cir 1993). As a result Red Oaks' rights are limited to those Sundquist had when the assignment was made and, in addition, are subject to any defense MOE had against Sundquist when it received notice of the assignment. Because Red Oaks' rights depend on the relationship Sundquist had with MOE, this brief will frequently refer to them as Sundquist's rights.

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). An insured contractor has control over the risk incurred from flaws in its work by "taking pains" to control the quality of its work and products. *Weedo, v.*

Stone-E-Brick, Inc., 81 N.J. 233, 239, 405 A.2d 788, 791 (1979). 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 normal business expense to be borne by the contractor in order to satisfy customers. *Id.* at 239. This cost is finite, within the control of the insured, and not normally the subject of liability insurance. Requiring an insurer to cover this type of loss is like “making the insurer a sort of silent business partner subject to great risk in the economic venture without any prospects of sharing in the economic benefit.” *Toombs NJ, Inc., v. Aetna*, 404 Pa Super 471, 476, 591 A.2d 304, 306 (1991).

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.* at 239 - 240. It is this risk of injury to persons and property other than the contractor’s work or product that is addressed by commercial liability policies.

Washington courts have for years observed the distinction between deficiencies in an insured’s own work or product and injury to other property or persons, as well as the consequent insurance coverage distinction, often saying the insurance 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). Washington

recognizes and enforces the distinction between uninsured business risks like the quality of a contractor's product, and insured liability to third parties caused by the contractor's negligently constructed product.

3. Sundquist's Policies Contain Business Risk Exclusions.

Sundquist purchased two policies from MOE: a CGL policy and an Umbrella Policy. CP 50-91. The coverage provided by the Umbrella is the only subject of this appeal, as Red Oaks does not challenge the summary ruling that the CGL policy does not cover its claim. Appellant's Brief at 9. That ruling results from this Court's holding that this policy's product exclusion, unlike a performance bond, prevents coverage. *Mutual of Enumclaw v. Patrick Archer Constr. Co.*, 123 Wn. App. 728, 97 P.3d 751 (2004). The Umbrella policy contains its own grant of coverage, and its own exclusions. It is made up of a "base" policy (UP2), which is modified by endorsements to that base. CP 71-78, 87. The UMB 3011 Umbrella endorsement adds two exclusions to that policy that prevent coverage in favor of Red Oaks as a matter of law. The first exclusion is the Insured's 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 87)

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 87)

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

a. The Work Exclusion Prevents Coverage For Red Oaks' Claims.

Red Oaks posits, and MOE agrees, that the damage in this case was included in the Completed Operations Hazard. Because the Red Oaks condominium complex was the "work" of Sundquist, there is no coverage under the Umbrella Policy for damage to this "work."

i. *A Builder's Building Is Its "Work."*

An insured builder's "work" is the building it constructs. *Federated Service Ins. Co. v. R.E.W. Inc.* 53 Wn. App. 730, 770 P.2d 654 (1989). In *R.E.W.* the insurer declined to cover the loss, citing, among others, the Insured's Work exclusion, word for word the same exclusion MOE had in its Umbrella Policy. *Id.* at 732; CP 87. The court held

coverage was excluded. *Id.* at 736. Similarly, there was no coverage for liability to Red Oaks for damage arising out of Sundquist's work.

ii. Work Performed By Subcontractors Merges Into The General Contractor's Work Upon Completion.

Red Oaks argues that the Insured's Work exclusion applies only to damages arising out of work actually performed by Sundquist, not work performed by a subcontractor; the upshot of this argument would be that the Insured's Work exclusion does not prevent coverage in this case because of Sundquist's extensive use of subcontractors. This is not a new argument. It has been the subject of much judicial thought, and has left jurisdictions in disagreement.

For ease of reference, the first line of cases in the resulting split of authority 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, Red Oaks argues that the majority of damage arose from the work of subcontractors, and thus that the majority of Red Oaks' claim is covered.

The second line of cases will be referred to as the Minnesota Rule.

(The seminal cases adopting this rule are *Bor-Son Bldg. Corp., v.*

Employers Commercial Union Ins. Co. of Am., 323 N.W.2d 58 (Minn

1982), and *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.

Red Oaks agrees that if the Minnesota Rule is the law here, then the Insured’s Work exclusion prevents coverage, and MOE is entitled to Judgment on this exclusion alone. As will be demonstrated, Washington has expressly adopted the Minnesota Rule, and there is no coverage in favor of Sundquist for this claim under the Umbrella policy.

There is no support for the Oregon Rule in any reported case in Washington. When it created the Oregon Rule, the court in *Fireguard* based its decision on what it perceived to be the insurer’s intent. The policy language at issue in *Fireguard* was the same as is at issue in the case at bar: the base policy contained an exclusion that prevented coverage for the property damage arising from work performed by or on behalf of the insured. On top of that base policy, there was an endorsement, as there is in this case, that replaced the exclusion with one that prevented coverage, in the context of completed operations, for property damage arising out of the insured’s work. 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. The court ruled that this unilateral "intent" was binding on the insurer, and that the insurer could not deny coverage which it "intended" to provide when it "drafted" the policy. The quotation marks are used because the insurer in *Fireguard* did *not* draft the policy – a third party, Insurance Services Office, Inc. (ISO), did, and the only evidence of the defending insurer's "intent" was evidence of ISO's post-hoc commentary¹.

While the Oregon Rule attempts to use engrafted, unilateral intent as a definitive aid to contract interpretation (contrary to the Washington approach, *Lynott, v. National Fire Ins. Co.*, 123 Wn.2d 678, 684, 871 P.2d 146 (1994)), the Minnesota Rule looks to the actual policy language and the facts of the claim to which the policy may apply. In *Knutson* the Supreme Court of Minnesota considered exclusionary language identical to that presently before this Court. The insured in that case had a base policy that excluded liability arising from work "by or on behalf of" the insured, and an endorsement that replaced that exclusion with one excluding, in the context of completed operations, liability arising from

¹ The Umbrella endorsement in this case, UMB 3011, is similar to, but is not an ISO form.

poor work “by” the insured. The insured argued that the property damage arose from the work of subcontractors, and that the deletion of the “or on behalf of” language indicated that the policy covered this liability. The Minnesota court held that because a general contractor is ultimately responsible for all work at a construction site once the project has been completed, “work” of the subcontractors merged into the “work” of the general contractor, and the entire project is the general contractor’s work for purposes of policy exclusions. This is because the general contractor has effective control over the quality of the work, and more importantly, the ultimate responsibility for ensuring that it was done correctly. Therefore, the deletion of the “or on behalf of” language in the endorsement did not change the meaning of the exclusion, because in the context of completed operations, all of the work is the general contractor’s work. *Knutson* 396 N.W. 2d at 232 - 237. **In fact, the merger of the subcontractor’s work into the general contractor’s work explains the deletion of “or on behalf of” in the context of completed operations. *Id.* 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.**

Washington courts have expressly adopted the Minnesota rule. As is true of most splits of authority, the ideological schism between the Oregon and Minnesota Rules stems from an elemental difference of opinion on the core issue; in this case, that difference is whether the work of subcontractors is a separate, insurable risk from the work of general contractors. Jurisdictions, including Washington, subscribing to the Minnesota Rule posit that the work of subcontracts merges into the work of a general contractor at the completion of a project. The Oregon Rule courts base their reasoning on the conceptual separateness of work of the subcontractors from that of the general contractor. There is no need to paraphrase that which these courts explain with clarity:

Fireguard (Oregon Rule)

In *Vari Builders*, 523 A.2d at 552, the court 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 disagree.**

Fireguard Sprinkler Systems, Inc. v. Scottsdale Ins. Co. 864 F.2d 648, 654 (9th Cir. 1988) (emphasis added)

Knutson (Minnesota Rule)

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.

Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co., 396 N.W.2d 229, 236 (Minn., 1986) (emphasis added).

Despite Red Oaks' protestations to the contrary, this Court has already adopted the Minnesota Rule. *Schwindt, v. Underwriters at Lloyds of London*, 81 Wn. App. 293, 914 P.2d 119 (1996). In *Schwindt*, the insured was a general contractor that built a medical building. The building suffered from a large number of construction defects, and the owners sued as a result. The insurer denied coverage based on a very similar "Assured's Work" exclusion. That policy excluded damage (in relevant part) to, "property upon which **the Assured** is or has been working." *Id.* at 295 (Emphasis added.) The assured general contractor argued to the court that much of the damage was a result of subcontractor work, and that this exclusion applied only to the work of the Assured, citing cases that had adopted the Oregon Rule. If there were any doubt about Washington's position on the split of authority, the court in *Schwindt* resolved it relying on *Knutson*: "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.**" *Id.* at 305-306. (Emphasis added.) The court stated that once a construction project is completed, the work of the subcontractors merges into the work of the general contractor, and that the

work exclusion applies to bar coverage for damage to the entire structure.
Id. 305 – 306.

The *Schwindt* court held this “merger” of the subcontractors’ work into the work of the general contractor once the operations were completed reflected the “realities of the commercial construction process.” *Id.* at 306. Division One repeated its position on the Minnesota merger doctrine, and affirmed the application of *Schwindt* recently in *Mutual of Enumclaw Ins. Co. v. Patrick Archer Construction, Inc.*, 123 Wn. App. 728, 735 –736, 97 P.3d 751 (2004).

Red Oaks 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. Once the Red Oaks condominiums were completed, the work of Sundquist’s subcontractors merged into its own, and the insured’s Work exclusion bars coverage for Sundquist’s liability to the homeowners in this case.

Despite the clarity of Washington’s position, Red Oaks argues that this State has not taken a position on whether it subscribes to the Oregon Rule or the Minnesota Rule, and that this Court should apply the more “modern” Oregon Rule. Red Oaks apparently believes that *Schwindt* (1996) and *Archer* (2004) are dusty relics of antiquated jurisprudence, to be replaced by the “modern” rule of *Fireguard*, coined sixteen years

before *Archer* was decided. Red Oaks' argument resonates with ghosts of lawsuits past. The insured in *Knutson* attempted to persuade the Minnesota court to abandon the "work merger" principle as obsolete. The *Knutson* court would have none of it. *Knutson*, 396 N.W.2d at 236. Red Oaks makes the same mistake here. Contrary to Red Oaks' argument, Washington's position on the merger doctrine is both modern, and every bit as clear as Minnesota's.² *Schwindt*, 81 Wn. App at 305-306.

iii. *The Unambiguous Work Exclusion Cannot Be Overcome By "Unexpressed Intent" Evidence.*

It is no surprise that Red Oaks would try to distinguish *Schwindt*, and given the tight fit with the facts of this case, it is no surprise that Red Oaks must stretch the imagination to connect its logical dots. Red Oaks is asking this Court to read the "work" exclusion in MOE's policy differently than the Court read the insured's Lloyds of London policy in *Schwindt*. The axis about which this argument revolves is necessarily the language of the exclusions themselves. In short, Red Oaks urges there is a

² Red Oaks cites the Minnesota case of *Wanzek*, 679 N.W. 2d 322 (2004), claiming that the *Knutson* business risk and merger doctrines have been abandoned in their own jurisdiction. Even a moderately careful reading of *Wanzek* reveals that the court was interpreting entirely different policy language. The *Wanzek* policy's work exclusion stated, "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.* at 326 Minnesota has not abandoned the business risk and merger doctrines; it simply does not apply them to override the express terms of an insurance agreement. Sundquist's policy is the *Knutson* version, not the *Wanzek* version.

critical difference between the following exclusions, such that one covers liability from the work of subcontractors, and one does not:

A. 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 [Lloyds of London] (*Schwindt*, 81 Wn. App. at 295)

B. 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. . . [Mutual of Enumclaw] (CP 87)

In the case of the first exclusion, *Schwindt* held that the work of the subcontractors necessarily merged into the work of the insured general contractor upon completion of that work. Red Oaks argues the MOE exclusion is different - not because of the language of the exclusion itself - but because of what it (fallaciously) considers to be MOE's "intent." There is not a wisp of evidence that MOE had *any* particular intent with respect to the work exclusion. Even if there were, in this State, the unexpressed intent of parties to a contract can never govern the interpretation of unambiguous terms. *Hearst Communs., Inc. v. Seattle Times Co.*, 154 Wn.2d 493, 502, 115 P.3d 262 (2005).

Red Oaks advances two "intent based" theories of why the Court should abandon the *Schwindt* merger doctrine in this case. The first is that the umbrella excluded damage to work performed "by or on behalf of the insured," but the endorsement excludes damage to work performed "by

the insured.” Red Oaks makes the *Fireguard* argument that the omission of the words “by or on behalf of” in the endorsement manifests an intention to cover liability arising from subcontractors’ work. Second, Red Oaks argues that the insurance agent represented that there was coverage for the work of subcontractors, and that MOE is bound by that representation³. Both of these “intent” arguments fail, first because the trial judge dispatched them in an Order explicitly unchallenged by Red Oaks, and second because they are unsupportable as a matter of law⁴.

iv. The Trial Court’s Order Re: “Intent” Stands Unchallenged.

