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No. 70143-6-I

COURT OF APPEALS
DIVISION 1
OF THE STATE OF WASHINGTON

WESTERN NATIONAL ASSURANCE COMPANY,
a Washington corporation,

Respondent,

v.

SHELCON CONSTRUCTION GROUP, LLC,
a Washington limited liability company,

Appellant.

BRIEF OF RESPONDENT

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

This Court should affirm the trial court orders on summary judgment motions that Western National Assurance Company's ("WNAC") denial of a defense obligation under a commercial general liability policy was well grounded and correct. WNAC properly applied its policy provisions and Washington's liability insurance duty to defend rules to the Complaint filed by A-2 Venture, LLC ("A-2") against appellant Shelcon Construction Group, LLC ("Shelcon"), a WNAC insured, in Pierce County Superior Court on February 10, 2011 (the "Underlying Action").

The A-2 Complaint against Shelcon did not allege "property damage," as defined in insurance policies issued by WNAC to Shelcon to invoke a duty to defend. *See* CP 82 to 86. Moreover, the Complaint allegations also triggered several coverage exclusions in the WNAC policies. *See* CP 93 to 94. These exclusions, cited in denial letters issued by WNAC, are alternative grounds to preclude the duty to defend Shelcon in the Underlying Action.

Complaint allegations are the focus in determining an insurer's duty to defend. Facts extrinsic to the complaint are only considered for a duty to defend determination where the complaint is ambiguous or contrary to known fact. WNAC properly followed these rules in denying

the defense of Shelcon in the Underlying action. The Complaint filed by A-2 against Shelcon was clear and unambiguous. A-2, a developer, suffered purely economic loss by way of diminished value of its property when it sold the property. No "property damage", i.e., tangible physical injury or loss of use, was alleged. During construction, Shelcon simply removed measurement stakes from dirt fill it added at a construction site making it impossible to prove dirt subsidence levels to support the original scope of intended housing development. CP 82-86. A-2 ultimately sold its property to another developer albeit at a claimed diminished sales price. It sought a damages recovery from Shelcon for the reduced property value difference. CP 82-86.

Despite the extensive statements to the contrary in Shelcon's multiple filings, the Underlying Action complaint, the focus of the duty to defend analysis, does *not* allege defined tangible physical injury to any real or personal property nor loss of use which might constitute "property damage." The core of the Underlying Complaint alleged, in pertinent part:

> The employees of defendant [*i.e.*, Shelcon] removed the settlement markers without the knowledge of the plaintiff or plaintiff's engineers and continued to install fill on top of the area. . . . The said actions by defendant reduced the value of the property substantially.

Emphasis added. *See* CP 84 to 85.

This fact states an uncovered diminished value claim under Washington law. Shelcon makes repeated statements that the settlement markers it installed for the Beaver Meadows project were "destroyed." (*See* pp. 3 and 4 of Appellant's Brief, citing to "Clerk's Papers" Number 18, p. 127, and pp. 61-62.) That claim is not supported by record and is completely unfounded and misleading. Nowhere in the *Complaint* is destruction of markers or any tangible property alleged. CP 84-85.

Shelon further states that Scott Haymond, a witness for A-2 testified in his deposition in the Underlying Action that the settlement markers were "destroyed." The assertion is also false. (*See* pp. 4 and 5 of Appellants Brief, citing to "Clerk's Papers" Number 18, pp. 91-111, 96-98 and 100-102.) Haymond actually testified that Shelcon "installed [the settlement markers] the first time, *pulled them out*, raised the fill, and never installed them a second time." (*See* p. 15 of Haymond Testimony, lines 3–4; CP 128) (emphasis added). Shelcon simply misleads on this point trying to manufacture covered property damage.

As explained more fully below, even if the A-2 Complaint could have conceivably been read to allege "property damage" as defined by the WNAC policies, Exclusions j.5, j.6 and m. of the WNAC policies were triggered by the Underlying Action complaint allegations. The exclusions

are alternative grounds for denying any duty by WNAC to defend Shelcon in the Underlying Action.

Shelcon suggested below (CP 34) and again in this appeal (see pp. 8 and 9 of Appellant's Brief) that Washington law required WNAC to (1) contact the parties and attorneys in the Underlying Action and interview them, (2) attend depositions in the Underlying Action, and (3) ask for and review written discovery responses and other written materials in the Underlying Action months after the complaint was filed to determine if there was a duty to defend. There is no authority for these assertions. It is not what an insurer must do when the complaint allegations are clear when tender is first made.

The Honorable Michael Trickey properly determined there was no duty of WNAC to defend Shelcon in the Underlying Action when he granted WNAC's motion for summary judgment. CP 276-278. Judge Trickey also properly determined there was no duty of WNAC to defend Shelcon in the Underlying Action *and* that WNAC did not breach any duty to defend when he denied Shelcon's cross-motion for summary judgment on these issues. CP 279-281.

WNAC respectfully requests this Court to affirm both orders of Judge Trickey finding that there was no duty to defend *and* no breach by

WNAC of a duty to defend Shelcon in the Underlying Action based on the allegations of the Complaint and the WNAC policy.

II. ISSUES ON APPEAL

Whether the trial court correctly ruled in granting WNAC's motion for summary judgment and denying Shelcon's cross-motion for summary judgment that WNAC had no duty to defend and did not breach any duty to defend Shelcon in the Underlying Action filed by A-2 against Shelcon?

III. STATEMENT OF THE CASE

A. A-2 Claim, Complaint and Tenders of Defense.

On or about February 10, 2011, A-2, a developer, filed a lawsuit against Shelcon in Pierce County Superior Court under Cause Number 11-2-06443-9 (the "Underlying Action"). CP 82-86. The A-2 complaint alleged that Shelcon performed improper soil preparation work under a January 10, 2006 written bid submitted to and accepted by A-2 for a residential construction project known as "Beaver Meadows." The Underlying Action Complaint alleged:

> During the site preparation by defendant [*i.e.*, Shelcon], settlement markers were put in place as required. The Markers were required to be monitored until the full amount of settlement had occurred during and after fill compaction.
>
> The employees of defendant [*i.e.*, Shelcon] *removed* the settlement markers without the knowledge of the plaintiff or plaintiff's engineers and continued to install fill on top of the area. This made it impossible to accurately measure the

settling. There was therefore a total failure to meet the geotechnical requirements of the job so that the property could be used to construct improvements on. When defendants said negligent actions had been discovered, the costs and time of remedying the errors was impractical. *The said actions by defendant reduced the value of the property substantially.*

...

The failure of defendant to properly prepare the site and soil on plaintiff's property caused the plaintiff to sustain fair reaching damages including, but not limited to the following:

Prior to defendant commencing work on the subject property the plaintiff, on December 12, 2005, entered into a purchase and sale agreement of the subject property to Sound Built Homes for the price of $8,550,00.00 being 57 lots at $150,000.00 per lot. The agreement included a feasibility contingency which provided that all site improvements would be completed so as to permit building on the site.

On August 15, 2007 Sound Built Homes rescinded its agreement to purchase the land because of the failure of the soil preparation to meet the requirements of the geotechnical soil report. The soil preparation had been negligently and improperly done by defendant as aforesaid.

