

Court of Appeals Case No. 64291-0

Case No. 86109-9

SUPREME COURT OF THE STATE OF WASHINGTON

JAMES BIRD,

Respondent,

v.

BEST PLUMBING GROUP, LLC,

Respondent,

v.

FARMERS INSURANCE EXCHANGE,

Appellant.

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STATE OF WASHINGTON
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CLIENT

RESPONDENT JAMES BIRD'S RESPONSE TO BRIEFS OF AMICI

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Table of Contents

INTRODUCTION 1

I. THE ISSUE OF WHETHER FARMERS WAS ENTITLED TO A JURY TRIAL AT THE REASONABLENESS HEARING CALLS FOR A STRAIGHTFORWARD ANALYSIS..... 1

II. THE CLOSEST ANALOGS FROM THE TIME OF STATEHOOD SUPPORT MR. BIRD, NOT FARMERS..... 3

III. THE COVENANT JUDGMENT PROCESS, INCLUDING THE USE OF A REASONABLENESS HEARING, IS FIRMLY ESTABLISHED BY LAW AND SUPPORTED BY PUBLIC POLICY..... 5

IV. THE FACT THAT THE RESULT OF A NONJURY PROCEEDING BARS RELITIGATION OF AN ISSUE IN A LATER JURY CASE DOES NOT OFFEND THE CONSTITUTION..... 12

V. *UNIGARD* LENDS FARMERS NO SUPPORT IN THIS CASE. 13

CONCLUSION..... 15

Table of Authorities

Cases

| | |
|--|--------------|
| <i>Besel v. Viking Insurance Co.</i> , 146 Wn.2d 730, 49 P.3d 887 (2002)..... | 6, 8, 11, 14 |
| <i>Brandon v. Webb</i> , 23 Wn.2d 155, 160 P.2d 529 (1945)..... | 10 |
| <i>Brown v. Safeway Stores, Inc.</i> , 94 Wn.2d 359, 617 P.2d 704 (1980)..... | 2 |
| <i>Chaussee v. Maryland Casualty Co.</i> , 60 Wn. App. 504, 803 P.2d 1339 (1991)..... | 6, 7, 15 |
| <i>Crown Controls, Inc. v. Smiley</i> , 110 Wn.2d 695, 756 P.2d 717 (1988)..... | 6 |
| <i>Dean v. Willamette Bridge Co.</i> , 29 P. 440 (Or. 1892) | 3 |
| <i>Evans v. Continental Cas. Co.</i> , 40 Wn.2d 614, 245 P.2d 470 (1952)..... | 5, 7, 14 |
| <i>Firchau v. Gaskill</i> , 88 Wn.2d 109, 558 P.2d 194 (1977)..... | 2 |
| <i>Glover v. Tacoma General Hospital</i> , 98 Wn.2d 708, 658 P.2d 1230 (1983)..... | 6, 10 |
| <i>Johanson v. United Truck Lines</i> , 62 Wn.2d 437, 383 P.2d 512 (1963)..... | 3 |
| <i>Madison v. Madison</i> , 1 Wash. Terr. 60 (1858)..... | 3 |
| <i>Meadow Valley Owners Ass'n v. St. Paul Fire & Marine Ins. Co.</i> , 137 Wn. App. 810, 156 P.3d 240 (2007)..... | 5 |
| <i>Mutual of Enumclaw Insurance Co. v. T&G Construction, Inc.</i> , 165 Wn.2d 255, 199 P.3d 376 (2008)..... | 6, 14 |

| | |
|--|----------------|
| <i>Nielson v. Spanaway General Medical Clinic, Inc.</i> , 135 Wn.2d 255, 956 P.2d 312 (1998)..... | 13 |
| <i>Parklane Hosiery Co. v. Shore</i> , 439 U.S. 322, 99 S. Ct. 645, 58 L. Ed. 2d 552 (1979)..... | 13 |
| <i>Safeco Ins. Co. v. Butler</i> , 118 Wn.2d 383, 823 P.2d 499 (1992)..... | 5, 6, 7, 8, 10 |
| <i>Schmidt v. Cornerstone Investments, Inc.</i> , 115 Wn.2d 148, 795 P.2d 1143 (1990)..... | 2, 10, 15 |
| <i>Tank v. State Farm Fire & Cas. Co.</i> , 105 Wn.2d 381, 715 P.2d 1133 (1986)..... | 8, 9, 10 |
| <i>Truck Ins. Exch. v. VanPort Homes, Inc.</i> , 147 Wn.2d 751, 58 P.3d 276 (2002)..... | 7 |
| <i>Unigard Insurance Co. v. Mutual of Enumclaw Insurance Co.</i> , 160 Wn. App. 912, 250 P.3d 121 (2011)..... | 13, 14, 15 |
| <i>Water's Edge Homeowners Ass'n v. Water's Edge Assocs.</i> , 152 Wn. App. 572, 216 P.3d 1110 (2009)..... | 11 |