On November 17, 2004, the trial court entered an Order granting MOE partial summary judgment, holding that there was no coverage for Red Oaks’ claims under Sundquist’s base liability policy. CP 700-702. But that was not the only issue the court resolved in that Order. The court

³ Red Oaks also seems to imply “intent” from the statement it paid “additional premiums for completed operations coverage” (*Appellant’s Brief at 4, 17*), and its “purchase” of the UMB 3011 endorsement (*Id. at 14*). Although none of Red Oaks’ arguments seem to be based on these allegations, it is worth noting completed operations coverage has nothing to do with coverage for subcontractor liability. Also, the premiums from completed operations coverage it cites are related only to the base policy, not the umbrella. CP 89, 91. The Umbrella premiums are undifferentiated. *Appellant’s Brief, Appendix A*. Furthermore, the UMB 3011 endorsement comes with Umbrella coverage for no additional premium. *Id.* CP 89, 91.

⁴ In what may be another lurking “intent” argument, Red Oaks states that Mutual of Enumclaw paid to settle other construction defect claims under the same policy. *Appellant’s Brief at 30*. The determination of whether to settle claims is a business decision based on evaluating the potential cost of settling versus declining to settle, including the associated attorney fees. CP 692, 694. These decisions are not based on a determination that coverage existed. Coverage arguments, of course, diminished settlement cost.

also held, “The unexpressed intent of the parties and the scope of the agency agreement between Brunni-Colbath and [MOE] are not relevant regarding an unambiguous policy.” CP 702.

Red Oaks did not identify this Order in its Notice of Appeal, and it did not assign error to this finding. In addition Red Oaks does *not* argue that it is incorrect, and expressly states, “This Order is not at issue in the appeal.” *Appellant’s Brief at 9*. The trial court’s ruling that unexpressed intent and scope of Brunni-Colbath agency is irrelevant to unambiguous policy provisions is a verity on appeal.

v. *The Omission of “by or on behalf” is Immaterial in the Context of Completed Operations.*

As was noted above, the *Knutson* court addressed the omission of the “by or on behalf of” language in the work exclusion, and held that it was immaterial because *all* of the work is the general contractor’s work once the project is completed. As was true in *Knutson*, the change in the work exclusion brought about by the UMB 3011 endorsement was not a simple deletion of the words “by or on behalf of.” The timeframe in which the exclusion operates changed as well. The work exclusion in the unendorsed umbrella is not time dependent; it applies with equal force to ongoing operations and completed operations. In that context, it applies to work done “by or on behalf of” the insured. The UMB 3011 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 “by or on behalf of” language becomes superfluous and was omitted. “Whether 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.”** *Schwindt*, 81 Wn. App. at 306 (emphasis added).

Red Oaks states “There are no cases denying coverage for damages to or arising out of subcontractor work, where the insurer omitted the language ‘on behalf of’ from the ‘your work’ exclusion.” *Appellant’s Brief* at 26-27. *Knutson*, did exactly that. Red Oaks also missed *Blaylock v. AIU Ins. Co.*, 796 S.W.2d 146 (Tenn. Ct. App. 1990), which considered and rejected the *Fireguard* rule in favor of the better reasoned Minnesota merger approach. This Court cited to the *Blaylock*, post-*Fireguard*, analysis in *Schwindt* with approval as it adopted the Minnesota approach. *Schwindt*, 81 Wn. App at 307. Because of the merger rule, the modification of the work exclusion does not provide coverage for the work of subcontractors.

Red Oaks also makes the second *Fireguard* argument, that an ISO circular interpreting a broad form endorsement to include coverage for

subcontractors work, is binding on MOE. Red Oaks again fails to connect the dots. Although it uses some similar language, UMB 3011 is not an ISO form.⁵ There is no evidence that MOE ever *saw*, much less adopted, the circular. The circular itself is not before the Court because Red Oaks never presented it to the trial court⁶. Ultimately, the contents of the circular are irrelevant because MOE never expressed such an intent to Sundquist at the policy's inception. In Washington unexpressed intent can never override the objective manifestations of intent in the contract. *Hearst Communs., Inc. v. Seattle Times Co.*, 154 Wn.2d 493, 503, 115 P.3d 262 (2005). Work exclusions are unambiguous, objective manifestations as a matter of law. *Schwindt*, 81 Wn. App at 303 n. 24. The ISO circular cited by *Fireguard* has no place in the resolution of the case at bar.

vi. *Nothing the Agent did Creates Coverage for the Work of Subcontractors.*

In an odd bid to resuscitate its “agent” argument without challenging the trial court’s rejection of it, Red Oaks attempts to show

⁵ Red Oaks attempts to gloss this fact when it states, “Enumclaw used standard industry forms for its policies.” *Brief of Appellant at 23*. A quick check of Red Oaks’ citation, CP 653, reveals the misrepresentation. MOE’s deponent said no such thing. There is no dispute of fact that UMB 3011 is *not* an industry standard form.

⁶ The failure to present the circular to the trial court may have been a strategic decision on Red Oaks’ part. Red Oaks avoided the certain evidentiary challenge that MOE would have mounted, while still claiming the right to rely on the contents of the circular as reported in *Fireguard*. Real, admissible evidence is made of stouter stuff.

MOE's intent with correspondence between Sundquist and the Brunni-Colbath insurance agency.⁷ That argument failed below because, as a matter of law, Brunni-Colbath did not have authority to alter the terms of the MOE policy. Two considerations lead to this conclusion. First, for all purposes relevant to this lawsuit, Brunni-Colbath was Sundquist's agent, not MOE's. Second, even if Brunni-Colbath had been MOE's agent, it was without power to alter the unambiguous terms of the policy.

Red Oaks refers to Brunni-Colbath exclusively as "Enumclaw's agent." This assertion does not reflect the true relationship between MOE, Brunni-Colbath, and Sundquist. Insurance agents occupy the role of dual agents, completing some tasks on behalf of the insurer, and some on behalf of their client. *See e.g. Prosser Commission Company, Inc. v. Guarantee National Insurance Company*, 41 Wn. App. 425, 433, 700 P.2d 1188 (1985) (Broker). At the same time, the traditional laws of agency govern the agencies created in the insurance industry. "To determine whether an actual agency relationship exists, Washington law requires that courts look to whether the parties consented mutually to the principal-agent relationship. The scope of an agent's authority is determined by the scope of that consent." *Northwestern National Insurance Company v. Federal Intermediate Credit Bank*, 839 F.2d 1366, 1369 (9th Cir. 1988)

⁷ It is interesting to note Red Oaks did not bring the agent into this action.

(citations omitted). In this case, MOE consented to allow Brunni-Colbath to perform a short list of functions. Brunni-Colbath was authorized “to receive and accept proposals for such contracts of insurance as company is licensed to write, and has authorized agent to effect.... [and to] remit to company gross premiums with all applications for new business....” CP 671. The agent may only bind “such classes of risks and to such limits as to which company may from time to time authorize....” CP 674. The agent’s authority is further restricted. “Agent has no authority to waive any provisions, terms or conditions of any policy of insurance issued or any rules and regulations of the company.” CP 674.