Plaintiff then reduced the price of the land to $6,412,500.00 by purchase and sale agreement to Harbour Homes dated October 19, 2007 based upon buyer's knowledge of the soil preparation errors of defendant and an estimate of the costs of rectifying them. Harbour Homes thereafter rescinded the lower priced agreement in February, 2008.

One loss to plaintiff was the immediate reduction in value of the property from $8,550,000.00 to $6,412,500.00, i.e. $2,137,500.00 and further losses because of resulting loan defaults and market changes because the property could not be developed or sold.

Emphasis added. *See* pp. 3 through 5 of Underlying Action Complaint, CP 84-86. Lots were ultimately sold. CP 423. A-2 never suffered a loss of entire value of the property. CP 84-86; CP 423. Its investment and expectations of profit were diminished. *Id.*

On October 4, 2011, counsel for Shelcon, Larry Linville, sent a tender of defense letter to Loralee Thatcher of WNAC of the A-2's lawsuit. CP 106-108. This letter was received on October 7, 2011. CP 301. In response, Ms. Thatcher wrote to Shelcon counsel Linville providing Shelcon with WNAC's position regarding the A-2 Venture lawsuit tender:

> A-2 maintains that Shelcon failed to adhere to the Riley Group Geotechnical Report dated October 24, 2005 that was part of the contract documents. Soils conditions at the site called for the installation of settlement markers to be inspected until 95% compaction was achieved at each level of fill. A-2 asserts that Shelcon removed the markers and simply continued to install fill material. Their actions resulted in 'a total failure to meet the geotechnical requirements of the job so that the property could be used to construct improvements on. When defendant's said negligent actions had been discovered, the costs and time of remedying the errors was impractical. The said actions by defendant *reduced the value* of the property substantially.'

Emphasis added. *See* December 19, 2011 letter, CP 110.

The letter went on to cite portions of the insuring agreement of the January 20, 2006 to January 20, 2007 WNAC's CGL policy issued to

Shelcon as well as exclusions j. and m. The letter set forth the definitions reiterated above.

The letter closed with the following conclusion:

> *We have reviewed the allegations contained in the A-2 complaint and they do not meet the definition of 'property damage.' Moreover, even if the allegations did allege 'property damage,' the 'property damage' exclusions j. and m. would exclude the claim.* Therefore, the claim is not covered by the Western National policy. Accordingly, Western National will not defend nor indemnify Shelcon from this suit.

Emphasis added. *See* December 19, 2011 letter, CP 111.

On February 17, 2012, counsel for Shelcon, Larry Linville, again wrote to Loralee Thatcher enclosing the deposition transcript of witness Scott M. Haymond taken in the underlying A-2 lawsuit. CP 137-139. The February 17, 2012 letter again tendered the defense of Shelcon in the A-2 lawsuit to WNAC and enclosed the A-2 contract. CP 137.

A review of Mr. Haymond's 21-page deposition transcript makes it clear that counsel for Shelcon *tried* to get Mr. Haymond to testify that Shelcon "damaged," not replaced, the settlement markers that A-2 Ventures alleged were removed. CP 114-134. However, although heavily pressed, Mr. Haymond did <u>not</u> contend that any damage was done to the markers or any other tangible property by anyone. CP 114-134. Haymond simply did not testify that Shelcon's work caused "property

damage" as defined under the WNAC policies. CP 114-134. No physical injury of any kind or loss of use was alleged by him on behalf of A-2.

The absence of proof of soil settlement measurements to support land sales value expectations was the alleged harm, not a physical injury or loss of use of the property. No amended complaint adding new information or damage claims was ever filed by A-2. The original complaint determined the duty to defend.

On March 20, 2012, WNAC responded to the February 17, 2012 re-tender letter. The letter stated as follows:

> The A-2 Venture ('A-2') complaint alleges that Shelcon Construction Group, LLC ('Shelcon') removed settlement markers in violation of the soils report and contract documents. A-2 further alleges that as a result of Shelcon's removal of the markers, the property in question became less marketable because it cannot prove soil compaction. *There is no claim that Shelcon's work resulted in physical injury to or loss of the property; only that the property became less attractive to potential buyers.*
>
> Even if the complaint did allege 'property damage' as that term is defined in the policy, exclusions in the policy would eliminate coverage. Removal of the settlement markers occurred while Shelcon was 'performing operations' at the site and policy CP30007658 excludes damage occurring while the insured is performing operations on a job site[.]

Emphasis added. *See* March 20, 2012 letter, CP 141-143.

The letter then quoted the exclusions 2.j.(5) and (6) and 2.m.(1) and (2), for "impaired property." CP 142. The denial letter went on to

explain the application of the exclusions to negate coverage of the claim in the complaint.

> The alleged damages in the A-2 complaint are not "property damage" as defined in the policy. *The land has not sustained a physical injury. Although it is less marketable, it can be used and therefore has not sustained a loss of use. Moreover, even if the allegations did allege 'property damage,' the alleged damage occurred at the time Shelcon removed the settlement markers which was during the operation of their work and exclusions j.(5) and (6) would exclude the claim.*
>
> *Any loss of use of the property that was not damaged is deemed to have occurred at the time of the 'occurrence' that caused the loss of use. Here, that would be the removal of the markers. However, because the markers were removed during operations, j.(5) and j.(6) exclude any subsequent loss of use.*
>
> *Exclusion m also excludes coverage. The property is tangible property that has not been physically injured or is less useful because of the removal of the settlement markers. It could be restored or used by replacement of the settlement markers and therefore satisfies the definition of 'impaired property.'* Exclusion m excludes coverage for any 'property damage' to impaired property.

Emphasis added. *See* March 20, 2012 letter, CP 143.

The denial letter then closed with a reiteration of the denial of the tender of defense based on the complaint allegations as well as newly-supplied information from Shelcon's counsel. It stated, "Because the allegations in the complaint failed to allege 'property damage' and, even if the allegations do allege property damage, the damages are excluded by exclusions j.(5), j.(6), and m, [WNAC] cannot defend or indemnify

Shelcon from the allegations in this lawsuit." CP 143. No amended complaint in the Underlying Action was ever tendered to Western National in which "property damage" as defined in the WNAC policies was alleged. CP 303.

B. Judgment for Shelcon and Findings of Fact and Conclusions of Law Supporting that Judgment.

Shelcon eventually obtained judgment in a bench trial in its favor against A-2 including Shelcon's counter-claim for contractual prevailing party defense fees and costs in the Underlying Action. Shelcon has a judgment against A-2 for the same attorney's fees and costs it seeks as breach of contract damages from WNAC. *See* September 28, 2012 Judgment, CP 412-413. Findings of Fact and Conclusions of Law on the Judgment were entered in favor of Shelcon on the A-2 claims. CP 415-426.

Nowhere in the underlying findings of fact is there any finding of "property damage" (including "loss of use") as defined by the WNAC policies and no findings of fact or conclusions of law that negate the application of the exclusions j.(5) and (6) and m. cited in the WNAC denial letters. CP 415-426. The findings do report actual sale of lots for building dispelling loss of use claims to the contrary. CP 423. Thus, even if this extrinsic evidence was relevant to the duty to defend issue at time of

tender, it did not establish a duty to defend Shelcon in the Underlying Action.

