66636-3

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

LAKE CHELAN SHORES HOMEOWNERS ASSOCIATION,

Appellant,

v.

ST. PAUL FIRE & MARINE INSURANCE COMPANY,

Respondent,

and

NORTHERN INSURANCE COMPANY OF NEW YORK,

Defendant.

OPENING BRIEF OF APPELLANT

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I. INTRODUCTION

This appeal arises from the dismissal at summary judgment of the coverage and extracontractual claims of appellant Lake Chelan Shores Owners Assoc. ("LCS") against its property insurer, St. Paul Fire & Marine Casualty Insurance Co. ("St. Paul"). St. Paul agreed to insure the condominium complex against the risk of loss involving collapse of a building, or any part of a building from August 1996 until August 1999. Neither the contract language nor Washington law requires that a building actually fall to the ground. It is sufficient if the building is at risk of loss due to collapse, or in a state of substantial structural impairment or "SSI," at any time while St. Paul's policies were in force.

This appeal addresses a number of issues of broad public importance, including the scope of an insurance carrier's duty to investigate a first party claim in good faith. This Court and others have recognized that an insurer has an independent obligation to investigate a first party claim in good faith. *See e.g. Coventry Associates, L.P. v. American States Ins. Co.*, 136 Wn.2d 269, 961 P.2d 933 (1998). These decisions, however, merely identify the existence of the duty, without addressing the scope of the duty to investigate. As a result, carriers such as St. Paul have interpreted the duty to investigate to benefit themselves, depriving their policyholders of a fair and impartial investigation.

LCS also seeks review of its motions to compel and for a CR 56(f) continuance. After similar motions were granted compelling answers to identical discovery requests from co-defendant Northern Insurance Co. of New York ("Northern"), Northern was held to have investigated the collapse conditions at Lake Chelan Shores in bad faith.

II. ASSIGNMENTS OF ERROR

1. The trial court erred in granting St. Paul's Motion for Summary Judgment dismissing all coverage claims.

2. The trial court erred in granting St. Paul's Motion for Summary Judgment dismissing all extracontractual claims.

3. The trial court erred in denying LCS's Motion to Compel.

4. The trial court erred in denying LCS's Motion for a CR 56(f) continuance.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Whether LCS met its burden of proof at summary judgment when it demonstrated there was a risk of loss involving collapse from hidden decay during St. Paul's policy periods? (Assignment of Error No. 1).

2. Whether a policyholder must prove that a loss occurred during a particular policy period when the insurer issued identical policies for three consecutive years and there is no requirement that the loss commence within a policy period? (Assignment of Error No. 1).

3. Whether the trial court erred by resolving disputed issues of fact at summary judgment regarding the qualifications and opinions of experts and failed to enter findings? (Assignment of Error No. 1).

4. Whether an insurance carrier breaches its duty to conduct a fair and

impartial investigation when it delegates its investigation to defense counsel, who thereafter conducts the investigation in the context of a zealous defense? (Assignment of Error No. 2).

5. Whether an insurance carrier breaches its duty to investigate in good faith when it retains an expert knowing he holds predetermined opinions beneficial to the carrier? (Assignment of Error No. 2).

6. Whether an insurance carrier acts in bad faith when it imposes a burden of proof for which there is no legal authority on its policyholder as a precondition to conducting an investigation? (Assignment of Error No. 2).

7. Whether the attorney-client privilege applies when an attorney conducts insurance adjusting functions such as the investigation of a claim? (Assignments of Error Nos. 3, 4).

8. Whether it was an abuse of discretion to deny LCS's Motion to Compel and Motion for a CR 56(f) continuance when the trial court granted similar motions against St. Paul's co-defendant Northern resulting in summary judgment establishing bad faith? (Assignments of Error Nos. 3, 4).

IV. STATEMENT OF THE CASE

A. The parties.

Appellant LCS is the homeowners' association for a condominium resort known as Lake Chelan Shores. CP 1914-15. Lake Chelan Shores is a 21-building, multi-family complex, built in three phases between 1980 and 1992. Id.; CP 1723. The defendants are respondent St. Paul and Northern, which together insured the resort from August 1996 to August 2002.[1] CP 21. Northern settled after summary

[1] After 2002, insurance companies typically limited their collapse coverage to actual collapse where the building falls to the ground.

judgment was entered against it for failing to investigate in good bad faith. CP 2299-2302.

B. The St. Paul policies.

St. Paul issued three policies to LCS from August 1996 through August 1999. CP 146-261, 263-346, 348-426. In pertinent part, the insuring clause of each policy provides coverage for the following:

> **Covered Causes of Loss**
>
> We'll insure the covered property against risks of direct physical loss or damage unless excluded in the Exclusions – Losses We Won't Cover section. However, the following restrictions apply.
>
> **Collapse coverage**. We'll insure covered property against the risk of direct physical loss or damage involving collapse of a building or any part of a building.
>
> The collapse must be due to any of the following causes of loss: . . .
>
> - hidden decay;

CP 177, 280, 377. Excluded is damage from "**Wear-tear-deterioration-animals**" including "deterioration, mold, wet or dry rot, rust or corrosion including fungal or bacterial contamination." CP 181, 284, 382. This exclusion does not apply to Collapse Coverage. CP 268, 357, 1749.

There is no language in the St. Paul policies which requires the damage commence during a specific policy period. CP 146-426. The only timing requirement is that the "risk of direct physical loss or damage involving collapse" exist during a policy period. CP 177, 280, 377.

C. The discovery of substantial structural impairment at Lake Chelan Shores in 2006.

In March 2006, LCS retained architect Olympic Associates Co. ("OAC") to advise it regarding cracks in the stucco siding. CP 1915-16. OAC recommended an intrusive investigation to determine the conditions beneath the stucco. CP 1916. OAC's resulting September 29, 2006 report documents significant hidden decay, and substantial structural impairment or "SSI" in approximately half the 48 openings made. CP 1603-61. The report also identifies construction defects, such as the absence of flashing, which allowed water to intrude into the structures from completion of construction. CP 1606-07, 1946. The report concluded that SSI was present throughout the complex. CP 1617.

After receiving the OAC report, LCS retained legal counsel to investigate coverage. CP 1917. The first notice of claim was sent to Northern in December 2006. CP 1917. St. Paul was given notice of the claim and a copy of the OAC report on June 29, 2007. CP 1917. Following OAC's advice, LCS began to prepare for a full investigation and repair in December 2006. CP 1946, 1916-18. It retained general contractor Tatley Grund Inc. ("TGI") to conduct the phased investigation and remediation project. CP 1916-19. The work commenced in October 2007 with a completion date of June 2009. *Id.*

At summary judgment, St. Paul argued that LCS irrevocably made the decision to strip and reclad the buildings in December 2006. CP 1586-88. LCS disputes this claim. Board member Geoff Revelle testified that LCS did not make a final decision until approximately March of 2007, and did not sign a contract with TGI until September 2007. CP 1778, 1919-20. Even then, LCS was open to less expensive alternatives, and would have allowed St. Paul to conduct a full investigation at any time. *Id.*

D. The handling of the LCS claim and investigation by St. Paul.

Approximately 90 days elapsed between the June 29, 2007 notice of claim and the time TGI commenced work. CP 1917, 1978. During this period, there is no evidence St. Paul did anything substantive to investigate the claim. Although Dennis Luoma, the Travelers Group adjuster assigned to the claim, retained Wiss, Janney, Elstner, Inc. ("WJE"), a professional engineering firm in mid-August, he waited until October 2nd when TGI was mobilizing to request that WJE do any work. CP 1597, 1964. Even then, he opined that an engineering investigation "probably was moot" and only asked WJE to monitor the repair project's progress. CP 1964. Although St. Paul knew the repair would proceed in phases, it never asked to conduct its own investigation, and never offered to share in the costs of stripping and recladding. CP 1918-19, 1968.

After suit was filed on August 30, 2007, St. Paul retained attorney James Derrig to defend the lawsuit and to direct the investigation. CP 141, 1598. According to Mr. Luoma, from that point on St. Paul's "investigation was performed through the legal process." CP 1598. WJE made several site visits, timing all but the first so the buildings could be inspected after stripping. CP 1967, 1976. Although St. Paul had retained WJE to back date decay in another case, WJE was not asked do so on this claim. CP 1964, 2059-64. After Buildings 1-8 were stripped and inspected, WJE developed an investigation protocol for the remaining buildings, but never conducted the proposed investigation.[2] CP 2022-43, 1918-19.

