

No. 79027-2

IN THE SUPREME COURT  
OF THE STATE OF WASHINGTON

Court of Appeals No. 55342-9-I

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MUTUAL OF ENUMCLAW INSURANCE COMPANY,

Respondent/Cross-Petitioner,

v.

DAN PAULSON CONSTRUCTION, INC., a Washington  
corporation, KAREN and JOSEPH MARTINELLI, and the  
marital community composed thereof,

Petitioners/Cross-Respondents.

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CONSOLIDATED RESPONSE OF PETITIONERS/CROSS-  
RESPONDENTS KAREN AND JOSEPH MARTINELLI  
TO AMICUS CURIAE BRIEFS OF WASHINGTON  
STATE TRIAL LAWYERS ASSOCIATION AND  
BUILDING INDUSTRY ASSOCIATION OF WASHINGTON

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**I. BIAW CORRECTLY EMPHASIZES THE INSURER'S DUTY TO FULLY, FAIRLY AND PROMPTLY COMMUNICATE WITH THE INSURED DURING THE RESERVATION OF RIGHTS DEFENSE.**

Amicus BIAW aptly asserts that an insurer's enhanced obligation of good faith, while defending under a reservation of rights, imposes a duty on the insurer to keep the insured fully, fairly, and promptly informed of matters affecting the insured's liability defense. BIAW Br., p. 5. BIAW thus argues that Mutual of Enumclaw's delays, followed by its resort to unilateral and *ex parte* communications with the arbitrator, without notice to or consent by its insured, breached Mutual of Enumclaw's enhanced duty to keep Paulson fully informed. *Id.*, pp. 5-6. See, Pet. for Review, pp. 10-15; Pet. Supp. Br., pp. 3-7.

Petitioners agree with BIAW. Placing BIAW's analysis into context, Washington requires insurers acting under an enhanced obligation of good faith to fully, fairly and promptly communicate with the insured in a variety of contexts, including: (a) insurers may not delay issuing reservation of rights letters;<sup>1</sup> (b) reservation of rights letters must be

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<sup>1</sup> T. Harris, *Washington Insurance Law* §17.2, pp. 17-5 to 17.7 (2<sup>nd</sup> ed. 2006), citing, *Transamerica Ins. Group v. Chubb & Son, Inc.*, 16 Wn. App. 247, 554 P.2d 1080 (1976).

specific and clear;<sup>2</sup> (c) insurers must *fully inform* the insured “of all developments relevant to his policy coverage and the progress of his lawsuit”;<sup>3</sup> (d) insurers must communicate with the insured concerning settlement, including timely disclosure of settlement offers and ascertaining whether the insured is willing to settle.<sup>4</sup> See further, *VanPort Homes, supra*, 147 Wn.2d at 763-64 (insurer breached duty of good faith when it delayed denial of coverage, issued vague letter explaining denial, and delayed filing declaratory judgment action); *Smith v. Safeco Ins. Co.*, 150 Wn.2d 478, 78 P.3d 1274 (2003)(insurer had duty to disclose insured’s policy limits to third party when necessary to protect insured’s interests); *Harris, supra* at ¶31.2, p. 31-2 (insurer under claims made policy may have “duty to keep insured informed of [accruing] costs of

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2 *Harris, supra*, §17.3, pp. 17-8 to 18.9, citing, WAC 284-30-330(13); *Tank v. State Farm Fire & Casualty Co.*, 105 Wn.2d 381, 388-89, 715 P.2d 1133 (1986), *Weber v. Biddle*, 4 Wn. App. 519, 525, 483 P.2d 155 (1971), and *Truck Ins. Exch. v. VanPort Homes, Inc.* 147 Wn.2d 751, 764, 58 P.3d 276 (2002).