C. The WNAC Policies Issued to Shelcon.

WNAC issued Shelton Policy No. CP-300007658-00, with effective policy dates January 20, 2006 to January 20, 2007, Policy No. CP-300007658-01, with effective policy dates January 20, 2007 to January 20, 2008, and Policy No. CP-300007658-02, with effective policy dates January 20, 2008 to January 20, 2009. See CP 353-367; CP 369-391; CP 393-410.

The insurance policies contained the following relevant policy provisions:

> SECTION I – COVERAGES
>
> COVERAGE A – BODILY INJURY AND PROPERTY DAMAGE LIABILITY
>
> 1. Insuring Agreement
>
> a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" and "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply.
>
> . . .

b. This insurance applies to … "property damage" only if:

(2) The … "property damage" occurs during the policy period; and

. . .

2. Exclusions

This insurance does not apply to:

. . .

j. Damage to Property

"Property damage" to:

. . .

(5) That particular part of real property on which you or any contractors or subcontractors, working directly or indirectly on your behalf, are performing operations, if the "property damage" arises out of those operations; or

(6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

. . .

m. Damage to Impaired Property or Property Not Physically Insured

"Property damage" to "impaired property" or property that has not been physically injured, arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work"; or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

See relevant portions of Western National issued Policies, CP 360, 362, 363, CP 382, 384, 385, CP 403, 405, 406.

The term "occurrence" is defined as follows, under the policies:

"Occurrence" means an accident, including continuous and repeated exposure to substantially the same harmful conditions.

CP 365, 389, 408.

The term "property damage" is defined in the policies as follows:

a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.

CP 366, 390, 409.

The term "impaired property" is defined under the Western National policies as follows:

"Impaired property" means tangible property, other than "your product" or "your work", that cannot be used or is less useful because:

a. It incorporates "your product" or "your work" that is known or thought to be defective, deficient, inadequate or dangerous; or

b. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by:

a. The repair, replacement, adjustment or removal of "your product" or "your work"; or

b. Your fulfilling the terms of the contract or agreement.

CP 364, 388, 407.

The term "your work" is defined as under the policies as follows:

"Your work" means

(1) Work or operations performed by you or on your behalf; and

(2) Materials, parts or equipment furnished in connection with such work or operations.

CP 367, 391, 410.

IV. ARGUMENT

A. Standard of Review.

The standard of review of a trial court's granting (and denying) of summary judgment is de novo with the appellate court engaging in the

same inquiry as the trial court. *See Keith v. Allstate Indemn. Co.*, 105 Wn. App. 251, 254, 19 P.3d 1077 (2001).

B. Summary Judgment Dismissal of Shelcon's Breach of Duty to Defend Claims Against WNAC Was Correct.

The interpretation of an insurance policy is an issue of law. *Schwindt v. Underwriters at Lloyd's of London,* 81 Wn. App. 293, 298, 914 P.2d 119, 122 (1996). Insurance policy language is interpreted as it would be understood by an average person and in a manner that gives effect to each provision. *Id.* Determining whether coverage exists is a two-step process. The insured must show the loss falls within the scope of the promise of coverage which is set forth in the Insuring Agreement section of the policy. *Allstate Ins. Co. v. Bowen*, 121 Wn. App. 879, 91 P.3d 897 (2004). In this case, that means that Shelcon must meet its obligations under the Insuring Agreement language and show facts supporting covered "property damage." If Shelcon meets its obligation, the burden would then shift to WNAC to show that the alleged "property damage" loss is excluded by specific policy language. *McDonald v. State Farm Fire and Casualty Company,* 119 Wn.2d 724, 730, 837 P.2d 1000, 1003-1004 (1992). WNAC's motion for summary judgment was properly granted because Shelcon failed in its burden and Western, in contrast,

showed exclusions would apply even if Shelcon met its burden on "property damage."

C. Allegations of A-2's "Losses" Caused by Shelcon Do Not Constitute "Property Damage" as Defined by WNAC's Policies.

Shelcon had the burden to establish that the A-2's complaint allegations fall within the coverage grant of WNAC's policies. In order to meet its burden, it had to show claims of "property damage," as defined, caused by an "occurrence," as defined, during the policy periods. This standard form language has been held to be unambiguous and has been applied to claims for "property damage" in numerous Washington decisions. *See, e.g., Queen City Farms, Inc. v. Central Nat' Ins. Co. of Omaha*, 126 Wn.2d 50, 71-72, 882 P.2d 703, 715-16 (1994); *State Farm Fire & Casualty Co. v. English Cove Ass'n, Inc.*, 121 Wn. App. 358, 363, 88 P.3d 986, 989 (2004).

The WNAC policies define "property damage" to mean "Physical injury to tangible property, including all resulting loss of use of that property" or "loss of use without physical property damage." WNAC policies do not provide coverage for products and work that merely breach contract conditions but do not cause secondary damage to property. Here no secondary property damage was alleged in the Underlying Complaint. Even if "property damage" to the insured's work was alleged

it would not be covered under a CGL liability policy because of its mere presence in an otherwise sound construction project. *Yakima Cement Product Company v. Great American Insurance Company*, 93 Wn.2d 210, 218 (1980) (no coverage where no damage to property other than insured's product/work). Here there was no alleged damage to Shelcon's property let alone A-2's property.

When an insurer issues a CGL policy, courts have ruled that it is not issuing a performance bond, product liability insurance or malpractice insurance. *Westman Industries Co. v. Hartford Ins. Group*, 51 Wn. App. 72, 80 (1988). A general liability policy is not intended to encompass the risk of an insured's simple failure to adequately perform work. *Id.* at 80. Economic damages attendant to the insured's own faulty work are part of every business venture and is a business expense to be borne by the insured-contractor. *Id.* at 80; *citing Indiana Ins. Co. v. DeZutti*, 408 N.E.2d 1275, 1279 (Ind. 1980). They are business risks long excluded by comprehensive general liability policies. *Id.*

A general liability policy does not insure a contractor against his own failure to simply perform his contract. *Id.; citing Weedco v. Stone-E-Brick*, 81 N.J. 233, 405 A.2d 788, 791-792 (1979); *Harrison Plumbing v. New Hampshire Ins. Group*, 37 Wn. App. 621 (1984). In *Harrison Plumbing*, an insured was sued for failure to complete an irrigation system

within the terms of its contract. The court ruled that the CGL policy was not intended to indemnify the contractor for damages resulting from defective or incomplete workmanship. *Id.* Restoration, repair and replacement of the insured contractor's work and consequential loss of use losses were not covered. *Id.*

An insurer's duty to defend is determined solely by the allegations in the Complaint. *Transamerica Ins. Co. v. Preston*, 30 Wn. App. 101, 103, 632 P.2d 900 (1981). More specifically, the duty to defend arises when a complaint against the insured, construed liberally, alleges facts which could, if proven, impose liability upon the insured within the policy's coverage. *Unigard Ins. Co. v. Levin*, 97 Wn. App. 417, 425, 983 P.2d 1155 (1999). If the allegations in the complaint are not covered by the policy, the insurer is relieved of its duty to defend. *Kirk v. Mt. Airy Ins. Co.*, 134 Wn.2d 558, 561, 951 P.2d 1124 (1998).