Conversely, the job of surveying the products offered by the hundreds of carriers in the market, and evaluating the coverage provided in relation to the needs of a particular insured is a task undertaken for the benefit of the *insured*. Mr. Brunni testified that Brunni-Colbath represented over one hundred insurers. CP 680-684. The nature of this work is contrasted with that which the agent is authorized to perform on behalf of the company. “The producer represents the insurance company when binding coverage, collecting premiums, issuing policies, and keeping records. On the other hand, the producer represents the consumer while guiding the selection of appropriate coverage.” Schag, *The Case For Expanded Illinois Insurance Producer Duties*, 16 N. Ill. U.L. Rev. 433,

441 (1996) (citations omitted; emphasis added). “Absent some conduct on the part of the insurer consistent with assuming broader duties, the insurer’s fiduciary duties are limited to those arising out of the insurance contract” *Shultz Steel Co. v. Hartford Accident and Indemnity Co.*, 187 Cal. App. 3d 513, 522, 231 Cal. Rptr. 715 (1986). The *Shultz* case, like this one, involved an agent that “had utilized approximately 100 different insurers to cover risks for its clients.” *Id.* at 516. The task of evaluating the coverage provided by competing insurers is performed for the insured.

The correspondence upon which Red Oaks’ relies to establish intent was generated in the context of evaluating Sundquist’s insurance needs. When Sundquist’s policies were up for renewal, Brunni-Colbath would advise Sundquist on what kind of insurance to obtain and where to buy it. CP 188-189. This work was done for Sundquist, not MOE. This conclusion is consistent with the general rule that an agent is working for the customer in renewing a policy. See *Dohlin v. Dwelling House Mutual Insurance Co.*, 122 Neb. 47, 238 N.W. 921 (1931) and *Barnett v. State Automobile and Casualty Underwriters*, 26 Utah 2d 169, 487 P.2d 311 (1971).

Even supposing, for the sake of argument, that Brunni-Colbath was MOE’s agent while discussing policy coverage, MOE expressly denied

Brunni-Colbath authority “to waive any provisions, terms or conditions of any policy of insurance” on MOE’s behalf. CP 674. The Agency Agreement, used by Red Oaks to prove that Brunni-Colbath could alter the express terms of Sundquist’s insurance policies proves exactly the opposite; Brunni-Colbath was *prohibited* from doing so. Brunni-Colbath had no authority to change the policies.

This limitation on Brunni-Colbath’s authority comes as no surprise to Sundquist. The policy itself contains an anti-waiver clause. CP 59. The anti-waiver clause in Sundquist’s policy is not just a question of contract law. It is statutory law. RCW 48.18.190. Aside from agency issues, MOE would have had to issue an endorsement to bring about the type of coverage alterations Red Oaks suggests. No “performance bond” endorsement was issued or even exists.

Finally, regardless of Brunni-Colbath’s authority, Sundquist was not entitled to rely on the agent to interpret unambiguous policy exclusions. When faced with similar arguments the Colorado Court of Appeals held the insured was charged with knowledge of the policy language and an agent’s oral representations couldn’t impose liability on the insurer where they contradicted the policy. *Pete’s Satire, Inc. v. Commercial Union Ins. Co.*, 698 P.2d 1388, 1391 (Colo. App. 1985); *Branscum v. American Community Mutual Ins. Co.* 984 P.2d 675, 680

(Colo. App. 1999)(oral misrepresentation contradicting express policy terms not imputed to the insurer – the insured is presumed to know them).

While Colorado authority is not binding on this Court, it accords with the long established law of this State, recognizing the insured's duty to read its policy. *Hein v. Family Life Ins. Co.*, 60 Wn.2d 91, 96, 376 P.2d 152 (1962) (citations omitted).

Sundquist had a copy of the insurance policies now at issue. Sundquist is not entitled to bury its head in the sand and rely exclusively on broad, general statements by Brunni-Colbath that Red Oaks now argues were contrary to the express terms of the policy. The Work exclusion prevents coverage for Red Oaks' claims.

b. The Faulty Workmanship Exclusion Prevents Coverage for Red Oaks' Claims.

The work exclusion standing alone is sufficient to exclude Red Oaks' claim, but there is a second exclusion contained in Sundquist's Umbrella Policy that operates to deny coverage for Red Oaks' claim: the Faulty Workmanship exclusion⁸. 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

⁸ The trial court, erroneously, ruled that the Faulty Workmanship exclusion did not apply to Red Oaks' claims. However, this court may sustain the trial court's ruling on *any* proper basis. *Lamon v. Butler*, 112 Wn.2d 193, 200-201, 770 P.2d 1027 (1989).

necessary by reason of faulty workmanship thereon by or on behalf of the Insured. (CP 87)

Washington case 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 the course of construction, the north wall collapsed in a landslide that was negligently caused by Vandivort. Vandivort tendered the claim to its insurer, which denied coverage based on a “that particular part” exclusion⁹. Vandivort argued that damage to the west side of the structure should be covered, because the slide had 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 Sundquist or its subcontractors provided faulty workmanship was the entire condominium structure.

That point was explored and expanded in *Schwindt, v. Underwriters at Lloyds of London*, 81 Wn. App. 293, 914 P.2d 119 (1996). In *Schwindt*, defects in the workmanship of the general contractor

⁹ The Vandivort policy 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 Sundquist policies, but is not applicable because it addresses only ongoing operations. Sundquist’s operations were completed. This case is cited for its application of the “that particular part” reasoning, which controls the reading of that language in this case.

and its subcontractors resulted in extensive consequential property damage to the building. *Id.* at 295 – 296. Lloyds relied upon the work exclusion, discussed in detail above, when it denied coverage for the claim. That exclusion also contained the “that particular part” language that is crucial to an interpretation of MOE’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 also 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.) Disagreeing, and noting the reluctance of Washington courts “to interpret such general liability policies as a form of performance bond, product liability insurance, or malpractice insurance,” the Court found that “because 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 poor 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 Lloyd’s faulty work exclusion in *Schwindt*. Sundquist was the general contractor, and poor workmanship allowed water to enter and caused other damage. Because the entire condominium structure was “that particular part,” the exclusion prevents coverage for property damage to the entire condominium. The Faulty Workmanship exclusion unambiguously prevents coverage for Sundquist’s liability to the homeowners as a matter of law, and following *Schwindt*, this Court should rule that this damage is excluded.¹⁰

B. Red Oaks’ Bad Faith Claim was Properly Dismissed.

On appeal, Red Oaks makes three arguments that MOE acted in bad faith in the handling of this claim. First, it argues MOE failed to perform a thorough investigation of its claim, second, MOE demonstrated

¹⁰ Red Oaks argued below that “faulty workmanship” really means “negligent construction” and that there were allegedly elements of Red Oaks’ damages resulting from work that Sundquist performed *correctly - free of negligence*. To support that suggestion, it cited the Black’s definition of “fault.” Red Oaks looked up the wrong word in the wrong dictionary. “Undefined terms in an insurance contract must be given their plain, ordinary, and popular meaning. To determine the ordinary meaning of an undefined term, courts look to standard English language dictionaries.” *Boeing v. Aetna*, 113 Wn.2d 869, 877. 784 P.2d 507 (1990). Webster’s Third New International Dictionary (1976) defines “faulty” as follows: “Faulty : marked by a fault : having a fault, blemish, or defect: IMPERFECT, UNSOUND.” Red Oaks’ odd claim is that “construction defects” are outside the exclusion for defective construction; this is nothing more than linguistic chicanery.

greater concern for its own financial interests than those of Sundquist and third, MOE breached its duty to inform Sundquist of all developments relevant to coverage. These unfounded allegations were correctly rejected by the trial court.