In early 2009, Mr. Derrig directed WJE to load test four decks. CP 1982-83, 1723-42. Mr. Derrig was told that the decks selected were not claimed to be in a state of SSI by LCS, but the testing proceeded anyway. CP 1981, 1987, 1723. No analysis was provided to demonstrate how the test results could be extrapolated to decks which were in a state of SSI, or to dissimilar structures such as stairs, landings, or walls with SSI. CP 1723-42. Despite notice to the contrary, St. Paul continued to claim that it tested decks claimed to be in a state of SSI. CP 1987, 2162.

[2] LCS does not know why WJE's inspection scope was never implemented since the post-litigation claim file for St. Paul was never produced. *See* Section IV G below.

Mr. Derrig also retained Dr. Barry Goodell, a wood scientist from Maine, to opine on timing of wood decay. CP 1962, 1955-56. Mr. Derrig knew Dr. Goodell believed it was impossible to back date decay because he used him as an expert on the same issue in two prior cases. CP 1955-56. According to Dr. Goodell, any effort to back date decay would have to be done to a laboratory standard of 95 percent certainty, requiring a decades long experiment monitoring every square foot of a building. CP 1959-60. Mr. Derrig chose Dr. Goodell over professional engineers who had testified on timing decay in other cases, including Mr. Dethlefs of WJE. CP 970-75, 952-57, 1597.

Prior to hiring Dr. Goodell, the Travelers Group had suffered a series of setbacks on its theory that SSI could not be back dated when its experts testified to a "more probable than not" standard. CP 954, 2051-54, 2105-14. Without explanation, Mr. Derrig asked Dr. Goodell to form his opinions in this case to "reasonable scientific certainty," a standard Dr. Goodell equated to laboratory testing standards. CP 1962, 1959. Dr. Goodell did not offer any opinions on a more probable than not basis, and never opined that it was impossible to back date the decay at Lake Chelan Shores on a more probable than not basis. CP 1958.

In January of 2009, LCS asked St. Paul to conduct an investigation of hidden decay in the Clubhouse. CP 2044-45. St. Paul

refused, claiming it did not know a method for back dating decay. *Id.* St. Paul further claimed it had no obligation to investigate until LCS identified specific locations of SSI in the building.[3] CP 2045. LCS's insurance expert, Kay Thorne, testified that he did not know of a similar instance in which an insurer refused to investigate based upon an expert's opinion that investigation was futile. CP 1939-40.

On September 22, 2009, St. Paul finally denied coverage. CP 2159-66. St. Paul summarized its reasons for denial as follows:

> The insured has failed to present sufficient evidence that any currently existing collapse conditions were present during St. Paul's policy periods of August 3, 1996 to August 3, 1999.

CP 2159. "[S]ufficient evidence" presumably refers to the "reasonable scientific certainty" standard specified by Mr. Derrig to Dr. Goodell. CP 1962. The principal grounds for the denial were the assertion that decay could not be back dated (as opined by Dr. Goodell), and the load testing conducted by WJE. CP 2161-62.

E. LCS's investigation of SSI conditions at Lake Chelan Shores.

After construction commenced, LCS asked OAC's structural engineer, Justin Franklin, to determine if the decayed structures were in a state of SSI, and to render an opinion on a more probable than not basis

[3] In an interrogatory, LCS asked St. Paul to identify when the LCS claim was accepted or denied and its procedure for accepting or denying the claim. St. Paul responded that "it has been waiting for the insured to provide *prima facie* evidence that any of the claimed 'collapses' took place during St. Paul's policy periods." CP 1852.

whether the decay reached SSI prior to August 1999. CP 1026-27. Mr. Franklin rendered his opinions based upon his experience, specialized knowledge and training. CP 1027-28. He also used a mathematical model developed by OAC to define an exponential curve portraying the estimated progress of the decay. CP 1028-31, 1041-1283.

LCS also retained wood scientist Kevin Flynn to review and comment upon Mr. Franklin's analysis. Mr. Flynn conducted an independent review, again based upon his experience, specialized knowledge and training, and concluded Mr. Franklin's estimates were accurate to a more probable than not standard. CP 1284-91. Mr. Flynn also compared Franklin's results to a predictive model using TimberLife software,[4] finding a 75% correlation for structures such as decks, stairs and landings which were especially prone to decay. CP 1288.

Mr. Flynn also opined that the 19-year time period relevant to St. Paul's polices did not require that a determination be made as to the precise moment the decay reached a state of SSI:

> My working understanding is that the St. Paul Travelers policies require that substantial structural impairment must be in existence during the policy periods. Therefore, if a wooden framing member reached a state of SSI at any time from the completion of construction in the 1980's or early 1990's until August 1999, then the SSI conditions existed within a time period relevant to St. Paul Travelers' policies. . . . [T]hese time periods do not require that a determination be made as to the precise moment when the

[4] TimberLife is a software package developed in Australia by wood scientists to predict the useful life of wood structures under varying conditions. CP 1287-90.

> decay progressed to a state of SSI, so long as it can be stated on a more probable than not basis that the conditions existed during the time periods relevant to each policy.

CP 1286. According to Mr. Flynn, the 95 percent certainty requirement used by Dr. Goodell at St. Paul's request set an "impossibly high standard which all but dictates" the negative opinions expressed by Dr. Goodell. CP 1286.

> This is not a laboratory experiment or procedure, and the underlying science is not in question. The observations of wood decay and degradation must necessarily be made in the field and not the lab, as it would be impractical and unnecessary to lab test every portion of a 20-building project which experienced readily observable degradation.

CP 1286. Mr. Franklin and Mr. Flynn both testified that they observed similar amounts of decay at Lake Chelan Shores in similar construction details occurring over similar periods of time. CP 1031, 1290. Both testified that this demonstrated far more consistency in the progression of the decay at Lake Chelan than claimed by Dr. Goodell. CP 1031, 1290.

F. The trial court dismisses all coverage claims against St. Paul at summary judgment.

By Order dated November 23, 2009, Judge Gonzalez granted St. Paul's Motion for Summary Judgment on coverage, adding the following language to St. Paul's proposed order.

> It may be possible to say that if the collapse happened during a coverage period it more probably happened under one policy as compared to another policy based on timing. However, it is not possible to say on a more probable than not basis, even in the

> light most favorable to Plaintiff, that collapse happened during a specific coverage period as opposed to some other time.

CP 1888-90. From this, it appears the trial court dismissed the coverage claims based upon the erroneous belief that "collapse" had to be timed to a specific, one-year policy period. However, St. Paul never made this argument. St. Paul stated its position as follows in its motion:

> The plaintiff thus bears the burden of showing the alleged collapse condition *existed* while St. Paul insured the property."

CP 35 (italics added). Similar language was used in St. Paul's denial letter. CP 2159. In fact, there is no language in St. Paul's policies requiring that a loss commence during a policy period.[5] Accordingly, the trial court's reasoning is contrary to both the policy language and the positions taken by St. Paul at summary judgment and in its denial letter.

Finally, the Order rules that the opinions of Mr. Flynn, and Mr. Franklin are inadmissible pursuant to ER 702 and the *Frye*[6] standard, but no findings supporting this ruling were entered. CP 1889. The ruling also impliedly resolves a dispute among the experts regarding back dating decay, again without the entry of findings. CP 1026-32, 1284-91, 90-104. Both rulings are reversible error.

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[5] The trial court may have confused the St. Paul policies with Northern's policies which include language requiring that a loss commence during Northern's policy periods.

[6] Washington follows the standards set forth in *Frye v. United States,* 293 F. 1013 (D.C.Cir.1923) to determine the admissibility of expert testimony relating to new or novel scientific theories.

G. St. Paul's motion to dismiss extracontractual claims, and LCS's motion to compel and motion for a CR 56(f) continuance.

LCS submitted Interrogatories and Requests for Production to St. Paul on July 20, 2009. CP 1842-66. St. Paul refused to produce adequate answers to all requests, and moved instead for summary judgment on LCS's extracontractual claims. CP 1838-39, 1578-94. LCS then filed a Motion to Compel discovery (CP 1826-36) of the following:

1. All claim file documents which post-dated the filing of the lawsuit, including all documents relating to the selection of experts, the investigation, and the coverage analysis. CP 1838-39, 1826-36.

2. A 167-page sub-file of the claims file labeled "subrogation file" which was withheld without explanation. CP 1838, 1826-36.

3. Information relating to other claims adjusted by St. Paul involving collapse, SSI, and the timing of hidden decay, including the identity of experts retained relative to those issues. CP 1838-39,1826-36.

4. All documents relating to the investigation withheld on grounds of attorney-client privilege or work product. CP 1871-72, 1826-36.

LCS also requested a CR 56(f) continuance until St. Paul produced the requested documents. CP 2236. The trial court denied both motions, and granted the motion for summary judgment. CP 2288-89, 2292-94.