Here, the Underlying Action complaint allegations refer only to a claim being made by A-2 against Shelcon for diminished economic value of land due to the alleged removal of settlement markers on a construction project preventing record proof of soil settlement per the geotechnical plan. The developer simply received less money when he ultimately sold the property. Complaint; *see* CP 82-86. There are no allegations of any "property damage," *i.e.*, tangible physical injury to A-2's property or loss

of use or repair costs in the Complaint to trigger any duty to defend. *See* CP 82-86. A-2 stated an uncovered diminished value claim.

Case law has long held that an economic loss (diminishment in value) asserted by a claimant resulting from failed performance without more is not "property damage." The Court of Appeals has held that complaint allegations of a breach of contract by the defendant resulting in the loss of profit did not constitute "property damage" under the policy definition because the "complaint did not allege loss of use of *tangible* property." *Scottsdale Ins. Co. v, Int'l Protective Agency, Inc.*, 105 Wn. App. 244, 249-250, 19 P.3d 1058 (2001) (citing out-of-state authorities holding no coverage for "pure economic loss"). Here, the damages alleged in the Underlying Action were purely economic, *i.e.*, lost value/diminishment in land development potential and sale value, and did not fit under the definition of "property damage." There was accordingly no duty to defend.

A recent federal court decision applied Washington law and analyzed complaint allegations made in a construction breach of contract case to conclude there was no duty to defend the construction-related claims. *See Big Construction, Inc. v. Gemini Ins. Co.*, 2012 WL 1858723 (W.D. Wash. 2012). In that case, the court explained how the complaint did not allege "conceivable" property damage and trigger a duty to defend:

The underlying Kim Complaint, liberally construed, fails to allege facts, if proven, which would impose liability upon the insured within the policy's coverage. First, the Kim Complaint alleges that Big Construction "failed to complete the construction work to the satisfaction of Plaintiff in a timely manner or in a manner at or above industry standards." Dkt. 26–1 pp. 23. *This does not describe any "property damage" caused by an "occurrence" so as to be even conceivably covered under Gemini's policy.* Allegations of incomplete, non-conforming, unsatisfactory, and otherwise defective work did not give rise to any duty to defend.

Second, the Kim Complaint alleges that there was "a failure in the steel framing and construction of the home [that] will require large amounts to repair." Dkt. 26–1 pp. 23. *Again this allegation fails to assert accidental physical injury to tangible property.*

Third, the Kim Complaint alleges that Big Construction "caused [the] residence ... to be over excavated by more than twelve inches, thus causing the failure of the steel framing." Dkt. 26–1 pp. 23–24. *This deviation from construction requirements may have impacted other construction at the project, but it does not involve any conceivable "property damage" or an "occurrence."*

Fourth, the Kim Complaint alleges that "more than $500,000 is needed for repairs and completion of the house" because of Big Construction's "failures," and that Big Construction "failed to repair substandard and below Pierce County Code construction" after being informed of the violations. Dkt. 26–1 pp. 24. *Costs to complete or repair Big Construction's defective or unsatisfactory work are not "property damage" or an "occurrence."*

...

Seventh, the Kim Complaint alleges that Big Construction's "[i]ncomplete and below industry standard work has caused Plaintiff to incur ....diminution of property value on the home." Dkt. 26–1 pp. 25. *Diminution in value by itself is*

> *pure economic loss and not "physical injury to tangible property." Allstate Ins. Co. v. Bowen,* 121 Wn. App. 879, 888, 91 P.3d 897 (2004).
>
> ...
>
> *In sum, the underlying Kim Complaint does not allege any claims that could have "conceivably" described "property damage" that was caused by an "occurrence."* Gemini had no duty to defend or indemnify Big Construction.

Emphasis added. *Big Construction, Inc. v. Gemini Ins. Co.*, 2012 WL 1858723, 7-9 (W.D. Wash. 2012).

Likewise, here, the A-2 complaint does not allege any claims that have "conceivably" described defined "property damage" caused by an "occurrence." *See* CP 82-86.

D. <u>The Economic Losses Alleged by A-2 Are Not Loss of Use-Type "Property Damage."</u>

The Complaint is clear that the subject property had a use albeit it at a reduced sales price in spite of the settlement marker removal and soil compaction issues. A-2 alleged, "When defendants said negligent actions had been discovered, the costs and time of remedying the errors was impractical. *The said actions by defendant reduced the value of the property substantially.*" *See* CP 85 (emphasis added). Ultimately lots were sold to homeowners albeit not at the expected values. CP 423.

The subject property always had a "use." A-2 did not allege in its complaint that it lost the entire anticipated $8,550,000.00 value of the

property due to the improper work by Shelcon, making the property "useless." Instead, the A-2 Venture complaint alleged "an immediate reduction in value of the property from $8,550,000.00 to $6,412,500.00, i.e.[,] $2,137.500.00." *See* CP 86. This is an uncovered diminished value, not a physical property damage or loss of use claim.

Case law establishes that "diminution in value" of tangible property is not "property damage" as it is defined in CGL policies. *Walla Walla College v. Ohio Cas. Ins. Co.*, 149 Wn. App. 726, 735, 204 P.3d 961 (2009) ("the College cannot establish that diminution in the value of the tank is property damage under the policies"); *see also Washington Pub. Util. Dists.' Utils. Sys. v. PUD 1*, 112 Wn.2d 1, 14, n.3, 771 P.2d 701 (1989) (case involving the validity and coverage of self-insurance agreements for claims between County PUD and its treasurer/controller over the loss of $1.7 million dollars in PUD funds in which the Court noted, "The parties do not dispute the fact that the securities investment losses in this case do not constitute tangible property as the term is used in insurance policies. [Citations omitted.]") These holdings are consistent with treatises and published authorities. *See* McCullough, *Property Insurance,* in PRACTICAL LAWYER'S INSURANCE MANUAL NO. 1, 61 (1975), *cited* in *Seattle First National Bank v. Washington Insurance Guarantee Association,* 116 Wn.2d 398, 409, 804 P.2d 1263 (1991) ("no

coverage for items of consequential loss, such as … diminution in value to property that is itself not physically damaged by an insured peril.")

Other courts have ruled that the loss of profits from the sale of property or diminished value of the property is not a "loss of use" constituting that prong of CGL defined "property damage." In *Tschimperle v. Aetna Cas. & Sur. Co.*, 529 N.W.2d 421 (Minn. 1995), the Court held, "[T]he general rule is that loss of investment does not constitute damage to tangible property. [Internal citations omitted.]" *Id.* at 425.

In *Hartford Acc. & Indemn. Co. v. Case Foundation Co.*, 10 Ill. App. 3d 115, 124, 294 N.E.2d 7 (1973), the Illinois Court of Appeals made these salient comments regarding the duty to defend alleged "loss of profits" in sale or development of property as "property damage":

> Wolman's complaint alleged that because of breaches of contract and negligence by Case, Skidmore and Tishman, there were delays in the construction of the 100-story John Hancock Center causing him to lose financing commitments and compelling him to sell his interest in the project to the loss of investments and anticipated profits. A different case would have been stated had Wolman alleged injury to or destruction of property by Case, Skidmore and Tishman which produced the claimed damages. Whether, had such allegations been made, consequential damages would have been covered by Hartford's policy is a question we need not decide because Wolman's complaint did not allege such facts.