Constitutional and Current Statutory Provisions

| | |
|--|----------|
| Article 1, Section 21 of the Washington Constitution | 2, 12 |
| RCW 4.22.060 | 5, 9, 10 |

Other Authorities

| | |
|----------------------------------|---|
| 1881 Territorial Code § 293..... | 4 |
| 1881 Territorial Code § 296..... | 4 |
| 1881 Territorial Code § 297..... | 4 |
| SPR Rule 98.16W | 2 |

INTRODUCTION

Respondent James Bird submits this response to the three briefs filed by amici curiae. For simplicity, this response refers to amicus Washington State Association for Justice Foundation as the WSAJ Foundation; refers to amicus Federation of Defense and Corporate Counsel as the Federation; and refers collectively to amici National Association of Mutual Insurance Companies, American Insurance Association, and Property Casualty Insurers Association of America as the Insurance Industry amici. Mr. Bird has already briefed the issues extensively, addressing most of the arguments made by the amici who support Farmers. In this response, he highlights the key reasons this Court should reject those amici's conclusions that Farmers had a right to a jury determination at the reasonableness hearing. Mr. Bird also registers his general agreement with the WSAJ Foundation, whose brief frames the discussion in a different, but nonetheless helpful, manner.

I. THE ISSUE OF WHETHER FARMERS WAS ENTITLED TO A JURY TRIAL AT THE REASONABLENESS HEARING CALLS FOR A STRAIGHTFORWARD ANALYSIS.

This is not an appeal from a money judgment against Farmers but an appeal from the determination that the settlement between Mr. Bird and Best Plumbing was reasonable. The issue is whether any party was entitled

to a jury at that hearing. The analytical framework is simple. Article 1, section 21 of the Washington Constitution grants a right to a jury trial to the extent it existed at the time of the adoption of the constitution. *Firchau v. Gaskill*, 88 Wn.2d 109, 114, 558 P.2d 194 (1977). When the Washington Constitution was adopted, the right to a jury trial extended to legal, not equitable, proceedings. *Brown v. Safeway Stores, Inc.*, 94 Wn.2d 359, 365, 617 P.2d 704 (1980). There are several scenarios in which courts are called upon to evaluate the terms of a settlement. In each of those scenarios, the law calls for an ancillary proceeding in which a judge, not a jury, determines the outcome. *See, e.g., Schmidt v. Cornerstone Investments, Inc.*, 115 Wn.2d 148, 159–61, 795 P.2d 1143 (1990) (joint and several liability); CR 23(e) (class actions); SPR 98.16W (minors and incapacitated persons). *Schmidt* unanimously holds, in broad terms, that “the right to jury trial does not extend to procedures in equity, such as whether the amount of a proposed settlement is reasonable. Such questions are properly within the province of the trial court to decide.” 115 Wn.2d at 161. Although Farmers and the amici who support it attempt to distinguish *Schmidt*, Mr. Bird has previously explained that there is no difference, that is material to the issue before this Court, between *Schmidt*’s joint-and-several-liability setting and the covenant judgment process in this case. *See, e.g.,* Respondent’s Br. at 36–37.

II. THE CLOSEST ANALOGS FROM THE TIME OF STATEHOOD SUPPORT MR. BIRD, NOT FARMERS.

The Federation argues that tort and contract claims called for jury trials at the time the Washington Constitution was adopted. Federation's Br. at 8. But no tort or contract claim has been tried against Farmers. Parties to a litigation had the ability to waive their right to a jury long before the Constitution was adopted, which is exactly what Mr. Bird and Best Plumbing did when they settled. *E.g., Madison v. Madison*, 1 Wash. Terr. 60, 61 (1858). And although the covenant judgment procedure had not yet been created, there are two analogs that underscore the non-jury nature of a reasonableness hearing.