H. Subsequent procedural history.

Following dismissal of St. Paul, the extracontractual claims against Northern remained at issue. LCS moved to compel answers from Northern to identical discovery requests as those served upon St. Paul. The trial court granted the motion, compelling the production of documents similar to those withheld by St. Paul. CP 2295-98. Cross-motions for summary judgment were decided by Judge Gonzalez on March 17, 2010. CP 2299-2302. LCS's motion establishing bad faith was granted, and Northern's motion was denied. *Id.* Northern subsequently settled with LCS. An order of dismissal was entered on April 2, 2010 and a Notice of Appeal was timely filed. CP 2303-04, 2305-19.

V. AUTHORITY

A. The trial court erred by dismissing the coverage claims against St. Paul at summary judgment and by applying *Frye* hearing standards to a summary judgment motion.

1. Standard of review for summary judgment.

An appellate court reviewing an order on summary judgment engages in the same inquiry as the trial court, considering all matters *de novo*. *Hisle v. Todd Pacific Shipyards Corp.*, 151 Wn.2d 853, 860-61, 93 P.3d 108 (2004). Summary judgment is appropriate only "if there is no genuine issue of material fact and the moving party is entitled to a

judgment as a matter of law." *Cowlitz Stud Co. v. Clevenger*, 157 Wn.2d 569, 573, 141 P.3d 1 (2006). All facts and inferences must be viewed in the light most favorable to the non-moving party. *Herron v. King Broadcasting Co.*, 112 Wn.2d 762, 768-69, 776 P.2d 98 (1989). Issues of credibility, including the credibility of experts, may not be resolved at summary judgment. *Id.* The evidence of the non-moving party must be believed at summary judgment. *Id.* (*citing Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S.Ct. 2505 (1986)).

2. The St. Paul policies cover the risk of direct physical loss or damage involving collapse due to hidden decay during its policy periods, a concept broader than actual collapse.

Each of the St. Paul policies at issue insures against the risk of direct physical loss involving collapse caused by hidden decay. CP 177, 280, 377. Most modern decisions interpreting collapse provisions do not require that the building actually fall to the ground. It is sufficient that the building, or any part of a building, reach a state of substantial structural impairment, or "SSI." This trend is particularly prevalent where, as here, the policies insure against the *risk of loss involving* collapse. *See Assurance Co. of America v. Wall & Associates, LLC*, 379 F.3d 557 (9th Cir. 2004)(applying Washington law) and the cases cited therein.

Although Washington appellate courts have not yet ruled on the

standard to be applied to establish the risk of loss involving collapse, *Panorama Village Condominium Owners Association v. Allstate Ins. Co.*, 144 Wn.2d 130, 26 P.3d 910 (2001) is instructive. The policy in *Panorama Village* contained a similar insuring clause to St. Paul's: "We will pay for risk of direct physical loss involving collapse of a covered building or any part of a covered building caused . . . [by] hidden decay." 144 Wn.2d at 134-35. At issue was when a loss occurred for purposes of the one-year claims limitation. Applying the language of the policy, the Court held:

> the date of loss is the earlier of either (1) the date of actual collapse or (2) the date when the decay which poses the risk of collapse is no longer obscured from view.

144 Wn.2d at 133-34. Significantly, the Court did not require that the decay meet a specific standard of degradation. Instead, the claims limitation period begins to run if the decay simply "poses the risk of collapse." *Id.*

In *Mercer Place Condominium v. State Farm*, 104 Wn. App. 597, 17 P.3d 626 (2002), Division I analyzed the collapse provisions of a State Farm policy. The parties stipulated that "collapse" meant substantial impairment of structural integrity. Nevertheless, the court noted:

> A growing majority of jurisdictions have assigned the more liberal standard, "substantial impairment of structural integrity,"

> to the use of "collapse" in insurance policies, as opposed to the minority view, which requires that the structure actually fall down. Judge Barbara Rothstein predicted that the Washington Supreme Court, if called upon to interpret a collapse provision in an insurance policy, would adopt the majority "substantial impairment" standard. *Allstate Ins. Co. v. Forest Lynn Homeowners Ass'n,* 892 F. Supp. 1310, 1314 (W.D.Wn.1995) (opinion withdrawn by *Allstate Ins. Co. v. Forest Lynn Homeowners Ass'n,* 914 F. Supp. 408 (W.D.Wn.1996)).

104 Wn. App. at 602 n.1.

In *Wall & Associates,* 379 F.3d 557, the 9th Circuit held that the Washington Supreme Court would likely interpret "risk of direct physical loss or damage involving collapse" to include concepts of imminent collapse or SSI. *Wall*, 379 F.3d at 563.

3. LCS is required to prove only that the risk of loss involving collapse from hidden decay existed while the St. Paul policies were in force to establish coverage.

For purposes of its coverage motion, St. Paul conceded that its collapse coverage was triggered when a building or any part of a building reached a state of SSI. RP (Nov. 20, 2009) 4:13-6:6; CP 20. However, St. Paul also argued that LCS could not prove hidden decay first reached a state of SSI during a time period covered by its policies. CP 20, 32-35. In making this argument, St. Paul ignored its policy language, and improperly attempted to shift the burden of proof from itself to LCS.

As set forth in subsection 2 above, the St. Paul policies insure against the risk of loss involving collapse. To paraphrase *Panorama*

Village, *supra*, the policies should be construed to mean what they say: To establish an insured loss, LCS should only be required to demonstrate that a risk of loss involving collapse from hidden decay existed while the St. Paul policies were in force. If St. Paul then asserts that the loss falls within an exclusion for mere decay, the burden should be upon St. Paul. *Schwindt v. Underwriters at Lloyd's of London*, 81 Wn. App. 293, 298, 914 P.2d 119 (1996).

In this case, St. Paul seeks to escape its obligation to pay for a covered loss based upon a "reasonable scientific certainty" standard of its own making. Yet, St. Paul agreed to insure against the risk of loss or damage involving collapse, a concept broader and more amorphous than actual collapse. *Wall & Assoc.*, 379 F.3d at 563. Moreover, "reasonable scientific certainty" is not a legally recognized standard of proof. Once LCS established that hidden decay existed during a St. Paul policy period which posed a risk of collapse on a more probable than not basis, it met its burden of proof. The burden then shifted to St. Paul to prove the structures suffered from mere decay during its policy periods, and that the loss was excluded. As a result, any failure of proof relating to timing should be on St. Paul, and not on LCS.

4. St. Paul failed to establish the absence of genuine issues of material fact, or that it was entitled to summary judgment as a matter of law.

The trial court dismissed LCS's coverage claims at summary judgment finding it is impossible to back date SSI to a specific policy period. In so holding, the trial court improperly resolved contested issues of fact, made determinations regarding the credibility of experts, applied a legal requirement which has no application to coverage under the St. Paul policies, and improperly shifted the burden of proof from St. Paul to LCS.

a. The trial court erroneously concluded that LCS must prove hidden decay first reached a state of SSI during a specific policy period, an argument never asserted by St. Paul.

The trial court erred in ruling that LCS must prove a collapse occurred "during a specific coverage period as opposed to some other time." CP 1890. St. Paul insured against the risk of loss involving collapse from hidden decay while any of its policies were in force. If SSI first occurred before St. Paul insured the property, or during any St. Paul policy period, the risk of collapse existed and there is coverage. CP 35; *Villella v. PEMCO*, 106 Wn.2d 806, 725 P.2d 957 (1986). St. Paul stated what it perceived to be LCS's burden of proof as follows:

> The plaintiff thus bears the burden of showing the alleged collapse condition *existed while St. Paul insured the property.*"

CP 35 (italics added). St. Paul has never argued that the commencement of SSI had to be timed to a specific policy period. Accordingly, the trial court erred when it applied this requirement.

The trial court's ruling was also in error as a matter of law. Damages for continuing losses such as decay are governed by the rule in *Gruol Construction Co. Inc. v. Insurance Co. of North America*, 11 Wn. App. 632, 524 P.2d 427 (1974) (since dry rot caused continuing damage, coverage existed during policy periods provided by three different insurance carriers). In *Mercer Place,* 104 Wn. App. at 629, Division I distinguished *Gruol* and ruled that a building is either in a collapse condition, or it is not. However, once a collapse condition such as SSI occurs, it becomes a continuing loss under *Gruol.* This would allow for liability over a number of policy periods, including coverage for SSI conditions which first arose before St. Paul insured the condominiums. *See also, Panorama Village,* 144 Wn.2d at 148-53. (Madsen, J., dissenting) (discussing proof problems with collapse caused by hidden decay); *Davidson v. United Fire & Casualty Co.*, 576 So.2d 586 (La. Ct. App. 1991) (insured's burden is merely to prove that damage occurred during any one of the policy periods).