This is the exact scenario here – the loss of profits from the reduced sale price of the Beaver Meadows project, *i.e.*, the diminished value of the project, were caused by Shelcon's errors. No damages were alleged for repair, replacement or substitution.

E. Shelcon's Distinction Between "Diminution in Value" and "Property Damage" Is Without Merit.

This section of Shelcon's brief rests on the faulty premise that "A-2's Complaint alleged physical injury to the Subject Property caused by Shelcon's placement of 4-6 feet of immeasurable fill dirt on top of the Subject Property" (see p. 36 of Appellant's Brief). The complaint makes no such claim. Shelcon simply is wrong when it asserts (on p. 38 of its Brief), "This case is about property damage (physical injury to tangible property and/or loss of use of tangible property that is not physically injured)" when it refers to the A-2 Complaint allegations.

Rather, A-2's complaint was based on the diminution in value allegedly caused by Shelcon's removal of the settlement markers preventing a land sale at the apparent high point of the real estate market. *See* CP 82-86. Diminution in value alone without the triggering "physical injury to tangible property" is not potentially-covered "property damage" under the Western National policies.

Shelcon cited below in the trial court briefing to *New Hampshire Ins. Co. v. Viera*, 930 F.2d 696 (9th Cir. 1991). This decision actually defeats Shelcon's arguments. In that matter, the issue was "[whether] the purported diminution of value in the housing projects due to the defective installation of drywall constitutes 'physical injury to or destruction of tangible property'" under California law. *Id.* at 698. The Court held, "In light of the new, narrowed definition of property damage, we are persuaded that diminution in value is not 'physical damage' to 'tangible property,' and hence not covered by New Hampshire's policy." *Id.* at 701.

The other "diminution in value" case cited here (and below) by Shelcon, *Missouri Terrazo Co. v. Iowa Nat'l Mut. Ins. Co.*, 740 F.2d 647 (8th Cir. 1984), does not further Shelcon's "property damage" arguments either. In that case, "cracking and discoloration" of the floor installed by the insured became apparent during the policy period of the liability insurance policy at issue. *Id.* at 649. Under these facts, the court held, "Here, the physical damage to tangible property, *i.e.*, the physical deterioration of the floor, is manifest. We agree with Missouri Terrazzo that the diminution in value in this case is 'merely a means of measuring the damage sustained as a result of the property damage.' We therefore hold that the district court did not err in its conclusion that Missouri Terrazzo's liability to National Supermarket was based on 'property

damage,' as that term is defined in the policy." *Id.* at 650. This means that coverage could extend to the diminution in value damages as long as there also is "physical damage to tangible property." That is not the case here.

The A-2 complaint only alleged diminution of value of the property as damages. If there had been both allegations of "physical injury to tangible property" *and* resultant diminution of value of the property, then there could be "property damage" coverage (assuming no exclusions applied). *See Hartford Acc. & Indemn. Co. v. Case Foundation Co.*, 10 Ill. App. 3d 115, 124, 294 N.E.2d 7 (1973) ("Wolman's complaint alleged that . . . there were delays in the construction . . . causing him to lose financing commitments and compelling him to sell his interest in the project to the loss of investments and anticipated profits. A different case would have been stated had Wolman *alleged injury to or destruction of property* by Case, Skidmore and Tishman *which produced the claimed damages.* Whether, had such allegations been made, *consequential damages would have been covered by Hartford's policy* is a question we need not decide because Wolman's complaint did not allege such facts.") (emphasis added). That is the case here as there is no underlying alleged "property damage" from which consequential loss of use damages could be covered.

F. Policy Exclusions Barring Coverage and a Duty to Defend.

Even if "loss of use" property damage of the subject property was alleged in the complaint, coverage was excluded by Exclusion 2.m. of the policy, as discussed below. WNAC's policies specifically exclude coverage for the underlying claim even *assuming* property damage was alleged. Coverage is defeated by operation of Exclusions J.(5) and J.(6).

1. Exclusion m. of WNAC's Policies Exclude Coverage for A-2's Allegations.

A-2 alleged non-conforming proof of soil settlement measurement by Shelcon in violation of its contractual obligations for soil preparation. This work was alleged to have caused A-2 economic losses (*i.e.*, "[t]he said actions by defendant reduced the value of the property substantially" (p. 4, lines 2 and 3 of A-2 Complaint). CP 85.

Exclusion 2.m. (invoked by WNAC in its February 17, 2012 denial) reads as follows:

> m. Damage to Impaired Property or Property Not Physically Injured
>
> "Property damage" to "impaired property" or property that has not been physically injured, arising out of:
>
> (1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work"; or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

CP 363, CP 385, CP 406.

The term "impaired property" is defined under the Western National policies as follows:

"Impaired property" means tangible property, other than "your product" or "your work", that cannot be used or is less useful because:

a. It incorporates "your product" or "your work" that is known or thought to be defective, deficient, inadequate or dangerous; or

b. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by:

a. The repair, replacement, adjustment or removal of "your product" or "your work"; or

b. Your fulfilling the terms of the contract or agreement.

CP 364, 388, 407.

Washington courts recognize that this "impaired property/loss of use" exclusion only applies when there has been no physical injury to tangible property, which is the case here, despite Shelcon's

misrepresentations. *Aetna Cas. & Sur. Co. v. M&S Industries, Inc.*, 64 Wn. App. 916, 926, 827 P.2d 321 (1992). "This exclusion helps distinguish between that which is covered under the policy, *i.e.*, the physical breakdown of the insured's product that results in some type of injury to person or property, and that which is not covered, *i.e.*, the mere failure of the product to perform as well as warranted. That is true because 'presumably [ ] the latter is a typical business risk whereas the former is more likely to have catastrophic consequences.'" *Hayden v. Mut. of Enumclaw Ins. Co.*, 141 Wn.2d 55, 66, 1 P.3d 1167 (2000).

In *Hayden*, the insurer "conceded" that there was a "loss of use of tangible property" resulting from deficient grafting of fruit buds onto a farmer's root stock to create a variety of fruit trees. *Id.* at 65. The issue in *Hayden* was whether the "loss of use" exclusion, here exclusion m., applied.

Applying exclusion 2.m. (numbered differently in *Hayden Farms*), the Washington Supreme Court ruled, "The complaint does not assert that there was any physical injury to the tangible property that would render the exclusion inapplicable *or its exception for 'sudden and accidental physical injury.'* To provide coverage here would transform [the insured's] CGL policy into a performance bond or malpractice insurance and substantially expand [MOE's] obligations under a policy beyond those

reasonably contemplated by the parties.'" *Hayden*, 141 Wn.2d at 66-67 (emphasis added). The court found the exclusion applied to deny coverage.