The Foundation draws an analogy to default cases, Foundation's Br. at 7–10, where this Court has held that there is no right for a jury determination of damages after the entry of default because the action stands "confessed." *Johanson v. United Truck Lines*, 62 Wn.2d 437, 444–45, 383 P.2d 512 (1963) (quoting *Dean v. Willamette Bridge Co.*, 29 P. 440 (Or. 1892)). Mr. Bird notes that another analog is found in the 1881 Territorial Code, which allowed parties to a civil action for contract damages to resolve a case through a confessed judgment. The parties were required to submit a verified statement to the trial court as follows:

SEC. 296. A statement in writing shall be made, signed by the defendant and verified by his oath, to the following effect:

1. It shall authorize the entry of judgment for a specified sum.

2. If it be for money due or to become due, it shall state concisely the facts out of which the indebtedness arose, and shall show that the sum confessed to be due, is justly due or to become due.

3. If it be for the purpose of securing the plaintiff against a contingent liability, it shall state concisely the facts constituting the liability, and show that the sum confessed therefor does not exceed the same.

1881 Territorial Code § 296. This statement would then be presented to a **judge** for approval:

SEC. 297. The statement must be presented to the district court or a judge thereof, and if the same be found sufficient, the court or judge shall endorse thereon an order that judgment be entered by the clerk; whereupon it may be filed in the office of the clerk, who shall enter a judgment for the amount confessed, with costs. Execution may be issued and enforced thereon in the same manner as upon judgments in other cases.

Id. § 297. A judicially approved confessed judgment would then bind the settling parties as well as nonsettling, jointly liable defendants to the extent of “their joint property and against the joint and separate property of the defendant making the confession.” *Id.* § 293.

Like the default and confession-of-judgment scenarios, the covenant judgment process involves an action that stands “confessed” by

its parties. Mr. Bird believes these procedures calling for judicial evaluation of the judgments to be entered are the closest historical antecedents to modern reasonableness hearings.

III. THE COVENANT JUDGMENT PROCESS, INCLUDING THE USE OF A REASONABLENESS HEARING, IS FIRMLY ESTABLISHED BY LAW AND SUPPORTED BY PUBLIC POLICY.

Up until this point, the court of appeals, the superior court, and the parties were all bound by court of appeals precedent holding that RCW 4.22.060 applies to a hearing evaluating the reasonableness of a covenant judgment. *Meadow Valley Owners Ass'n v. St. Paul Fire & Marine Ins. Co.*, 137 Wn. App. 810, 818, 156 P.3d 240 (2007). This is reflected, for example, in Mr. Bird's brief in the court of appeals. As amici observe, however, this Court has never held that the statute itself governs such reasonableness hearings (although, as discussed below, the Court has held that reasonableness hearings are appropriate and that the same reasonableness test applies). *E.g.*, Federation's Br. at 7. Needless to say, this Court is not bound to follow a holding of the court of appeals.

The Supreme Court has long held that a reasonable settlement serves as the measure of damages in a bad-faith case, *Evans v. Continental Cas. Co.*, 40 Wn.2d 614, 628, 245 P.2d 470 (1952), and this includes covenant judgments, *Safeco Ins. Co. v. Butler*, 118 Wn.2d 383, 397, 823

P.2d 499 (1992). In *Besel v. Viking Insurance Co.*, 146 Wn.2d 730, 738–39, 49 P.3d 887 (2002), this Court unanimously authorized the use of reasonableness hearings to evaluate covenant judgments and borrowed the judicially created standard for determining reasonableness from its decision in *Glover v. Tacoma General Hospital*, 98 Wn.2d 708, 717–18, 658 P.2d 1230 (1983),¹ and the court of appeals’ decision in *Chaussee v. Maryland Casualty Co.*, 60 Wn. App. 504, 512, 803 P.2d 1339 (1991). In *Besel*, the Court was explicit in adopting the reasonableness-hearing procedure: “[T]he *Chaussee* criteria protect insurers from excessive judgments especially where, as here, the insurer has notice of **the reasonableness hearing** and has an opportunity to argue against the settlement’s reasonableness.” *Besel*, 146 Wn.2d at 739 (emphasis added). The Court repeated the same rule, again unanimously, four years ago. In *Mutual of Enumclaw Insurance Co. v. T&G Construction, Inc.*, 165 Wn.2d 255, 264, 267, 199 P.3d 376 (2008), the Court noted, “[i]n *Besel*, we approved the procedure,” and the Court recognized that a covenant judgment “judged reasonable by a judge” serves as “the presumptive damage award for purposes of coverage.”