LCS presented the testimony of two qualified experts who opined that SSI occurred in 120 separate locations at Lake Chelan Shores, 49 of

which posed a risk of collapse prior to August 1999. CP 677-80, 1041-1283. Since all facts and inferences must be interpreted in LCS's favor, this established a material issue of fact regarding coverage, sufficient to defeat St. Paul's motion. No findings were entered to support the ruling that this testimony was inadmissible. CP 1889. It was therefore error to dismiss LCS's coverage claims.

b. Conflicting opinion testimony offered by opposing experts cannot be resolved at summary judgment.

Disputed opinion testimony, offered by qualified experts,[7] cannot be resolved at summary judgment. *Postema v. Pollution Control Hearing Bd.*, 142 Wn.2d 68, 119-20, 11 P.3d 726 (2000) (opposing expert opinions create disputed issues of fact which cannot be resolved at summary judgment); *Larson v. Nelson*, 118 Wn. App. 797, 810, 77 P.3d 671 (2003) ("weighing of evidence, balancing of competing experts' credibility and resolution of conflicting material facts are not appropriate at summary judgment"). "In general, an affidavit containing admissible expert opinion on an ultimate issue of fact is sufficient to create a genuine issue of fact, precluding summary judgment." *J.N. By and Through Hager v. Bellingham School Dist.*, 74 Wn. App. 49, 60-61, 871 P.2d 1106 (1994). If a party disputes that evidence is admissible, it must

[7] Mr. Franklin and Mr. Flynn both hold masters degrees and have years of experience in their fields. CP 1026, 1295. Without express findings, there is no basis in the record for concluding their testimony is inadmissible.

bring a motion to strike; otherwise, the evidence is part of the record and must be believed. *Lamon v. McDonnell Douglas Corp.*, 91 Wn.2d 345, 352, 588 P.2d 1346 (1979); *Herron,* 112 Wn.2d at 768-69. No motion to strike was filed.

The testimony of Franklin and Flynn, as compared to that of Dr. Goodell, raised genuine issues of material fact which should not have been resolved at summary judgment. These include the following:

- Franklin and Flynn both opined that mathematical models could be used in regard to biological processes. CP 1285-89, 1028-30. Dr. Goodell testified they could not. CP 92.

- Both Franklin and Flynn testified that their opinions regarding the progression of decay would have been the same whether they used mathematical models or simply based their opinions on their professional experience and observations. CP 1290, 1032. Dr. Goodell testified it was impossible to time decay by any method. CP 92.

- Franklin and Flynn testified their opinions were formed using a more probable than not standard. CP 1286, 1028. Dr. Goodell testified his opinions assumed a "95% confidence limit," such as would be required in a laboratory. CP 1959.

- Flynn testified it was inappropriate to apply laboratory testing standards to field observations which were based upon generally accepted science. CP 1286. Dr. Goodell testified it would be necessary to conduct a decades long test of every square foot of a building to acquire the desired results. CP 1959-60.

- Dr. Goodell testified there were too many potential variables to form a valid opinion regarding the progression of decay in an existing structure. CP 94-98. Franklin and Flynn testified that if all these variables were in play at Lake Chelan Shores, they

would have expected to see significant variability in the progression of decay. Instead, they observed that similar amounts of decay occurred in similar construction details over similar periods of time. CP 1287, 1290, 1031.

- Dr. Goodell testified that weather conditions were highly variable and could significantly affect the progression of decay. CP 99-100. Flynn testified that weather records for Lake Chelan indicated the area had been in a similar weather pattern for the last 30 years. CP 1287-88. As a result, the decay fungi would have been exposed to similar, seasonal weather conditions on a year-to-year basis. CP 1287-88, 1290.

These are but a few examples of conflicting testimony between the experts which should have precluded summary judgment. The court erroneously resolved all these issues in the moving party's favor.

c. The trial court erred by weighing the evidence as if it were presiding at a Frye hearing rather than deciding a motion for summary judgment.

The court's role at summary judgment is to determine if genuine issues of material fact exist, not to resolve factual issues. *Herron,* 112 Wn.2d at 768-69. When there are conflicting declarations from opposing experts, material issues of fact exist. *Larson,* 118 Wn. App. at 810. The trial court does not have the latitude under CR 56 to apply *Frye* hearing standards to a summary judgment. The procedural posture of the case is important in this regard. St. Paul moved for summary judgment and had the burden of proving there were no material issues of fact. CR 56; CP 20. In the alternative, St. Paul asked that a *Frye* hearing be set. CP 21. However, at oral argument, St. Paul conflated the two and argued that

the court could decide the summary judgment using *Frye* hearing standards. RP (Nov. 20, 2009) 3:17-4:6. St. Paul thus asked the trial court to weigh the evidence, over LCS's objection, inviting the trial court's error. RP (Nov. 20, 2009) 3:17-4:6, 24:8-25; CP 1888-90.

Although both a *Frye* hearing and summary judgment are reviewed de novo, there is no Washington authority which allows the two proceedings to be combined so that factual determinations may be made at summary judgment. If a *Fyre* hearing were deemed necessary, summary judgment should have been denied and a *Fyre* hearing set as St. Paul requested. CP 20-21. By weighing the evidence and making implied factual determinations, the trial court stepped beyond the allowable bounds of CR 56 and committed reversible error.[8]

d. *The testimony of Dr. Goodell was based upon a standard of proof of St. Paul's making for which there is no legal authority; accordingly, his testimony failed to establish the right to summary judgment as a matter of law.*

In addition to the factual issues raised by the testimony of the experts, there are at least two flaws in Dr. Goodell's testimony which make summary judgment for St. Paul inappropriate.

First, Dr. Goodell was asked by St. Paul whether it was possible

[8] LCS argued that a *Frye* hearing was unnecessary because the science from which its experts made their deductions was well established, and neither new nor novel. CP 919-21. However, since the trial court granted summary judgment and declined to order a *Frye* hearing, those issues are not part of this appeal.

to back time decay "with reasonable scientific certainty," a phrase Dr. Goodell interpreted to require 95 percent confidence. CP 1962, 1959, 103-04. However, reasonable scientific certainty and/or 95% confidence are not legal standards. In civil cases, the standard of proof is a preponderance of the evidence, a more probable than not standard. *See* WPI 21.01 and cases cited therein. Expert medical and other expert opinion testimony is admissible so long as it is offered as "more probable than not." 5B Teglund Wash. Practice § 702.30; *Torno v. Hayek*, 133 Wn. App. 244, 135 P.3d 536 (2006); *Merriman v. Toothaker*, 9 Wn. App. 810, 515 P.2d 509 (1973). Dr. Goodell never offered an opinion to a more probable than not standard, and never testified that the opinions of Mr. Flynn and Mr. Franklin were inaccurate to a more probable than not standard. CP 1958. Accordingly, Dr. Goodell's testimony failed to establish St. Paul was entitled to summary judgment as a matter of law.

Secondly, the issue at this summary judgment was whether coverage existed under the St. Paul policies. Dr. Goodell's testimony failed to address whether there was a risk of collapse from hidden decay during the 19-year period relevant to the St. Paul policies. Since St. Paul insured against the risk of loss involving collapse, the issue was not whether decay could be timed with "scientific precision" to a specific point in time, but whether the risk of loss could be placed within the

relevant 19-year time period using the correct legal standard. Dr. Goodell never addressed this issue, nor did any other St. Paul witness.

Finally, even if Dr. Goodell's testimony is accepted at face value, any failure to precisely back date decay should have been St. Paul's risk and not its insured's. LCS was required to establish only that a risk of loss involving collapse from hidden decay existed prior to August 1999. The testimony and reports of Franklin and Flynn more than met this requirement. The burden then switched to St. Paul to prove that prior to August 1999, the decay posed no risk and was excluded from coverage. If this task was impossible, then the failure is St. Paul's. *Queen City Farms v. Central Nat'l Ins. Co.*, 126 Wn.2d 50, 72, 882 P.2d 703 (1994).

For the reasons set forth above, St. Paul failed to establish there were no genuine issues of material fact and that it was entitled to dismissal of LCS's coverage claims as a matter of law. The summary judgment should be reversed, and all coverage issues remanded for trial.

B. The trial court erred by dismissing LCS's extracontractual claims for bad faith, WAC violations, and breach of the Washington Consumer Protection Act at summary judgment.

St. Paul breached its contractual, statutory, and regulatory duties to investigate the LCS claim in bad faith. Whether an insurer breached its duty of good faith is a question of fact. *Safeco v. Butler*, 118 Wn.2d 383, 395, 823 P.2d 499 (1992). It was therefore error for the trial court

to dismiss LCS's extracontractual claims unless the record was so clear reasonable minds could not differ, a standard St. Paul did not meet.