Likewise, the *M&S Industries, Inc.* court interpreted the "loss of use" exclusion as "exclud[ing] coverage when either: (1) the named insured delays or fails to perform the contract or (2) *the insured's products or work fails to meet the standards warranted by the contract, resulting in loss of use of another's tangible property that has not been physically injured or destroyed.*" *Id.* at 926 (emphasis added).

Any "loss of use" of the Beaver Meadows project that could conceivably be read into the allegations of the Underlying Action complaint is a loss in which Shelcon's products or work failed to meet the standards warranted by its contract, without tangible injury. The exclusion applies to any potential loss of use allegations or claims against Shelcon.

A recent Western District of Washington federal court decision applied Exclusion m. in similar circumstances to bar coverage for (including, the duty to defend) a construction-related claim. See *Big Construction, Inc. v. Gemini Ins. Co.*, 2012 WL 1858723 (W.D. Wash. 2012). In *Big Construction, Inc.*, the Court granted summary judgment to the insurer on a duty to defend issue, in part, due to the application of Exclusion m. It stated, "This exclusion bars coverage for any loss of use

property damage arising out of Big Construction's defective work or breach of contract. . . . The on-going operations and loss of use exclusions are common 'business risk' exclusions, designed to prevent the commercial general liability policy from being considered a performance bond, product liability insurance, or malpractice insurance. [Citations omitted.]" *Big Construction, Inc. v. Gemini Ins. Co.*, 2012 WL 1858723, 9-10 (W.D. Wash. 2012).

The out-of-state case cited in Shelcon's discussion of Exclusion m. below and in its appellant's brief does not provide support for Shelcon's coverage positions. In *Essex Ins. Co. v. BloomSouth Flooring Corp.*, 562 F.2d 399 (1st Cir. 2009), the duty to defend issue was whether there were any allegations of "physical injury" in the complaint filed against the insured to negate the application of exclusion "(m)," the "impaired property" exclusion. Factually, Suffolk, a general contractor, had been hired by Boston Financial Data Services (BFDS) for a tenant improvement project at BFDS's offices. Suffolk in turn hired subcontractor BloomSouth to install carpet, tile and related materials throughout the building.

After carpet was installed, odors were noticed by BFDS's employees. The general contractor Suffolk paid BFDS $1,417,500 for remediation efforts. Suffolk tendered the defense of itself and indemnity

for the payments to BloomSouth's insurer based on Suffolk's status as an additional inured under the BloomSouth policy. The tender was denied. Eventually, the additional insured general contractor Suffolk sued the subcontractor BloomSouth on multiple theories including negligence and breach of contract.

The Suffolk complaint alleged (1) BloomSouth was responsible for negligently and defectively providing and installing carpet "resulting in damage to and loss of use of the building, including an alleged unwanted odor which permeated the building," and (2) money was spent on, among other things, "removal of the existing carpet tile and adhesives, bead-blasting of the concrete floor and replacement of the carpet tile and related materials." *BloomSouth Flooring Corp.*, 562 F.2d at 402. The Court in *BloomSouth Flooring Corp.* ruled that the allegations of "an unwanted odor permeated the building and [ ] that the concrete floor required 'bead blasting'" were reasonably susceptible to the interpretation that they alleged "physical injury." *Id.* at 404.

In this context, the Court later held, "The first reason why the exclusion *[i.e.*, the "impaired property" exclusion] does not apply is plain. Suffolk's complaint alleged that odor 'permeated the building.' As we have concluded, this allegation is reasonably susceptible to an interpretation that the odor *physically injured* the property." *Id.* at 408.

Again, here, in contrast, there is no predicate "physical damage" alleged in the complaint to defeat exclusion m. The *BloomSouth Flooring Corp.* case is distinguishable.

Finally, Shelcon's analysis of the "impaired property" exclusion (*see* pp. 26 and 27 of Appellant's Brief) places additional restrictions on the application of Exclusion m. Shelcon cites the definition of "impaired property" as the source of the additional restrictions. The analysis, however, misses a critical distinction. The language of Exclusion m. does not apply only to "impaired property," a defined term in the WNAC policies. The Exclusion applies to "'Property damage' to "impaired property' *or property that has not been physically injured . . . .*" (emphasis added).

The latter emphasized language is not a redundant definition of "impaired property" (which is defined elsewhere in the policies). It is an *alternative* category of property to which exclusion m. applies. Thus, Shelcon's arguments that additional language found within the definition of "impaired property" necessarily limits the scope of the exclusion (*see* pp. 26 and 27 of the its brief) are incorrect.

The WNAC denial of the duty to defend under exclusion m. was proper. WNAC had no duty to defend Shelcon *and* had no duty to

reimburse Shelcon for its attorney's fees and costs incurred in the Underlying Action.

2. Exclusions j.(5) and j.(6) of WNAC's Policies Exclude Coverage for A-2's Allegations.

a. Exclusion j.(5)

Coverage is also precluded under Exclusion j.(5) where the insured's work must be repaired or replaced because its work is simply incorrect. It reads as follows:

> j. Damage to Property
>
> "Property damage" to:
>
> . . .
>
> (5) That particular part of real property on which you or any contractors or subcontractors, working directly or indirectly on your behalf, are performing operations, if the "property damage" arises out of those operations; or

CP 362, 384, 405.

Exclusion j.(5) applies directly to alleged "property damage" including loss of use that occurs during the course of the work on the project. It excludes coverage for losses to the property upon which a contractor works during the construction period. *Vandivort Construction v. Seattle Tennis Club,* 11 Wn. App. 303 (1974). There is no dispute here that claims asserted against Shelcon arose during the construction period.

In *Vandivort*, the insured contractor argued that earth slide damages extending beyond the property line of its client (i.e., outside of the "particular part of any property upon which operations were being performed") meant that the exclusion did not apply. *Id.* at 308. The court held that where a contractor is performing operations on property under construction and the property damage "arose out of those operations," then coverage for damage to the property is subject to the j. (5) exclusion. *Vandivort*, 11 Wn. App. 303, 308 and 310 (1974)("Vandivort was performing operations on the property and the injury here for which damages are claimed arose of those operations.").

In *Vandivort*, the court held that where a contractor is performing operations on property under construction and the property damage arose out of those operations, then coverage for damage to the property is subject to this exclusion. *Id.* Shelcon removed soil stakes during its ongoing operations. Had Shelcon wanted coverage for property damage occurring during the course of its work, it should have purchased a Builder's Risk policy. A CGL policy does not cover alleged property damage during ongoing operations.

A-2 alleged non-conforming staking and settlement monitoring work by Shelcon. This work allegedly violated a contract. Any violation of Shelcon's contractual duties by removing the settlement markers could

have only occurred during the course of Shelcon's work and prior to substantial completion of the project. As such, any claimed damages are excluded by Exclusion j.(5). *See Big Construction, Inc. v. Gemini Ins. Co.*, 2012 WL 1858723, 9-10 (W.D. Wash. 2012) (discussed in Footnote 2). *See also Vandivort, supra.*

Shelcon's citations to and lengthy quoting from numerous out-of-state cases discussing the "performing operations" j.(5) exclusion miss the important distinction between the insureds' "work" at issue in those cases and Shelcon's "work" at issue in the allegations of the A-2 Complaint.