¹ Overruled on other grounds by *Crown Controls, Inc. v. Smiley*, 110 Wn.2d 695, 756 P.2d 717 (1988).

Insurance Industry amici argue that the “authority and reasons for using this method for determining the amount of damages in an insurance bad faith action have become obscured over time.” Insurance Industry Amici’s Br. at 1. This is simply incorrect. The authority supporting the covenant judgment process includes such pathmarking cases as *Evans*, *Butler*, and *Besel*—cases from which this Court has never retreated. The reason for the process is that an insurer who acts in bad faith in either failing to defend or failing to settle a claim exposes the insured to a potentially devastating excess judgment. As a matter of public policy, an insured placed in that position ought not be “required to wait until after the storm before seeking refuge.” *Evans*, 40 Wn.2d at 629 (quotation omitted); see also *Truck Ins. Exch. v. VanPort Homes, Inc.*, 147 Wn.2d 751, 765, 58 P.3d 276 (2002) (“An insurer faced with claims exceeding its policy limits should not be permitted to do nothing in the hope that the insured will go out of business and the claims simply go away.”).²

A masterwork of judicial craftsmanship, the covenant judgment procedure carefully balances competing interests. The trial judge holds a hearing in which the settling parties have the burden of proving reasonableness. *Chaussee*, 60 Wn. App. at 512. The judge carefully

² Insurance Industry amici, while arguing that the authority and reasons for the covenant judgment process are obscure, notably fail to cite either *Evans* or *Butler*.

applies a substantive test of reasonableness that protects insurers from excessive settlements and the risk of fraud and collusion. *Besel*, 146 Wn.2d at 738. The plaintiff then brings a separate action against the insurer where the amount of the covenant judgment serves as the presumptive measure of harm, but only if the plaintiff proves liability against the insurer in a jury trial. The plaintiff gets nothing if he cannot prove the insurer acted in bad faith. As Mr. Bird states in his supplemental brief, the process requires all of the parties to “put their money where their mouths are.” It incentivizes the plaintiff and the insured defendant to settle for a reasonable amount and only if they believe they will prove that the insurer committed bad faith. On the other hand, the covenant judgment process creates an incentive for the insurer to fulfill its statutory and common-law duty of good faith. *Butler*, 118 Wn.2d at 392 (“Finally, imposing a presumption of prejudice only after the insured shows bad faith adequately protects the competing societal interests involved. It provides a meaningful disincentive to insurers’ bad faith conduct while protecting insurers from frivolous claims.”); *see Besel*, 146 Wn.2d at 739–40 (“Insurers can avoid this result in the future by acting in good faith.”); *Tank v. State Farm Fire & Cas. Co.*, 105 Wn.2d 381, 386, 715 P.2d 1133

(1986) (explaining that the duty of good faith has been imposed “by a long line of judicial decisions,” and “the Legislature has imposed it as well”).³

There is, therefore, a solid foundation for the reasonableness hearing that occurred below. Actually, it is the position advocated by Farmers and its amici that would dramatically alter existing Washington law for the worse. As explained in Mr. Bird’s supplemental brief, requiring a jury trial to determine the reasonableness of a settlement is a contradiction of Washington law, which gives insureds the right to enter into a settlement without having to go through a trial and without risking a devastating excess judgment. Respondent’s Suppl. Br. at 12–13. One purpose of the covenant judgment procedure is to give the insured that which the insured bargained for in the first place—if at all possible, a

³ The Federation states that the covenant judgment procedure “allows the insured to escape liability, regardless of its actions, and permits the injured party to seek recovery solely and directly from the insurer’s pocket.” Federation’s Br. at 6 (emphasis added). The suggestion is that it is somehow improper for an insured defendant who has committed the acts forming the basis of the plaintiff’s claims—Best Plumbing’s negligence, for example—to invoke the covenant-judgment procedure. But the defendant is an insured, and Washington law requires the insurer to act in good faith. The primary purpose of having liability insurance is to avoid having to pay a judgment based on the insured’s “actions” to the extent covered under the policy.