1. St. Paul owed LCS a duty of good faith in all matters touching upon its claim, including the duty to investigate.

"[A]n insurer must deal fairly with an insured, giving equal consideration *in all matters* to the insured's interests." *Tank v. State Farm Fire & Cas.*, 105 Wn.2d 381, 386, 715 P.2d 1133 (1986) (italics added).

> The duty of good faith is not specific to either of the main benefits of an insurance contract but permeates the insurance arrangement. The good faith duty between an insurer and an insured arises from a source akin to a fiduciary duty. This fiduciary relationship, as the basis of an insurer's duty of good faith, implies more than the "honesty and lawfulness of purpose" which comprises a standard definition of good faith. It implies "a broad obligation of fair dealing" and a responsibility to give "equal consideration" to the insured's interest.

St. Paul Fire & Marine v. Onvia, Inc., 165 Wn.2d 122, 129-30, 196 P.3d 664 (2008). Similarly, RCW 48.01.030 provides:

> The business of insurance is one affected by the public interest requiring that all persons be actuated by good faith, abstain from deception, and practice honesty and equity in all insurance matters.

The duty of good faith implicates all matters relating to insurance, including the duty to investigate. *Coventry Associates, L.P. v. American States Ins. Co.*, 136 Wn.2d 269, 281, 961 P.2d 933 (1998) (the failure to conduct a reasonable investigation is a breach of the duty of good faith).

The duty to investigate is independent of the insurance company's obligation to defend or indemnify. *Id.*

> St. Paul asks this court to find that there is no liability for violation of insurance claims-handling regulations absent a bad-faith breach of the other obligations imposed under coverage provisions of the contract. But under state law insurers have not only a general duty of good faith, but also a specific duty to act with reasonable promptness in investigation and communication with their insureds following notice of a claim and tender of defense. These are necessarily obligations read into every policy.

Onvia, 165 Wn.2d at 132 (citations omitted). Accordingly, St. Paul may be liable for bad faith even if there is a no coverage determination. *Id.*; *Coventry*, 136 Wn.2d at 285.

RCW 48.30.010 gives the Insurance Commissioner authority to promulgate regulations governing the claims handling process. Breach of a single regulation constitutes an unfair practice in violation of the Consumer Protection Act, RCW 19.86. *Industrial. Indemnity. Co. of the NW, Inc. v. Kallevig,* 114 Wn.2d 907, 921, 792 P.2d 520 (1990).

WAC 284-30-330 (3)-(4) provides that failing to adopt and implement reasonable standards for the prompt investigation of claims, and failing to pay claims without a reasonable investigation are deceptive practices. Every investigation must also be completed in a timely manner.

> Every insurer shall complete investigation of a claim within thirty days after notification of claim, unless such investigation cannot reasonably be completed within such time.

WAC 284-30-370. An insurer must also act in a manner which ensures that a policyholder obtains the full benefit of his or her policy:

> No insurer shall fail to fully disclose to first party claimants all pertinent benefits, coverages or other provisions of an insurance policy or insurance contract under which a claim is presented.

WAC 284-30-350(1). As set forth below, St. Paul violated each of these regulations, in breach of its duty of good faith and the CPA. *Truck Ins. Exch. v. VanPort Homes*, 147 Wn.2d 751, 764, 58 P.3d 276 (2002); *Leingang v. Pierce County Med. Bureau, Inc.*, 131 Wn.2d 133, 151, 930 P.2d 288 (1997).

2. St. Paul failed to conduct a timely investigation of the LCS claim as required by WAC 284-30-370.

WAC 284-30-370 provides that an insurance company must complete an investigation within 30 days of notification, unless the investigation cannot be reasonably completed with that time. Even if the investigation takes longer than 30 days, the obligation to act promptly remains. *Onvia*, 165 Wn.2d at 132.

Following receipt of the notice of claim, St. Paul did nothing for 30 days. On the 30th day, St. Paul requested LCS's historic maintenance records. Drawing all inferences in LCS's favor, it must be inferred that St. Paul only sought to determine whether it could deny based upon the

two-year contractual suit limitation period. CP 1663.[9] St. Paul took no other action to investigate until it requested a proposal from WJE 90 days after it received notice. Even then, St. Paul took the position that any need to conduct an engineering investigation through WJE was "moot" because LCS intended to conduct a full investigation and to remediate any structural damage. CP 1964, 1597, 1668.

Over two years elapsed between the notice of claim and the denial letter from St. Paul. CP 1601, 2159-66. During that time, St. Paul demanded and received LCS's cooperation, but provided no information to LCS to justify the delay. CP 1917-20. Even when served with formal discovery, St. Paul withheld most of the information from its investigation, and provided no analysis regarding the 120 instances of SSI identified by LCS. CP 1837-79. St. Paul's experts eventually conducted load testing on four decks, even though the support structures of the decks were not claimed to be in a state of SSI, as St. Paul was informed prior to testing. CP 1981, 1987. Accordingly, the test results were meaningless.

For purposes of summary judgment, the burden was upon St. Paul to justify its failure to complete a timely investigation. No evidence justifying the delay was offered. As a result, it was error to dismiss

[9] Although it could cite no supporting evidence, St. Paul asserted its two-year contractual suit limitation as a reason for denial two years later. CP 1744.

LCS's claim for the failure to conduct a timely investigation.

3. St. Paul failed to conduct a fair, reasonable and impartial investigation in good faith.

The evidence of St. Paul's failure to conduct a fair, reasonable and impartial investigation raises numerous issues of material fact which should have precluded summary judgment, including the following:

- St. Paul charged defense counsel with the dual roles of defending the lawsuit and conducting the investigation. CP 1598. These roles are inherently contradictory as defense counsel cannot be both a zealous advocate and give equal consideration to the insured's interests as to its client's. Insurance expert Kay Thorne testified this was a violation of good faith claim adjusting standards. CP 1934.

- St. Paul retained Dr. Barry Goodell to opine whether it was possible to back date decay knowing in advance that he believed the task was impossible. CP 1962, 1955-56. A jury could find Dr. Goodell was hired to provide a pretext for St. Paul's failure to investigate and denial of the claim.

- St. Paul asked Dr. Goodell to render his opinions to a standard of "reasonable scientific certainty" rather than the legally relevant "more probable than not" standard. CP 1962. St. Paul asked other experts to render opinions to the correct more probable than not standard in this and other cases. CP 1964, 2119.

- St. Paul never asked its experts to investigate the basic insurance coverage issue in this case: whether the decay at LCS posed a risk of loss involving collapse within the 19-year time period relevant to St. Paul's policies. CP 1958, 1964-65.

- St. Paul declined to hire qualified professional engineers to investigate the progression of decay at Lake Chelan Shores when it had used such experts previously or knew of them. CP 970-75, 952-57.

- St. Paul refused to conduct an investigation of the Clubhouse after LCS's experts demonstrated there was a risk of collapse from hidden decay unless LCS could prove to St. Paul's satisfaction that decay could be back dated. CP 1928-30.

- St. Paul tested four decks knowing they were not claimed to be in a state of SSI and used the results to claim there was no risk of collapse at Lake Chelan Shores, including dissimilar structures such as walls, stairs and landings. CP 1981, 1987, 1723-26, 2162.

Particularly troubling among these facts are the roles of Dr. Goodell and defense counsel James Derrig. Although St. Paul was entitled to defense counsel after suit was filed, St. Paul placed counsel in an untenable position when it tasked him with directing the investigation. Mr. Derrig owed duties of loyalty and advocacy to his client: duties which are fundamentally at odds with St. Paul's duty to perform a fair, reasonable and impartial investigation, giving equal consideration to its insured's interests as its own. *Tank v. State Farm*, 105 Wn.2d at 385-86. This arrangement breached good faith adjusting standards. CP 1934.