In the cases relied upon by Shelcon, the "work" at issue by the insured was always performed on a smaller discrete "part" of a larger project or the newer, re-modeled part of a pre-existing structure or building. In the A-2 complaint, the "work" of Shelcon was "the improvements by defendant of plaintiffs' vacant land known as 'Beaver Meadows'" (*i.e., the entire project being developed from vacant land*). The markers at issue covered the whole site as did the dirt fill. These alleged facts make Exclusion j.(5) apply more broadly than it applied to the insureds in Shelcon's cited cases and negate any coverage for a diminution in value of *the entire project*.

In *Transportation Ins. Co. v. Piedmont Constr. Group, LLC*, 301 Ga. App. 17, 686 S.E.2d 824 (2009), the insured "was performing

renovation work in [the pre-existing historic Browning Hall] building" when a fire started extensively damaging the building. *Id.* at 17. More specifically, "[d]uring the renovation, a plumbing subcontractor soldering copper pipes in Room 143 accidentally ignited a wooden wall stud, starting a fire which completely destroyed the roof and entire second floor of the building and caused extensive damage to the rest of the structure." *Id.* at 18.

The insurer argued that the phrase "that particular part of real property" refers to "the entire building which was being renovated because [the insured] was performing work throughout [the building]." *Id.* at 18. The insured argued the "renovation was limited to less than one-fifth of the building and that the damage was not due to 'defective workmanship" resulting in damage to the contractors work, . . ." *Id.*

In this context, the Court applied the j.(5) exclusion more narrowly while noting, "This case is not limited to damages to 'that particular part of real property' on which the plumbing subcontractor was working when it accidentally started a devastating fire. It involves damage to the entire building, including portions to which [the insured] had not originally contracted to perform any work." *Id.* at 21. In contrast, here, the A-2 Venture complaint alleged Shelcon was responsible through its contract for "the improvements by defendant of plaintiffs' vacant land known as

'Beaver Meadows'" (*i.e.*, the entire project) and the alleged diminution in value was for the entire land. The *Piedmont Constr. Group, LLC* case is distinguishable.

Similarly, in *Columbia Mut. Ins. Co. v. Schauf*, 967 S.W.2d 74 (Missouri 1998), the work at issue was for a subcontractor of the insured "to paint, stain, or lacquer all interior and exterior surfaces of the Sodaros' [newly constructed] house." *Id.* at 76. While the subcontractor was cleaning his "spraying" equipment after previously applying lacquer, the "pump generator started a fire, which caused extensive damage ... and required the replacement of sheetrock, insulation, subflooring, molding, windows, a sliding door, and textured ceilings." *Id.*

Considering these facts, the Court in *Schauf* applied the j.(5) exclusion more narrowly to negate coverage for the damages caused by the insured's subcontractor. "Under this interpretation, only the damage the insured causes to the particular part of the property that is the object of the insured's work when the damage occurs is excluded from coverage; any other damage would not be the subject of the exclusion." *Id.* at 80. In *Shauf*, the object of the insureds/sub-contractors work was the "paint[ing], stain[ing], or lacquer[ing of] all interior and exterior surfaces of the Sodaros' [newly constructed] house." *Id.* at 76. The A-2 Venture complaint alleged Shelcon was responsible through its contract for soil

work on *the entire Beaver Meadows project* and the alleged diminution in land value was for the entire project.

Finally, in *Acuity v. Burd & Smith Constr., Inc.*, 721 N.W.2d 33 (N.Dak. 2006), the court had distinguishing facts before it which called for a more narrow application of the j.(5) exclusion. In *Acuity,* the insured (and under it, a subcontractor) were contracted to "replace the roof of the existing apartment complex." *Id.* at 35. In its complaint against the general contractor-insured, the owners of the complex "essentially claimed that while replacing the roof, [the insured] failed to protect the apartment building from rainstorms, which caused extensive damage to the interior of the building. Additionally, two building tenants claimed they sustained property loss as a result of water damage and also sued [the owner and the insured]." *Id.*

The *Acuity* court cited to cases from other jurisdictions which held:

> [O]ther courts have generally construed those property damage exclusions to exclude coverage when the property damage is to the property on which the insured has contracted to perform operations and not to exclude coverage when the property damage is to property that the insured was not performing operations on. [Citations omitted.] Some courts have specifically recognized that facts in each case are determinative of the particular part of property on which an insured is performing its operations and that buildings may be divided into parts in attempting to determine which part or parts are the object of the insured's work product. [Citation omitted.] The common thread for deciding whether there is coverage for property

> damage is the scope of the insured's contract. [Citations omitted.]

Acuity v. Burd & Smith Constr., Inc., 721 N.W.2d 33, 41 (N.Dak. 2006).

The court limited the exclusion to the damages to the roof itself, not the rest of the complex. Again, in contrast, Shelcon was responsible through its contract with A-2 Venture for improvements to *the entire Beaver Meadows project* (which was formerly vacant land). The discussion and holding from *Acuity,* for that reason, are irrelevant.

b. Exclusion j.(6).

Similarly, Exclusion j.(6) bars coverage for alleged "property damage" to that particular part of any property that must be "restored or repaired" because Shelcon's work was incorrectly performed on it. The exclusion reads as follows:

> j. Damage to Property
>
> "Property damage" to:
>
> . . .
>
> (6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

CP 362, 384, 405. *See Schwindt v. Underwriters at Lloyd's of London*, 81 Wn. App. 293, 302-306, 914 P.2d 119 (1996) (coverage excluded for damage to that particular part of any property upon which the Assured is or has been working caused by the faulty manner in which the

work has been performed...."); *see also Harrison Plumbing v. New Hampshire Ins. Group*, 37 Wn. App. 621, 625-626 (1984) (similar exclusion). A-2's soil or land restoration or loss of use, if alleged, is not covered because of this exclusion.

Exclusion j.(6) applies because the *entire* sales price of Beaver Meadows project (the work of Shelcon) had to be reduced by estimated rectification costs. This is referred to in the complaint allegations--

> Plaintiff then reduced the price of the land to $6,412,500.00 by purchase and sale agreement to Harbour Homes dated October 19, 2007 based upon buyers knowledge of the soil preparation errors of defendant and an estimate of the costs of rectifying them. [See Section VI of Complaint.] CP 85. (emphasis added).

Shelcon completely misses the point with its argument that exclusion j.(6) does not apply because "A-2 never claimed that the settlement markers could be restored, repaired or replaced."[1] (See page 24 of Appellant's Brief.) The diminution in value allegation at p. 5 of the Complaint (CP 86) refers to the later sale of the project at a lower price to account for rectification expenses. The property was eventually developed, sold and houses built on it albeit at a reduced price. (See Findings of Fact 73-83 in the September 28, 2012 Findings of Fact and

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[1] Again Shelcon baldy asserts that the "settlement markers" were destroyed. The A-2 complaint did not allege the destruction of any the "settlement markers." The Haymond deposition supplied to WNAC did not establish that assertion either, even if the testimony was relevant to the duty to defend analysis (which it is not).

Conclusions of Law, CP 153-154; 423.) Shelcon's j.(6) arguments are flawed.