Strong evidence that the insured defendant committed the acts in the complaint makes an insurer’s bad-faith failure to settle all the more harmful to the insured because it increases the insured’s exposure to an excess judgment. Here, for example, Farmers asks the Court to revisit the risk of treble damages in Mr. Bird’s action against Best Plumbing. But it was always easy for Farmers to be bullish on this issue because, in risking an excess verdict, Farmers was gambling not its own money but with Best Plumbing’s assets and William Lilleness’s livelihood. The insurer’s bad faith has broader societal effects, too, because the failure to settle delays compensation to the injured plaintiff when the insured defendant’s liability is clear.

settlement within policy limits. In this case, Farmers twice rejected within-limits settlements. Respondent's Br. at 14–16. Requiring a jury determination of reasonableness would dramatically impair the parties' ability to negotiate covenant judgments and would therefore remove a key incentive for third-party insurers to act in good faith. Respondent's Suppl. Br. at 12–13; *Butler*, 118 Wn.2d at 392.

Ultimately, whether the reasonableness hearing was an “RCW 4.22.060 hearing” or one authorized by a pronouncement of common law, the resolution of the issue currently before the Court is the same because “whether the amount of a proposed settlement is reasonable” is a “procedure[] in equity,” *Schmidt*, 115 Wn.2d at 161, and because the scope of the constitutional right to a jury is no different when applied to a judicial, as opposed to a legislative, act. *Cf. Brandon v. Webb*, 23 Wn.2d 155, 159, 160 P.2d 529 (1945).

Were this Court to hold that the source of a reasonableness hearing for covenant judgments lies in common law, Mr. Bird believes this holding would have little, if any, practical consequence in how the hearings are conducted. Reasonableness hearings are, after all, judicial creatures. When the legislature enacted RCW 4.22.060, it left it to the courts to develop the procedures and standards to be used. *Glover*, 98 Wn.2d at 716–18 & n.3. For example, RCW 4.22.060 by its terms allows a

reasonableness hearing on five days' written notice and does not mention whether a party opposing reasonableness is entitled to discovery. The Federation argues that this makes the process unfair to insurers. Federation's Br. at 3. The fact of the matter is that superior courts in covenant-judgment cases routinely delay reasonableness hearings for a considerable amount of time to permit discovery, as the superior court did below.⁴ See also, e.g., *Water's Edge Homeowners Ass'n v. Water's Edge Assocs.*, 152 Wn. App. 572, 582, 216 P.3d 1110 (2009). Another example involves Insurance Industry amici's observation that RCW 4.22.060 does not require notice to a defending insurance company. Insurance Industry Amici's Br. at 5. In fact, *Besel* holds that the amount of a covenant judgment is the presumptive measure of damages in a later bad-faith case only if the insurer has notice of the hearing, the insurer has an opportunity to argue against the covenant judgment's reasonableness, and the judge finds the covenant judgment reasonable after applying the nine reasonableness factors from *Glover*. *Besel*, 146 Wn.2d at 739.

⁴ It is also the case that the vast majority of cases involve the same insurer that had the right and duty to handle the defense of the insured. Here, Farmers claims personnel and in-house counsel controlled Best Plumbing's defense for a lengthy period of time before settlement. Then, the start of the reasonableness hearing was continued by more than four months from the time Farmers received notice of the settlement.

IV. THE FACT THAT THE RESULT OF A NONJURY PROCEEDING BARS RELITIGATION OF AN ISSUE IN A LATER JURY CASE DOES NOT OFFEND THE CONSTITUTION.

Insurance Industry amici argue that the characterization of a reasonableness hearing as equitable “begs the question of how the result of such an equitable proceeding can displace an insurer’s right as a defendant in a bad faith action, which sounds in tort at law, to have damages (reasonableness) decided by a jury in the bad faith action.” Insurance Industry Amici’s Br. at 12. The reasonableness hearing was a fiercely contested matter spanning half a year, involving discovery and thousands of pages of court filings. Even before the parties settled, the insurer had defended the case with in-house counsel for more than a year. At the hearing, the settling parties had the burden of proving reasonableness. After four days of testimony and argument, the superior court issued a thorough, written ruling that worked methodically through each reasonableness factor. CP 3434–46. Although the Federation describes the settlement amount as “totally arbitrary,” Federation’s Br. at 5, at the end of this lengthy, exhaustive process, the superior court determined that the amount negotiated by Mr. Bird and Best Plumbing was, in fact, reasonable. The court of appeals affirmed, and Farmers no longer assigns error to the reasonableness determination.