The evidence also establishes that Mr. Derrig hired Dr. Goodell knowing he would opine it was impossible to back date decay. Dr. Goodell had worked as an expert for Mr. Derrig on two previous cases, and his opinions were well known. CP 1962, 1955-56. St. Paul and Mr. Derrig had retained engineers to back date decay in previous cases, yet declined to retain them on this claim. CP 952, 970, 2051, 2105. This

raises an inference that Dr. Goodell was sought out and retained to express his preexisting opinion, and not to conduct a true investigation. Dr. Goodell's opinion was then used to justify St. Paul's refusal to investigate the Clubhouse, and the denial of coverage. CP 2044-45, 1746-47. [10]

The Texas Supreme Court decision in *State Farm Lloyd's v. Nicolou*, 951 S.W.2d 444, 448-50 (Texas S. Ct. 1997) is instructive on this issue. In *Nicolou*, the Court held State Farm acted in bad faith by selecting an expert who "as a general rule" gave an opinion beneficial to State Farm. The underlying issue involved whether a plumbing leak caused foundation damage to a home. State Farm's expert held the "general opinion" that plumbing leaks could not cause foundation damage. *Id.* at 449. Out of approximately ninety foundation claims reviewed by the engineer, he found plumbing leaks caused damage in two. *Id.* The Court concluded there was an issue of fact whether State Farm failed to conduct a fair and objective investigation when it selected

[10] CP 1964-68. WJE and Richard Dethlefs had previously testified that decay could be back dated. St. Paul and Mr. Derrig themselves in previous claims had retained architects or engineers to back date decay, yet refused to retain them on this claim. CP 954. 970, 2051, 2105. LCS was never given the explanation for this because its Motion to Compel was denied. However, the Travelers Group's recent setbacks, Mr. Derrig's own involvement in them, and Travelers Group's efforts to prove back dating could not be done on a more probable than not standard creates an inference that St. Paul always intended to deny this claim based solely on Dr. Goodell's opinion that back dating decay was impossible to accomplish with 95% certainty. St. Paul denied the claim for precisely this reason. CP 1746-47.

this expert, and whether his selection was a pretext for denial of the claim. *Id.* at 449-50.

A similar situation exists here. St. Paul knew Dr. Goodell believed it was impossible to back date decay, raising an inference he was retained because of that opinion. CP 1962, 1955-56. This is especially true since he was chosen over a number of qualified local engineers who developed opinions regarding the progression of decay which were accepted into evidence in other cases. CP 970-75, 952-57, 2051, 2105, 2047-48. As in *Nicolou,* a jury could find Dr. Goodell was hired to provide a pretext, and not as part of a fair and impartial investigation. *See also State Farm Fire & Cas. Co. v. Simmons*, 963 S.W.2d 42 (Texas Sup. Ct. 1980) ("an insurer cannot insulate itself from bad faith liability by investigating a claim in a manner calculated to construct a pretextual basis for denial.").

St. Paul also used Dr. Goodell's opinion to claim it had no obligation to investigate until LCS could demonstrate to its satisfaction that (1) SSI existed at the condominiums during its policy periods, and (2) that it was possible to back date decay with reasonable scientific certainty. CP 2044-45. This issue goes to the heart of St. Paul's bad faith. Although the duty to investigate is triggered by notice of a claim, and it is bad faith to deny a claim without conducting a reasonable

investigation, St. Paul arbitrarily reversed roles and demanded that its policyholder conduct the initial investigation. In doing so, St. Paul adopted a burden of proof of its own making,[11] and applied it to its policyholder, as a precursor to its own investigation. This role reversal has no basis in the policy or applicable law, and therefore was done in bad faith.

In other insurance related cases, this Court has refused to allow an insurer to impose its own view of the law on its insured. *Woo v. Fireman's Fund Insurance*, 161 Wn.2d 43, 60, 164 P.3d 454 (2007) (precluding a carrier from utilizing its own interpretation of equivocal state law); *American Best Food, Inc., v. Alea London, Ltd.*, 168 Wn.2d 398, 408, 920 P.3d 31 (2010) (requiring any uncertainty in state law to be interpreted in the light favorable to the insured). The Travelers Group, of which St. Paul is a part, also unsuccessfully tried this argument in *Misawa On The Green II L.P. v. The Travelers Indemnity Co.*, USDC C00-2054C, only to be ordered by Judge Coughenour to conduct an investigation. CP 2051-57. Accordingly, St. Paul's arbitrary demand that LCS prove the existence of SSI as precursor to an investigation is a violation of the duty of good faith, which requires "the

[11] LCS has the burden of proving coverage by a preponderance of the evidence at trial. *Queen City Farms, Inc. v. Central Nat'l Ins.*, 126 Wn.2d 50, 72, 882 P.2d 703 (1994). However, it is the insurer, not the insured, who has the duty to investigate a claim. *Coventry*, 136 Wn.2d at 281.

insurer to conduct any necessary investigation . . . before denying coverage." *Coventry*, 136 Wn.2d at 281 (quoting 1 Windt, *Insurance Claims & Dispute: Representation of Insurance Companies and Insureds*, § 2.05).[12]

St. Paul's duty to conduct a fair and impartial investigation includes a duty to investigate all facts supporting coverage, as well as those facts which might support denial. *Kallevig*, 114 Wn.2d at 917; *see also Jordan v. Allstate Ins. Co.*, 56 Cal. Rptr. 3d 312, 148 Cal. App. 4th 1062 (2007) (an insurer owes a duty to its insured to investigate all possible bases for coverage). *Kallevig* involved a claim for fire damage. The insurer concluded its policyholder set the fire, but failed to investigate the possibility that the fire resulted from faulty workmanship. The Court held that Industrial Indemnity's failure to investigate evidence which might have undercut its coverage defense was sufficient evidence of bad faith to support the jury verdict. *Kallevig*, 114 Wn.2d at 917-19.

The insurer in *Kallevig*, like St. Paul here, also claimed its denial of coverage was not in bad faith because it relied upon a recognized

[12] See also *Tank v. State Farm*, 105 Wn.2d at 386 (an insurer must deal fairly with an insured in all matters); *Industrial Indemnity v. Kallevig*, 114 Wn.2d 907, 917, 792 P.2d 520 (1990) (an insurer which denies a claim after conducting an inadequate investigation violates its duty of good faith and the CPA); *Onvia*, 165 Wn.2d at 132 (every insurer has a duty to investigate promptly and in good faith); *Aecon Buildings, Inc. v. Zurich North America*, 572 F. Supp. 2d 1227, 1236 (W.D. Wash. 2008) ("it is an insurer's affirmative duty to investigate a claim before it denies coverage, not the insured's duty to continue supplementing the record to an uninquisitive insurer.")

expert to support its position. The Court rejected this assertion, stating:

> It is not the stature of any one investigator that is crucial. What is determinative is the reasonableness of the insurer's action in light of all the facts and circumstances of the case.

114 Wn. 2d at 920. Accordingly, St. Paul cannot rely upon Dr. Goodell to throw a cloak of legitimacy over its failures. St. Paul could have retained other experts who would have rendered an opinion on timing. It could have conducted an investigation into collapse conditions at Lake Chelan Shores. It could have chosen not to hide behind Dr. Goodell's opinions when asked to investigate the Clubhouse, and it could have refrained from demanding that LCS conduct an investigation as a precursor to its own. All these actions showed far more concern for St. Paul's economic position, than that of its insured, the very definition of bad faith. *Tank,* 105 Wn.2d at 386; *Onvia,* 165 Wn.2d at 129.

4. St. Paul forced LCS to fund 100 percent of the cost to strip and reclad the siding, a necessary part of any investigation into hidden decay.

St. Paul's failure to independently investigate, or to cooperate with LCS in funding an investigation, forced LCS to incur the full cost of stripping and recladding all 21 buildings at Lake Chelan Shores. It is undisputed that hidden decay, a required condition for collapse coverage, cannot be inspected without removing at least some of the stucco cladding. LCS waited 20 months, from October 2007 through June

2009, while its contractor sequentially removed and replaced stucco siding on each of 20 buildings for St. Paul to assist in or take over the investigation. St. Paul allowed LCS to incur the full cost of removing and replacing siding, and inspected the buildings only after the stucco had been removed. CP 1919. According to Kay Thorne, LCS's insurance expert, St. Paul should have borne the full cost of the investigation, or at least a portion of the cost. CP 1937-38. The failure of St. Paul to pay any of these costs raises an issue of fact regarding its failure to investigate in good faith.

5. St. Paul failed to share the results of its investigation, even when requested through formal discovery. This effectively denied LCS the full benefit of its policies.

WAC 284-30-350 provides, "No insurer shall fail to fully disclose to first party claimants *all pertinent benefits* . . . of an insurance policy or insurance contract . . ." (italics added). Washington case law recognizes that the results of an investigation are a benefit of the policy. *Coventry,* 136 Wn. App. at 282 (when an insurer fails to adequately investigate, "the insured does not receive the full benefit due under its insurance contract."). St. Paul's policies expressly require the insured to:

> Cooperate with us in the investigation and settlement of the claim. Permit us to inspect the damaged property and any records pertaining to your loss as many times as may be required. Permit us to take samples of damaged and undamaged property for testing and analysis.

CP 157, 308, 360. The insurance contract therefore contemplates an open process where the parties cooperate "in the investigation and settlement of the claim;" not a closed process where the investigation is skewed to deliver a predetermined result.