In *Mid-Continent Cas. Co. v. JHP Development, Inc.*, 557 F.3d 207 (5th Cir. 2009), the insured entered into "an agreement for the construction of a condominium project ... [consisting of five-units in] a four story wood-frame structure with partial concrete and masonry bearing walls at the first floor/garage level, supported by a concrete slab-on-grade foundation." *Id.* at 210. The failure to properly water seal the exterior finishes and retaining walls led to water penetrating the interior of the structure though ceilings, walls door and other points damaging "contiguous building materials and interior finishes, including interior drywall, stud framing, electrical wiring, and wood flooring, prior to the completion of the project." *Id.*

The owner terminated its agreement with the insured and hired another contractor to repair and complete the condominiums. Again, the court applying j.(6) exclusion more narrowly than the insurer argued it should focused on the object of the insured's work under the contract:

> The narrowing 'that particular part" language is used to distinguish the damaged property that was itself the subject of the defective work from other damages property that was either the subject of nondefective work by the insured or that was not worked on at all by the insured. . . .We find that exclusion j(6) bars coverage only for property damage to parts of a property that themselves were the subject of

> the work by the insured; the exclusion does not bar coverage for damage to parts of a property that were the subject of only nondefective work by the insured and were damaged as a result of defective work by the insured on other parts of the property.

Mid-Continent Cas. Co. v. JHP Development, Inc., 557 F.3d 207, 215 (5th Cir. 2009).

As noted above, the A-2 Venture complaint alleged Shelcon was responsible through its contract for "improvement" of the vacant land which was *the entire Beaver Meadows project* surface area and the alleged diminution in value was *for the entire project*. CP 82-86. Accordingly, the *JHP Development* discussion and holding are inappropriate.

A-2 alleged diminished land value because Shelcon's dirt and measuring rod placement "work" was incorrectly done. It was supposed to enable land subsidence measurement and failed to do so. To the extent the property or lots were later sold at a lower price, there was no coverage under WNAC's policies for diminution in value associated with Shelcon's work and thus no duty to defend. In relying on Exclusions j.(5), j.(6) and m., WNAC properly denied the duty to defend Shelcon.

G. <u>Reliance on Extrinsic Facts for Duty to Defend</u>.

After the initial tender, Shelcon sent discovery material to WNAC as the underlying matter progressed. There are only two circumstances where facts extrinsic to the complaint may determine a duty to defend:

(1) if the allegations in the complaint are unclear or ambiguous, or (2) if the allegations conflict with facts known by the insurer. *Truck Ins. Exchange v. Vanport Homes Inc.*, 147 Wn.2d 751, 761, 58 P.3d 276 (2002). Neither circumstance applies here. First, the complaint unambiguously alleges that Shelcon caused A-2 pure economic loss. Second, the discovery provided did not substantiate a physical injury or loss of use of any property.[2]

An insurer must look outside the allegations in the complaint only if those allegations conflict with facts known to or are readily ascertainable by the insurer. *R.A. Hansen Co. v. Aetna Ins Co.*, 26 Wn. App. 290, 294, 612 P.2d 456 (1980). Here, however, the facts made known to WNAC outside of the complaint well after original tender are not in conflict with the allegations in the complaint. A-2 consistently alleged Shelcon caused its land value economic diminution and the trial court agreed.

H. There is No Requirement for WNAC to Search for Additional Extrinsic Facts Outside of the Complaint Allegations.

Shelcon suggested below (CP 34) and again in this appeal (see pp. 8 and 9 of Appellant's Brief) that Washington law required WNAC to

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[2] A review of Mr. Haymond's 21-page deposition transcript makes it clear that counsel for Shelcon for whatever reason *tried* unsuccessfully to get Mr. Haymond to testify that Shelcon "damaged" its own settlement markers which were actually removed. CP 114-134.

(1) contact the parties and attorneys in the Underlying Action and interview them, (2) attend depositions in the Underlying Action, and (3) ask for and review written discovery responses and other written materials in the Underlying Action months after the complaint was filed to determine if there was a duty to defend. There is no Washington law cited to support these assertions. That type of "investigation" is not what an insurer must do when the complaint allegations and policy provisions are clear when tender is made.

In *Truck Ins. Exchange v. Vanport Homes, Inc.*, 147 Wn.2d 751, 58 P.3d 276 (2002), the court stated:

> There are two exceptions to the rule that the duty to defend must be determined only from the complaint, and both exceptions favor the insured. If coverage is not clear from the face of the complaint but may exist, the insurer ***must*** investigate the claim and give the insured the benefit of the doubt in determining whether the insurer has an obligation to defend. [Citation omitted.] Similarly, facts outside the complaint ***may*** be considered if '(a) the allegations are in conflict with facts known or readily ascertainable by the insurer, or (b) the allegations of the complaint are ambiguous or inadequate.' *Atl. Mut. Ins. Co. v. Roffe, Inc.*, 73 Wash. App. 858, 882, 872 P.2d 536 (1994) (*quoting E-Z Loader Boat Trailers, Inc. v. Travelers Indemn. Co.*, 106 Wn.2d 901, 908, 726 P.2d 439 (1986).

Truck Ins. Exchange v. Vanport Homes, Inc., 147 Wn.2d 751, 761, 58 P.3d 276 (2002)(emphasis added).

Vanport requires that an insurer investigate facts extrinsic to the complaint if coverage is not clear on its face. Where, as here, it is clear from the face of the complaint that the allegations are not covered under the policy, an insurer may properly decline to defend. *Holly Mountain Resources, Ltd. v. Westport Ins. Corp.*,, 130 Wn. App. 635, 649-650, 104 P.3d 725 (2005).

As the court in *Holly Mountain* recognized: "Neither [*Vanport*] exception applies here, however, because it is clear from the face of [the] complaint against Holly Mountain that there was no coverage under the West Port policy." *See, Holly Mountain*, 30 Wn. App. at 649-650; *Burns v. Scottsdale Ins. Co.*, 2010 WL 2947345, *4 (W.D. Wash. 2010) (unpublished), *aff'd*, 434 Fed. Appx. 675 (9th Cir. 2011) (insurer not required to investigate when the complaint allegations are clear). *Burns* is appropriately cited. (See GR 14.1).

A-2's complaint did not allege that Shelcon's work caused physical injury to tangible property or loss of use of tangible property. Rather, the Complaint alleged that Shelcon's settlement marker removal breached the obligations of Shelcon under its contract with A-2 and caused an economic loss, i.e., diminished land development sale value. Shelcon's stake removal was a failure to meet contractual requirements causing economic loss. Scott Haymond of A-2 did not ever testify in his

deposition that there was physical injury caused by Shelcon's work to either Shelcon's stakes or A-2's land. WNAC had no duty to defend Shelcon at time of tender and has no duty to reimburse Shelcon for its attorney's fees and costs incurred in defending itself in the Underlying Action.

V. CONCLUSION

For the reasons stated, this Court should affirm the trial court's order (a) granting WNAC's motion for summary judgment on duty to defend issues, and (b) denying Shelcon's cross-motion for summary judgment on duty to defend and breach of duty to defend issues.

RESPECTFULLY SUBMITTED this 21st day of August, 2013.

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