Red Oaks asserts that MOE's position is, "that there was no bad faith because coverage for the underlying claims were resolved in its favor." *Appellant's Brief at 10*. Red Oaks misunderstands MOE's arguments. There was no bad faith because Red Oaks' claim was handled properly. But ultimately, the Court should not get to the merits of Red Oaks' bad faith claims, because they represent an affirmative defense that Red Oaks waived.

1. Red Oaks Waived Its "Bad Faith Estoppel" Affirmative Defense And Should Not Be Allowed To Raise It To Re-Establish Coverage.

Based on its bad faith claim Red Oaks seeks to estop MOE from using policy exclusions that prevent coverage. Red Oaks first raised this argument after two MOE Summary Judgments determined there was no coverage under Sundquist's policies. CP 700-702, 898-900, 901-929. Red Oaks' argument fails because it abandoned the estoppel by bad faith claim.

Red Oaks was required to bring its estoppel by bad faith argument as a defense to MOE's Summary Judgment Motions. By failing to do so

Red Oaks waived that affirmative defense. If a party resisting a motion for summary judgment “fails to make a showing sufficient to establish the existence of an element essential to that party’s case, and on which that party will bear the burden of proof at trial’, then the trial court should grant the motion.” *Young v. T. Pharmaceuticals, Inc.*, 112 Wn.2d 216, 225, 770 P.2d 182 (1989). To defend against a Summary Judgment Motion the response must set forth specific facts showing that there is a genuine issue for trial. CR 56(e). This is a significant burden which requires the non-moving party to articulate its arguments with clarity. “[T]here is no ‘onus’ on the district court to distill any possible argument which could be made based on the materials before the court. Presenting such arguments in opposition to a motion for summary judgment is the responsibility of the non-moving party, not the court.” *Pandrol USA, LP v. Airboss Railway Products, Inc.*, 320 F.3d 1354, 1366 (D.C. Cir. 2003) (Citations omitted).

Estoppel is an affirmative defense. CR 8 (c). If the non-moving party can bring an affirmative defense to avoid a summary judgment it must do so or the affirmative defense is waived. *Diversey Lever, Inc. v. Ecolab, Inc.*, 191 F.3d 1350 (D.C. Cir. 1999). *Diversey* was a patent infringement case. The district court held that Ecolab’s failure to raise an affirmative defense of estoppel to oppose Diversey Lever’s summary

judgment motion caused its waiver by abandonment. On appeal to the D.C. Circuit Court of Appeals, Ecolab argued under the three separate categories of defenses in the patent law that because Diversey's motion was based on an issue of "liability" under the statute and, because equitable estoppel was classified as an "unenforceability" defense, it was not required to raise the defense to resist the Summary Judgment Motion. The court disagreed stating "however, regardless of its classification under §282, an affirmative defense must be raised in response to a summary judgment motion, or it is waived." *Diversey*, 191 F.3d at 1353 (Citations omitted). Also Cf. e.g., *First State Ins. Co. v. Kemper Nat'l Ins. Co.*, 94 Wn. App. 602, 614, 971 P.2d 953 (1999) (Affirmative defenses waived unless timely pleaded, asserted in a CR 12 Motion, or tried with consent). The rule is required to produce finality of judgments and avoid unnecessary trials when no genuine issue of material fact exists. Cf., *Young v. T. Pharmaceuticals, Inc.*, 112 Wn. 2d at 226. Red Oaks waived its bad faith defense.

2. MOE Did Not Act In Bad Faith.

Even if the Court considers Red Oaks' bad faith - estoppel arguments, they fail as a matter of law. In order to understand the context of Red Oaks' bad faith claims, it is necessary to consider the nature of a reservation of rights defense. Claims on liability insurance policies

usually begin when the insured gives notice to its insurer that it has been sued. When the insured tenders the claim to the insurance company, the insurer can respond in one of three ways: first, if it determines that there is coverage for the claim, it can accept the claim without reservation and hire lawyers to defend the insured; second, if the insurer determines that there is no coverage, it can deny the tender and leave the insured to defend its own interests; finally, if the insurer determines that coverage turns on undetermined facts or debatable questions of law, it can alert the insured that there are serious coverage limitations, but accept the tender of the defense while reserving its rights to decline coverage should the facts or the law ultimately be resolved against the insured.

If the insurer defends under a reservation of rights, a conflict of interest can naturally arise between the insurer and the insured as to how the defense should be conducted. The insured's raw financial self-interest will always be to maximize coverage, without regard to the size of the judgment the insurer could ultimately bear. Conversely, the insurer may wish to resist expansive coverage demands. Therefore, when an insurer defends under a reservation of rights, courts have held that the insurer must make the insured aware of its position on coverage and provide the insured with an attorney whose sole accountability is to the insured. That way, the insured can make informed decisions regarding its own defense.

Tank v. State Farm Fire & Casualty Co., 105 Wn.2d 381, 388-389, 715 P.2d 1133 (1986). Courts have termed the insurer's obligation of fairness in the reserved rights context the "enhanced obligation of good faith." *Id.* at 387-388.

Nevertheless courts have made it clear that they have no intention of encouraging insurers to deny coverage rather than defend subject to a reservation. *Id.* at 391. In Washington, "A reservation of rights is a means by which the insurer avoids breaching its duty to defend while seeking to avoid waiver and estoppel. When that course of action is taken, the insured receives the defense promised and, if coverage is found not to exist, the insurer will not be obligated to pay." *Truck Ins. Exch. v. Vanport Homes, Inc.*, 147 Wn.2d 751, 761, 58 P.3d 276 (2003) (citations omitted). The *Tank* enhanced obligation of good faith requires the insurer to provide the insured with a fair defense, but does not require any concession regarding any duty to pay. "In a reservation-of-rights setting, an insured's sole entitlement is to a fair and coverage-neutral defense. . . . [A]n insured does not have a right to force the insurer to waive its legitimate right to litigate coverage issues." Thomas V. Harris, *Washington Insurance Law* § 17-1 (2003).

i. MOE Thoroughly Investigated Sundquist's Claim.