Contrary to the arguments of the Federation and Insurance Industry amici, Federation's Br. at 15-16; Insurance Industry Amici's Br. at 16-17, there is nothing unfair, or unconstitutional, in precluding either Mr. Bird, Best Plumbing, or Farmers from relitigating an issue decided in a reasonableness hearing when that issue arises in a subsequent jury case so long as all of those parties had notice of the hearing and a full and fair opportunity to participate. *Besel*, 146 Wn.2d at 739. The analysis in *Nielson v. Spanaway General Medical Clinic, Inc.*, 135 Wn.2d 255, 266-69, 956 P.2d 312 (1998), undermines Farmers' position. The Court held that precluding a party in a jury case from relitigating an issue decided in a prior, non-jury case did not offend the right to a jury under the Washington Constitution. Cases concerning the right to a jury under the U.S. Constitution are in accord. *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 333-37, 99 S. Ct. 645, 58 L. Ed. 2d 552 (1979). As the WSAJ Foundation observes, reasonableness hearings do not address the insurer's liability or other damages; those issues must be tried to a jury under article 1, section 21 of the Constitution. WSAJ Foundation's Br. at 11 n.11.

V. UNIGARD LENDS FARMERS NO SUPPORT.

The Federation cites *Unigard Insurance Co. v. Mutual of Enumclaw Insurance Co.*, 160 Wn. App. 912, 250 P.3d 121 (2011), in support of Farmers' position that it was entitled to a jury at the

reasonableness hearing. But *Unigard* did not involve a settlement that fixed the amount of the defendant's liability. Instead, the settlement provided that the defendant would assign his rights against the insurer to the plaintiff, that he would pay \$20,000, and that the claims against him would survive to the extent they could be satisfied through the assignment of rights. *Id.* at 917. No reasonableness hearing occurred because the parties did not agree to the value of the claims and the defendant did not agree to a stipulated judgment. *See id.* at 917, 923. The case therefore did not implicate the holdings in *Evans* and *Besel* that an insurer is liable for the amount of a reasonable settlement, and the case did not implicate the holdings in *Besel* and *T&G Construction* sanctioning the use of reasonableness hearings. *Unigard*, 160 Wn. App. at 923 ("Because [the parties] did not settle on an amount that Engelmann suffered in damages, the determination of damages was a task for the jury."). The jury in *Unigard*, it must be noted, was never called upon to decide the reasonableness of a settlement. It was, instead, instructed that the "defendant is liable for **all damages** contemplated by the Settlement Agreement (Exhibit 28) unless you find that the settlement is the product of fraud and collusion." *Id.* at 921, 923 (emphasis added). At most, *Unigard* stands for the proposition that the parties are entitled to a jury trial in a bad-faith case against an insurer. This is a proposition with which

Mr. Bird has always agreed.⁵ Under *Schmidt*, however, there is no right to a jury in an equitable reasonableness hearing. No case has ever called the validity of *Schmidt's* unanimous holding into question.

CONCLUSION

To the extent Mr. Bird does not directly address any of amici's arguments above, he relies on the analysis in his prior briefs, including his brief before the court of appeals, his response to the petition for review, and his supplemental brief. Mr. Bird respectfully requests that this Court affirm the decisions of the superior court and the court of appeals.

RESPECTFULLY SUBMITTED this 13th day of January, 2012.

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⁵ Interestingly, Mutual of Enumclaw, the insurance defendant in *Unigard*, argued that it was owed a reasonableness hearing under *Chaussee*. The court of appeals disagreed because there was no covenant judgment. *Unigard*, 160 Wn. App. at 923.

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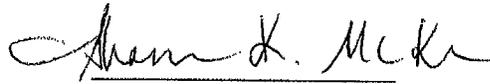
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Washington, this 13th day of January, 2012.

A handwritten signature in cursive script, appearing to read "Shannon K. McKeon".

Shannon K. McKeon

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BIRD

Plaintiff/Petitioner

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BEST PLUMBING GROUP, LLC

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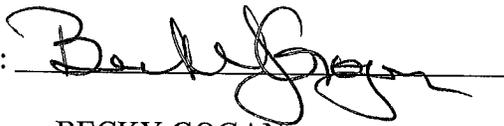
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Pursuant to the provisions of GR 17, I declare as follows:

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Dated: January 13, 2012, at Olympia, Washington.

Signature: 

Print Name: BECKY GOGAN