St. Paul carefully tailored its investigation to avoid generating information beneficial to LCS. It hired Dr. Goodell as its expert on timing issues, knowing he would opine an investigation was impossible. No one else was asked to offer an opinion on timing even though Mr. Dethlefs, St. Paul's engineering expert, had done so in other cases. CP 970-1014. Similarly, St. Paul asked Mr. Dethlefs to load test four decks knowing LCS did not claim there was SSI in the support structures. CP 1981, 1987. St. Paul then relied upon these results to claim the entire project, including structures such as stairs, decks and walls which it never tested, had no risk of collapse. CP 2162. Ironically, these tests took place at the same time St. Paul refused to investigate hidden decay in the Clubhouse. CP 1981, 2044. These actions raise genuine issues of material fact whether St. Paul conducted its investigation in bad faith.

6. St. Paul's assertion that LCS suffered no harm from its failure to investigate should be rejected as a matter of law. When an insurer fails to investigate and places the full burden of investigation on its insured, there is harm.

At summary judgment, St. Paul argued there was no harm caused

by its failure to investigate because LCS previously decided to strip and reclad the buildings. CP 1586-88. LCS Board member Geoff Revelle filed a declaration contradicting this assertion. CP 1914-20. This should have been sufficient to defeat summary judgment on this issue. However, even if a preliminary decision was made to repair the buildings, St. Paul had the opportunity to conduct an investigation either before construction began,[13] while construction was proceeding on other buildings, or by cost sharing. CP 1918-19. No action taken by LCS in any way prevented St. Paul from conducting a reasonable investigation. CP 1918-19, 1937-38.

The harm to LCS is shown by the undisputed fact that LCS bore 100 percent of the cost to make intrusive openings and to remove stucco so the structure beneath could be observed. *See Coventry*, 136 Wn.2d at 285 (harm may be shown by establishing the insured incurred the costs of investigation as a result of the insurer's breach). As set forth in Mr. Thorne's Declaration, the costs of the investigation, or at least a share of the costs, should have been paid for by St. Paul. CP 1937-38. The removal and replacement of siding is a necessary cost of investigation for hidden decay. Although St. Paul had a duty to investigate, it paid none of this expense causing harm to LCS. If

[13] St. Paul had three months to commence its investigation before construction began in October 2007. CP 1601, 1668, 1964-68.

material issues of fact exist regarding the reasonableness of an insurance company's actions, summary judgment is not appropriate. *Smith v. Safeco Ins. Co.*, 150 Wn.2d 478, 486, 78 P.3d 478 (2003).

Finally, St. Paul's argument that it was relieved from its duty to investigate by LCS's decision to repair is a clever bit of misdirection. The issue is St. Paul's failure to investigate, not the actions of the LCS Board. LCS did not have time to wait for a dilatory or uninquisitive insurer to investigate. *Cf. Aecon v. Zurich*, 157 F. Supp. 2d at 1236. An analogous argument was made in *Ledcor Inds. (USA), Inc. v. Mutual of Enumclaw Ins. Co.*, 150 Wn. App. 1, 9, 206 P.3d 1255 (2009). MOE failed to investigate or provide a defense, but claimed its obligations were "relieved" because another insurer defended. Division I rejected this argument. "The fact that Ledcor's other insurers were actively defending Ledcor's interests does not relieve MOE of its duties, under *Tank* and its own contract, to investigate and defend." *Id.*

7. The trial court erred by dismissing LCS's Consumer Protection Act claim.

To prove a CPA claim, a policyholder must show:

> (1) an unfair or deceptive act or practice, (2) in trade or commerce, (3) that impacts the public interest, (4) which causes injury to the party in his business or property, and (5) which injury is causally linked to the unfair or deceptive act.

Kallevig, 114 Wn.2d at 920-21. An unfair or deceptive practice may be

established by a single violation of WAC 284-30-330, -350, or -370:

> A violation of WAC 284-30-330 constitutes a violation of RCW 48.30.010(1), which in turn constitutes a per se unfair trade practice by virtue of the legislative declaration in RCW 19.86.170. This per se unfair trade practice may result in CPA liability if the remaining elements of the 5-part test for a CPA action under RCW 19.86.090 are established.

Kallevig, 114 Wn.2d at 923; *Onvia,* 165 Wn.2d at 133 (any violation of Chapter 284-30 WAC automatically establishes the first two elements of a CPA claim). An insurer may be liable for bad faith under the CPA even in the absence of coverage. *Onvia,* 165 Wn.2d at 133-34.

The record in this case, as discussed above, establishes numerous issues of fact relating to St. Paul's violation of WAC 284-30-330, -350, and -370 arising from its failure to timely, fairly and reasonably investigate the LCS claim. The remaining elements of a CPA claim are also met. The sale of insurance occurred within trade or commerce; the business of insurance affects the public interest; the failure to investigate in good faith caused LCS to incur the costs of investigation; and the harm is linked to the failure to investigate. The trial court's dismissal of the CPA claim as a matter of law was in error and should be reversed.

C. The trial court abused its discretion by denying LCS's motion to compel discovery from St. Paul, and by denying its motion for a CR 56(f) continuance.

1. Standard of Review

The trial court's denial of a motion to compel discovery and a

motion for a CR 56(f) continuance are reviewed under an abuse of discretion standard. *Weber v. Biddle,* 72 Wn.2d 22, 431 P.2d 705 (1967) (motion to compel); *Colwell v. Holy Family Hospital,* 104 Wn. App. 606, 611, 15 P.3d 210 (2003) (CR 56(f) continuance).

2. The trial court abused its discretion by denying LCS's motion to compel, by allowing St. Paul to withhold numerous claim file documents from production, and by allowing St. Paul's claims adjusting functions to be shielded from discovery by the attorney-client privilege.

LCS sent identical sets of Interrogatories and Requests for Production to St. Paul and Northern on July 20, 2009. CP 1842-67. In overview, these requests sought the insurers' claim files in their entirety, and documents and information relating to the handling of other collapse cases. CP 1837-40, 1869-79. Although St. Paul made numerous objections, it did not seek a protective order. LCS then moved to compel responsive answers. CP 1826-36. The trial court denied the motion contemporaneously with granting St. Paul's motion to dismiss LCS's extracontractual claims. CP 2288-89. When LCS filed a similar Motion to Compel against Northern a few weeks later, the motion was granted and the production of Northern's claims file was compelled. CP 2295-98, 2299-2302. LCS was able to use this discovery to obtain summary judgment against Northern for bad faith. CP 2299-2302. Accordingly, the trial court's disparate treatment of these motions denied LCS the

opportunity to fully prepare its case against St. Paul and resulted in polar opposite outcomes for two very similar claims.

a. A party responding to discovery must provide responsive answers. It cannot redefine the requests, or unilaterally limit its search.

In *Magana v. Hyundai Motor America*, 167 Wn.2d 570, 220 P.3d 191 (2009), the Supreme Court upheld a default judgment of $8,000,000 as a discovery sanction. Magana, injured because of an automobile seat back failure, had requested historical claims records. Hyundai limited its search to its legal department, made similar objections to those asserted by St. Paul, and finally produced limited documents shortly before trial. Upholding the sanctions, the Supreme Court held:

> If a party objects to an interrogatory or request for production, then the party must seek a protective order under CR 26(c). If the party does not seek a protective order, then the party must respond to the discovery request. . . . "[A]n evasive or misleading answer is to be treated as a failure to answer."

167 Wn.2d at 584. The Court further held that a corporation is required to "search all of its departments," when a party requests discovery, and cannot use a limited search "as a shield." *Id.* at 586. The Court found Hyundai was a "sophisticated multinational corporation" "experienced in litigation." It was, therefore, required to "maintain a document retrieval system which would allow the corporation to respond to the plaintiff's requests." *Id.* at 586. The Court concluded that Hyundai engaged in

willful discovery abuses that substantially prejudiced Magana's ability to prepare his case for trial. *Id.* at 601.

As in *Hyundai*, St. Paul arbitrarily limited its search for prior claims files to those known to Mr. Luoma, and Mr. Derrig, claiming it did not maintain a database. CP 1845-46, 1853. St. Paul also unilaterally limited the requests to Washington, although this geographical limitation has no relevance. CP 1854. Like Hyundai, St. Paul is a large corporation, sophisticated in litigation. CP 1853-54. St. Paul was therefore required to maintain a system which would allow it to respond to discovery, and it should not have been allowed to use a limited search as a shield.

b. St. Paul's claim file is discoverable.

In *Escalante v. Sentry Insurance*, 49 Wn. App. 375, 743 P.2d 832 (1987), *review denied,* 109 Wn.2d 1025 (1988), Division I considered whether an insurer's claim file is discoverable in a bad faith case.