Red Oaks also claims that MOE failed to investigate its claim against Sundquist. This claim is exceedingly unusual in that Red Oaks does not suggest that MOE failed to have a full and complete apprehension of the factual basis for Red Oaks claims. Instead, Red Oaks asserts that MOE failed to “investigate” the legal issues related to its coverage defenses by *actually obtaining an order*, presumably from a court of last resort, that there was no coverage prior to a *pre-lawsuit* mediation between Red Oaks and Sundquist.

Contrary to Red Oaks position, an insurer often has an obligation, not just a right, to wait for a resolution of the underlying action prior to even filing the coverage lawsuit, because “it would be inappropriate for an insurer to use the declaratory judgment process to litigate issues that might establish its insured’s tort liability.” *Thomas V. Harris, Washington Insurance Law* § 14-2 (2003). That concern would have been particularly acute in this case, where MOE would have had to prove that Sundquist’s workmanship was faulty prior to such a determination in the underlying case. Had MOE prevailed, Sundquist would have been left both without coverage, and collaterally estopped to deny liability to Red Oaks.

Washington may or may not recognize an obligation to wait for a resolution of the underlying case, but it has certainly noted that doing so is

appropriate. *Associated Indem. Corp. v. Wachsmith*, 2 Wn.2d 679, 99 P.2d 420(1940). See also *Western Nat. Assurance Co. v. Hecker*, 43 Wn. App. 816, 821 at n.1, 719 P.2d 954 (1986) (Noting that it can be appropriate to stay a declaratory judgment to avoid this problem). Also, the recent case of *Alaska Nat'l Ins. Co. v. Bryan*, 125 Wn. App. 24, 35, 104 P.3d 1 (2004), citing both Washington and Alaska law, held that an insurer has no obligation to resolve coverage issues within the underlying action, and has the right to file a declaratory judgment action to establish that there was no coverage without risk of bad faith. MOE's obligation to investigate the claim against its insured did not include obtaining a judgment on the coverage issues prior to its insured's pre-trial negotiations with Red Oaks. The trial court correctly dismissed this bad faith claim.

ii. MOE Properly Weighed Sundquist's Interests.

Red Oaks alleges that MOE acted in bad faith by putting its own financial interests ahead of Sundquist's. The *only* factual basis for that claim is that MOE did not pay Red Oaks to settle its claim against Sundquist. Red Oaks' remarkable argument is that any time an insurance company defends under a reservation of rights, it has a "duty to settle" the claim regardless of whether there is coverage, if doing so would be in the insured's best financial interest. Red Oaks misunderstands the insurer's duties in a reservation of rights scenario. The fact that MOE did not pay

to settle Red Oaks claims, based on a well founded belief of non-coverage, does not amount to a failure to properly consider the financial interests of its insured.

Several cases in Washington have noted that an insurer has a duty to give equal consideration to the insured's interests in "all matters." e.g., *Tank*, 105 Wn.2d at 386. The Court can be certain, however, that the duty to give equal consideration to the insured's interests in "all matters" does *not* prohibit an insurer from defending under a reservation of rights, even though the insured may face liability for uncovered claims. Providing such a defense when there are legitimate coverage disputes is actively encouraged in our caselaw. *Tank*, 105 Wn.2d at 390. Similarly, it does not prohibit an insurer from creating an actively adversarial relationship with its insured by bringing a declaratory judgment action, even *subsequently* to the resolution of the underlying lawsuit. *Associated Indem. Co. v. Wachsmith*, 2 Wn. 2d 679, 685, 99 P.2d 420 (1940); see, *Alaska Natnl Ins. Co. v. Bryan*, 125 Wn. App. 24, 104 P.3d 1 (2004) (Declaratory Judgment action continued after underlying action resolved). MOE's position that it was entitled to a judicial declaration of coverage before it paid a claim based on a well founded coverage defense, is entirely consistent with Washington law, and did not violate its duty to consider the insured's interests.

Red Oaks is correct that under certain circumstances, an insurer can have a duty to settle a claim on behalf of its insured. An uncomfortable situation can arise when an insured is facing a potential for liability above its policy limits. The insurer has absolutely no incentive to accept a policy limits settlement offer if there is a chance of a defense verdict. But the insured has a tremendous interest in not facing an excess (non-covered) judgment. It is in this sort of situation that courts have imposed upon insurers a “duty to settle”, whereby the insurer must decide whether to accept a settlement offer under a “no limits” scenario. The insurer must imagine that it would be responsible for any excess (above policy limits) judgment when it makes its settlement decision. If the insurer fails to take advantage of an otherwise reasonable settlement opportunity **within policy limits**, and the ultimate judgment is greater than policy limits, courts will scrutinize the insurer’s motivation; if the insurer made its decision in bad faith, then it will be liable for the excess judgment. *Hamilton v. State Farm Ins. Co.*, 83 Wn.2d 787, 523 P.2d 193 (1974).

A primary reason why Red Oaks’ “duty to settle” claim fails is that there is no duty for an insurance company to settle claims for which there is no coverage. It seems tautological that where an insured had no coverage for a claim, the insurer has no obligation to actually *indemnify*

the insured for that loss. Washington law, unsurprisingly, supports the proposition that an insurer only has an obligation to pay for claims *actually covered* by the policy. *James E. Torina Fine Homes, Inc. v. Mut. of Enumclaw Ins. Co.*, 118 Wn. App. 12, 18, 74 P.3d 648 (2003). (citing *Hayden v. Mutual of Enumclaw Ins. Co.*, 141 Wn.2d 55, 1 P.3d 1167 (2000) for the identical proposition). The courts in California have specifically applied this principle to an alleged duty to settle. “Finally, we cannot accept defendant's complaint that [this] rule requires an insurer to settle in all cases irrespective of whether the policy provides coverage. **Clearly, if defendant's belief that the policy did not provide coverage in the instant case had been vindicated, it would not be liable for damages flowing from its refusal to settle;** all that [this rule] establishes is that an insurer who fails to settle does so ‘at its own risk.’” *Johansen v. California State Auto Assn. Inter-Ins. Bureau*, 15 Cal 3d 9, 19, 538 P.2d 744 (1975) (emphasis added). That risk, of course, is that the insurer will be liable for a judgment in excess of policy limits, should one be entered against the insured. No case in any jurisdiction has held that an insurer has a duty to indemnify an insured by funding a settlement when there is a failure of coverage under the policy.

An additional impediment to Red Oaks’ claim that MOE breached a duty to settle is that, in the context of a reservation of rights defense, it is the *insured*, not the insurer, who must decide whether to settle. In the case of *Tank v. State Farm Fire & Cas. Co.*, 105 Wn.2d 381, 715 P.2d 1133

(1986), the insured made the same argument that State Farm had a duty to have settled his case. The court rejected that argument, because the insured was fully informed that State Farm was disputing coverage, and the insured was required to make settlement decisions. *Id. at* 389. In this case, Sundquist and its lawyer, Jeff Frank, were the conduit through which all “settlement activity” was transmitted to MOE. CP 942, p. 37 l. 10 – p. 38 l.19. Sundquist was, beyond a doubt “fully informed.” Sundquist apparently understood that it had this right, in light of the fact that Sundquist exercised it.