The Court first examined the attorney-client privilege, considering whether the civil fraud exception applies in bad faith litigation. *Id.* at 393. Adopting the reasoning in *Caldwell v. District Court,* 644 P.2d 26 (Colo. 1982), the Court held the privilege may be overcome by a showing of a foundation in fact for bad faith tantamount to civil fraud. Recognizing the inherent difficulties of proof in bad faith

litigation, the Court held the "foundation in fact" could be established after an in camera inspection. To justify the in camera inspection, the insured need only make a showing "adequate to support a good faith belief by a reasonable person that wrongful conduct sufficient to invoke the . . . fraud exception . . . has occurred." *Id.* at 394.[14]

Escalante then examined the issue of work product immunity. Relying upon *Heidebrink v. Moriwaki,* 104 Wn.2d 392, 706 P.2d 212 (1985), the Court remanded for a determination whether the claim file documents were created in anticipation of litigation, and if so, whether the plaintiff could show substantial need. In a footnote, the Court stated:

> We note that, in general, the nature of the issues in this type of [bad faith] action automatically establishes substantial need for discovery of certain materials in an insurer's claims files.

Id. at 396 fn. 11; *accord Barry v. USAA*, 98 Wn. App. 199, 208, 989 P.2d 1172 (1999). Finally, *Escalante* considered whether the mental impressions of attorneys and others are discoverable.

Given the unique nature of bad faith actions, and considering the

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[14] In *Cedell v. Farmers Ins. Co. of Wa*, 2010 WL 3003535 (Div. II, August 3, 2010) Division II recently held that all nine elements of common law fraud must be proven to establish a foundation in fact justifying an in camera review. The Court expressly distinguished between a claim for fraud and a claim for bad faith, holding that evidence of bad faith was not sufficient to justify an in camera review. This holding conflicts with *Escalante* which noted that the civil fraud exception "is usually invoked only upon a *prima facie* showing of bad faith tantamount to civil fraud." 49 Wn. App. at 394. Moreover, the party seeking the documents need only make a showing "adequate to support a good faith belief by a reasonable person" that wrongful conduct sufficient to invoke fraud exception has occurred. 49 Wn. App at 394. This foundation in fact can also be accomplished *after* the in camera inspection. *Id.* No mention is made of proving all nine elements of common law fraud before an in camera inspection occurs.

> protection available in the form of in camera inspections, we hold that mental impressions, etc., are discoverable in a bad faith action if they are directly in issue, and if the discovering party makes a stronger showing of necessity and hardship than is normally required under CR 26.

49 Wn. App. at 397.

As stated in *Escalante and Barry*, there is no substitute for a claim file to determine whether a claim was investigated and adjusted in good faith. Without access to the claim file,[15] LCS was denied the opportunity to prove what St. Paul did or did not do, and the reasons for its actions, based upon St. Paul's contemporaneous record of events. LCS met its initial burden of a foundation in fact for civil fraud through the facts discussed above. The importance of these documents is beyond dispute, as demonstrated by the disparate outcomes in this case when production was compelled and when it was not. Accordingly, it was an abuse of discretion for the trial court to deny the motion to compel.

3. <u>When an insurance carrier appoints counsel to conduct an investigation, the documents relating to that investigation should be discoverable.</u>

Prior to summary judgment, St. Paul withheld from production numerous documents from its claim file claiming attorney-client privilege, including documents which appeared to be an integral part of

[15] St. Paul divided its claim file into a pre suit claim file, a subrogation file and a litigation file. Almost the entirety of the investigation took place after suit was filed; accordingly, the majority of the claim file is believed to be in kept in the litigation file.

the investigation and adjustment of the LCS claim. CP 1845-66, 1869-79. St. Paul delegated the task of selecting and/or supervising the professional consultants to defense counsel, James Derrig. CP 1598. Mr. Derrig engaged Dr. Goodell, and asked him to render his opinions to a "reasonable scientific certainty," a standard of St. Paul's own making. CP 1962. Mr. Derrig also directed St. Paul's engineering experts to test four decks not claimed to be in a state of SSI. CP 1723, 1987. By handling its claim file in this manner, St. Paul placed all communications with Mr. Derrig at issue, and waived any privilege which might attach.

a. *The attorney-client privilege in Washington is limited to communications made in the course of a professional engagement as an attorney, not as an insurance adjuster.*

Washington's attorney-client privilege was codified in RCW 5.60.060(2)(a). The privilege does not protect all communications between a client and its attorney. The communication must occur "in the course of professional employment" and must have been for the purpose of seeking or giving legal advice. *Id.* In *Cedell v. Farmers*, 2010 WL 3003535 (Div. II, August 3, 2010) Division II recently held:

> [A]n insurance company may not hire an attorney as a claims adjuster just to fall within the attorney client privilege. A claims adjuster's conduct is not privileged simply because the claims adjuster happens to be a lawyer.

Id. Other jurisdictions have come to similar conclusions holding that when an attorney performs claim adjusting functions, his or her

communications are not protected from discovery.[16] By delegating the investigation to Mr. Derrig, and particularly the selection and direction of investigating experts, St. Paul sought to shield ordinary adjusting functions from discovery. The attorney-client privilege does not apply and it was an abuse of discretion to allow these documents to be withheld.

4. The trial court abused its discretion by denying the request for CR 56(f) continuance in regard to St. Paul's extracontractual motion for summary judgment.

In conjunction with the Motion to Compel and its response to St. Paul's motion for summary judgment on the extracontractual claims,

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[16] *See National Farmers Union Property & Casualty Co. v. District Court for the City and County of Denver*, 718 P.2d 1044, 1049 (Colo. 1986) (results of factual investigation conducted by outside attorney for insurance company not protected by attorney-client privilege); *Merrin Jewelry Co. v St. Paul Fire & Marine Ins. Co.*, 49 F.R.D. 54 (SDNY 1970) (using an attorney to conduct an investigation of a claim did not "cloak with privilege matters that would otherwise be discoverable); *Spectrum Systems Intl. Corp. v. Chemical Bank*, 575 N.Y.S.2d 809, 78 N.Y.2d 371, 379 (1991) ("a lawyer's communication is not cloaked with privilege when the lawyer is hired for business or personal advice, or to do the work of a nonlawyer."); *Evans v. United Servs. Auto. Ass'n*, 541 S.E.2d 782, 791 (N.C. Ct. App. 2001) (insurer could not claim privilege if attorney was not acting as a legal advisor when communication was made; claims investigation documents are generally discoverable); *Westhampton Adult Home, Inc., v. National Union Fire Ins. Co. of Pittsburgh Pa*, 481 N.Y.S.2d 358, 105 A.D.2d 627 (1984) (hiring counsel to supervise investigation and take statements under oath were activities normally performed in the ordinary course of insurance business and were not privileged.); *Hawley v. Travelers Ind. Co.*, 455 N.Y.S.2D 884, 90 A.D.2d 684 (1982) (where insurance company retains an expert to assist it in deciding whether to accept or reject a claim, the expert's report is not privileged); *Mission National Ins. v. Lilly*, 112 F.R.D. 160, 163 (D. Minn. 1986) (to the extent that attorneys acted as claims adjustors, their work product, communications to client, and impressions about the facts were treated as the ordinary business of insurance, outside the scope of the asserted privileges); *Montebello Rose Co., Inc. v. Agricultural Labor Relations Board*, 119 Cal. App. 3d 1, 173 Cal. Rptr. 856 (1981) (attorney-client privilege does not attach when an attorney is acting in another capacity).

LCS requested a CR 56(f) continuance. CP 2236. As set forth above, LCS requested numerous documents from St. Paul which were not produced. This information was requested in a timely manner, it would have established the process by which St. Paul conducted its investigation, and is perhaps the best evidence of bad faith. It was an abuse of discretion not to grant a continuance to allow this information to be produced, and to allow LCS to fully prepare for St. Paul's motion. *Coggle v. Snow*, 56 Wn. App. 499, 508, 784 P.2d 554 (1990) (the primary consideration on a motion for a continuance is justice).

VI. CONCLUSION

For the above-stated reasons, the decisions of the trial court at summary judgment dismissing the contract and extracontractual claims of LCS against St. Paul should be reversed. The order denying LCS's Motion to Compel discovery form St. Paul and the Motion for a CR 56(f) continuance should also be reversed and the case should be remanded.

DATED this 16th day of September, 2010.

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DECLARATION OF SERVICE

I declare that on the 16th day of September, 2010, I caused to be served the foregoing document on counsel for Respondent, as noted, at the following address:

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Dawn L. Fisher, Legal Assistant

Dated: September 16, 2010

Place: Seattle, WA

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