For all of these reasons, the Court should rule that MOE did not breach the duty to consider Sundquist’s interests, and affirm the trial court’s dismissal of Red Oaks’ bad faith claim.

iii. MOE Properly Provided Sundquist A Defense Subject To A Reservation Of Its Right To Deny Coverage Based On Policy Exclusions. Sundquist Was Fully Apprised Of MOE’s Position.

Sundquist and its cadre of sophisticated coverage and defense attorneys were fully informed that MOE was disputing its alleged obligation to indemnify and reserving its rights on the Red Oaks claim at all times relevant to this lawsuit¹¹. Red Oaks argues that MOE failed to

¹¹ Red Oaks asks this Court to rule that MOE had a duty not only to keep its insured apprised of coverage developments, but that MOE had the same duty to *Red Oaks* the claimant. Red Oaks may complain that it did not know what it was getting when it traded its lawsuit for Sundquist’s insurance claim, but it would be difficult to blame the insurer

“inform Sundquist of all developments relevant to coverage,” but what Red Oaks *means* is that because MOE provided Sundquist with a defense, the insurer was obligated to indemnify, regardless of its reservation of rights. This is an incorrect view of the law.

MOE provided Sundquist with legal counsel months *before* the lawsuit was filed. Before Sundquist sought MOE’s approval to enter into the Mediation Agreement, MOE had already told Sundquist that there was no coverage for property damage to its own “work” (specifically in the identical context of condominiums) in the Barrington reservation of rights.

In November of 2003, MOE again reserved its rights to deny coverage under the policy, this time specifically with respect to Red Oaks, citing the same exclusions relied upon in the Barrington claim. CP 44-49. *Appellant’s Brief, Appendix B.* Red Oaks’ suggestion, reiterated several times, that MOE withheld notice that it was relying on the work exclusion in the Umbrella is not only wrong, it is incomprehensible given Red Oaks’ verbatim quotation from the reservation of rights that the policy would not pay for damage to Sundquist’s “work or products,” citing the very policy

for that. In any event, only the insured has direct cause of action for bad faith. *Tank* 105 Wn. 2d at 394.

provisions in the base policy and the Umbrella on which MOE has relied all along¹². *Appellant's Brief* at 37.

Red Oaks appears to think MOE, after it had reserved its rights, secretly determined that there was no coverage, and failed to inform Sundquist. In fact, as the reservation of rights letter demonstrates, MOE has been entirely consistent in its belief that there is *no coverage* under either policy for damage to Sundquist's work or products. MOE told Sundquist in the reservation that there could be coverage for damage to property other than Sundquist's work or products. CP 46-47. It is important to keep in mind that Red Oaks had not filed a Complaint against Sundquist, and no one knew if there ultimately would be allegations of damage to property other than the buildings¹³. In addition, while MOE strongly believes its arguments regarding the policy exclusions have been correct, it was entitled to a judicial resolution of those issues. Although MOE did not bet Sundquist's defense of Red Oaks' claims on the outcome

¹² Red Oaks also makes the irresponsible rhetorical assertion that "When Enumclaw failed to have the case dismissed under the "your product" and "cost of repair" exclusions identified in its reservation of rights letter, Enumclaw examined the umbrella policy for the first time to find other language that might defeat coverage." *Appellant's Brief* at 9. Of course there is no citation because it simply is not true. The reservation of rights letter itself is proof positive that MOE was familiar with, and relying upon, the Umbrella work exclusion from the beginning.

¹³ The duty to defend is broader than the duty to indemnify, and is triggered when a Complaint against the insured is filed that alleges covered liability. *Truck Ins. Exch. v. VanPort Homes, Inc.*, 147 Wn.2d 751, 760, 58 P.3d 276 (2002).

of those issues, it has been upfront with Sundquist about its position on coverage.

Red Oaks complains that the trial court's resolution of the *Archer* case was a "development" of which MOE was required to apprise Sundquist. Aside from the fact that a trial court's decision is not authority for the purpose of any other case, the resolution of *Archer* is perfectly consonant with the position that MOE took in its reservation of rights. An insurer has no obligation to inform its insured that a trial court in another case has confirmed the legal basis for its position. Red Oaks cites no authority to the contrary.

Red Oaks says MOE was required to deny Sundquist's claim because MOE believed most or all of it was outside of policy coverage. Red Oaks' position boils down to the assertion that an insurer with a well founded belief there is no coverage for a claim cannot provide a defense without waiving its coverage defenses. But that is *exactly* the point of a reservation of rights defense, the concept of which has been endorsed repeatedly by Washington courts as a valuable service to the insured. *Vanport Homes*, 147 Wn. 2d at 761; *Tank*, 105 Wn. 2d at 390. This Court

should not deprive Mutual of Enumclaw of the right to provide a defense under a reservation¹⁴.

C. MOE Did Not Violation The WAC.

Red Oaks cites a laundry list of WAC provisions that MOE allegedly violated, but it only addressed two with any kind of application to the facts of the case. Those two are:

WAC 284-30-330(13): Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

And:

WAC 284-30-380(1): Within fifteen working days after receipt by the insurer of properly executed proofs of loss, the first party claimant shall be advised of the acceptance or denial of the claim by the insurer. No insurer shall deny a claim on the grounds of a specific policy provision, condition, or exclusion unless reference to such provision, condition, or exclusion is included in the denial. The denial must be given to the claimant in writing and the claim file of the insurer shall contain a copy of the denial.

¹⁴ Incidentally, Red Oaks also asserts that “The record shows that Michlitsch testified he suspected on October 29, 2003 that Enumclaw did not intend to provide any settlement authority for Red Oaks’ claims, but this was not communicated to Sundquist or its attorney Jeff Frank until March 1, 2004. CP 1174-75.” Red Oaks is wrong. Their citation is to Mr. Frank’s deposition, where he testified that Mr. Michlitsch told him on October 29 that MOE did not intend to provide indemnity for the Barrington claim, but that he does not remember if the Red Oaks claim was discussed. CP 1169, l. 14-22. CP 1170, l. 1. - CP 1171, l. 13. Mr. Michlitsch, however, testified that he *did* tell Mr. Frank at that meeting that MOE did not intend to indemnify Sundquist for the Red Oaks claim. CP 938, p. 20 l. 17 – p. 22 l. 12. This testimony is unchallenged. More importantly, as noted above, MOE had consistently taken the position that there was no coverage for damage to Sundquist’s work or product at Red Oaks, and MOE had no duty to constantly reiterate its position on that issue. (Note there is confusion whether the meeting was on the 28th or 29th).

With respect to 330(13), Red Oaks argues this provision creates an obligation to investigate and resolve the coverage issues, in a declaratory judgment action, and not only disclose the ultimate coverage resolution to Sundquist before mediation, but to actually agree to pay or deny coverage before the mediation occurred. *Appellant's Brief* at 34, 35, and 37. There are at least three reasons why 330(13) has no application to this case.

First, MOE did not deny coverage; it accepted the tender under a reservation of rights. The regulation requires an insurer to explain the basis for an offer to compromise a coverage dispute or a decision to deny coverage. WAC 284-30-330(13). As a result of having reserved rights there was neither an offer of compromise nor a denial of coverage to explain.

Second, even though the regulation does not apply to this circumstance, MOE *did* explain its coverage position to Sundquist in some detail in the letters reserving its rights. CP 44-49, 1119-1121.

Third, Red Oaks' argument that MOE had the immediate obligation to resolve its ultimate coverage position, through a declaratory judgment if necessary, is not only contrary to the purpose of reserving rights it is contrary to other Washington authority, it is impractical, and often not even possible. This issue was addressed in some detail above at pages 36 and 37.

With respect to 380(1), a primary observation is that it applies only to first party claims. Red Oaks attempted to fix this problem by omitting the first sentence of the section. *Appellant's Brief* at 44. Furthermore, and once again, MOE did not deny Sundquist's claim. But MOE did tell Sundquist exactly why it intended to challenge coverage, including its reliance on the work exclusion. 380(1) is of no application to this case, and this Court should affirm the trial court's dismissal.

D. Red Oaks Waived Its "Scattergun" WAC Claims By Not Arguing Them.

Red Oaks argued that MOE committed multiple per se Consumer Protection violations in its dealings with Sundquist. It provided no analysis to explain the legal basis for the majority of these claims or how MOE's actions violated the insurance regulations, requiring both the Court and MOE to speculate about the nature of the supposed violations. For example, "Red Oaks asserts the conduct described above and other instances summarized at CP 1311-1315 violated the minimum standards for insurers set forth at WAC 284-30-330." *Appellant's Brief* at 42. That regulation contains nineteen individual requirements.

Red Oaks' failure to explain and argue its theory for the Consumer Protection claims constitutes a waiver of these claims. If the Court were to entertain these claims it would be required to speculate about their basis

and nature. “As the 11th Circuit has observed, there is no ‘onus’ on the district court to distill any possible argument which could be made based on the materials before the Court. Presenting such arguments in opposition to a Motion for Summary Judgment is the responsibility of the non-moving party, not the Court.” *Pandrol USA, LP v. Air Boss Ry Prods.*, 320 F. 3d 1354, 1366 (DC Cir. 2003) (citations omitted). MOE is similarly left in an awkward position if it must guess the nature of the argument and then rebut it. Red Oaks failure to argue these provisions amounts to waiver.

E. Red Oaks Lacks Standing To Bring CPA Claims.

Red Oaks casually states it has standing to bring assigned per se CPA claims against MOE because it “stands in the shoes” of Sundquist as its assignee¹⁵. Appellant’s Brief at 47. However, this issue is not resolved in Washington. *Cf. Pain Diagnostics and Rehabilitation Assoc., v. Brockman*, 97 Wn. App. 691, 699-700, 988 P.2d 972 (1999) (valid assignments encompassing the right to bring CPA claim *assumed arguendo* only).

It is well established that per se CPA claims can only be brought by an insured. *Tank v. State Farm*, 105 Wn. 2d at 394. At least one

¹⁵ MOE did not raise the standing issue below. Standing, however, is a jurisdictional issue which may be raised for the first time on appeal. *Int’l Ass’n of Firefighters, Local 1789 v. Spokane Airports*, 146 Wn.2d 207, 45 P.3d 186 (2002).

Washington case appears to hold the right to bring per se CPA claims against an insurer cannot be conferred by assignment. *Kagel v. Aetna*, 40 Wn. App. 194, 197-199, 698 P.2d 90 (1985). Not even a subrogee can bring a per se CPA claim against an insurer without demonstrating a special relationship. Division I of the Court of Appeals permitted a subrogated excess insurer to bring per se CPA claims against a primary carrier only after finding the primary carrier owed both its insured and the excess carrier identical duties and further after finding the excess carrier was a proper “intermediary” representing its damaged premium paying customers. Because it represented damaged policyholders and was owed a direct duty by the primary carrier in addition to being subrogated, the excess carrier was a proper private attorney general to bring the claims. *First State Ins. Co. v. Kemper Nat’l Ins. Co.*, 94 Wn. App. 602, 609-611, 971 P.2d 953 (1999). These additional findings were necessary despite the analogy between a subrogated right and an assigned right.

Despite these standing issues, Red Oaks has made no effort to describe why it should have standing to bring these claims. Unlike First State, it is not an intermediary representing premium paying policyholders. See, *First State Ins. Co.*, 94 Wn. App. at 610, and *Washington State Physicians Ins. Exch. v. Fisons Corp.*, 122 Wn. 2d 299, 313, 858 P.2d 1054 (1993). Whatever duties MOE may have owed to

Sundquist, it did not owe them directly to Red Oaks. *Tank*, 105 Wn. 2d at 394-395. As a result, Red Oaks is not eligible to bring Sundquist's CPA claims.

F. Red Oaks Is Not Entitled To Attorney Fees.

Because there is no coverage under the Sundquist policies, Red Oaks is not entitled to attorney fees under *Olympic Steamship*. Because MOE is not guilty of bad faith, Red Oaks is not entitled to attorney fees under the CPA.

G. Conclusion.

For all of the foregoing reasons, MOE respectfully requests that this Court affirm the judgment of the trial court dismissing Red Oaks' Complaint with prejudice.

Respectfully submitted this 10th day of March, 2006.

HACKETT, BEECHER & HART



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THE COURT OF APPEALS,
DIVISION I, AT SEATTLE

RED OAKS CONDOMINIUM
OWNERS ASSOCIATION

No.: 56591-5-1

Appellant,

CERTIFICATE OF
SERVICE

v.

MUTUAL OF ENUMCLAW
INSURANCE COMPANY,

Respondent.

I, Linda Voss, declare that on the date noted below I caused to be delivered via Facsimile and ABC Legal Messengers, Inc., a copy of Brief of Respondent to: Ken Harer, Condominium Law Group, 10310 Aurora Avenue N., Seattle, WA 98133.

I Certify Under Penalty Of Perjury Under The Laws Of The State Of Washington That The Foregoing Is True And Correct. (RCW 9A.72.085)

Signed in Seattle, WA this 10th day of March, 2006.



Linda Voss
Hackett, Beecher & Hart

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