3 *Tank, supra*, 105 Wn.2d at 388 (emphasis by the Court). See, *Harris, supra*, §17.4, pp. 17-10. The insurer’s duty to keep the insured fully informed corresponds to assigned counsel’s three-pronged duty to keep the insured fully informed and to avoid conflicts of interest. *Tank, supra*, 105 Wn.2d at 388-89; *Harris, supra*, §17.5, p. 17-11. As *Harris* explains, “[t]he courts will deal strictly with an insurer who places defense counsel in the ‘extremely compromising position’ in which he must [choose] between conflicting interests.” *Id.*, at 17-10 to 17-11.

4 *Harris, supra*, §19.4, p. 19-5, quoting WPI 320.05.

defense”), quoting, *Ross v. Fank B. Hall & Co. of Wash.*, 73 Wn. App. 630, 638, 870 P.2d 1007 (1994). Considering the nature of the insurers’ enhanced obligation under *Tank*, insurers should also not just meet but exceed the “minimum standards”<sup>5</sup> governing insurers’ duty to fully and fairly communicate with insureds set forth in WAC 284-30-330, 284-30-350, and 284-30-360.

The insurer’s enhanced duty to fully and fairly communicate with the insured during the reservation of rights defense must include a duty by the insurer to disclose *all* facts that would aid its insureds in protecting their interests. *Van Noy v. State Farm Mut. Auto. Ins. Co.*, 142 Wn.2d 784, 791-95, 15 P.3d 574 (2001).<sup>6</sup> In this narrow context, the insurer’s duty to fully and fairly communicate to its insured, when acting under an enhanced obligation of good faith, is analogous to and consistent with the “fiduciary or other similar relation of trust and confidence” duty of *affirmative disclosure*. *Van Noy, supra*, 142 Wn.2d at 793. See further,

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5 The Washington Administrative Code establishes “minimum standards” and applies to all insurers and insurance policies. WAC 284-30-300 and 310.

6 *Van Noy, supra*, arose out of first-party PIP benefit claims. Petitioners suggest that the scope of the insurer’s duty to disclose under its *enhanced obligation* of good faith in the context of a reservation of rights defense must at least meet (if not exceed) its obligation of good faith in the first-party PIP context.

*Colonial Imports, Inc. v. Carlton Northwest, Inc.*, 121 Wn.2d 726, 731-33, 853 P.2d 913 (1993)(recognizing that prohibition against silence applies in quasi-fiduciary relationship).

Here, as BIAW correctly recognizes, Mutual of Enumclaw's enhanced obligation of full, fair and prompt communication with Paulson concerning its defense meant that Mutual of Enumclaw could neither delay notifying Paulson that it had filed the declaratory judgment action nor communicate *ex parte* or unilaterally with the arbitrator of Paulson's liability case. BIAW Br., pp. 5-6. This Court should so hold.

**II. WSTLA MISSTATES THE PRESUMPTION OF REASONABLENESS ESTABLISHED IN *VANPORT HOMES*.**

Amicus WSTLA asserts that the *VanPort Homes* presumption of reasonableness applies only if "reasonableness was appropriately established in either the underlying litigation or this declaratory judgment action." WSTLA Br., p. 19. In the instant case, reasonableness was appropriately established when the trial court made an independent determination that the settlement was reasonable on summary judgment in the declaratory judgment/bad faith action to which Mutual of Enumclaw

was a party. CP 689-90. However, to the extent WSTLA suggests that *VanPort Homes* requires a full-blown reasonableness hearing and evaluation of the *Chaussee* criteria even if the insurer has been found to have acted in bad faith, WSTLA has misread the specific holding of *VanPort Homes*.

When a Washington insurer breaches its duty of good faith, the insured's subsequent settlement with the plaintiff enjoys a *presumption of reasonableness unless the insurer proves* "fraud or collusion" in the settlement. *VanPort Homes, supra*, 147 Wn.2d at 764-766. See further, *Besel v. Viking Ins. Co.*, 146 Wn.2d 730, 735-6, 49 P.3d 887 (2002); *Greer v. Northwestern National Ins. Co.*, 109 Wn.2d 191, 202, 743 P.2d 1244 (1987) ("when an insurer breaches its contract...[r]ecoverable damages include...(2) the amount of the judgment entered against the insured in the underlying action"). The burden shifts from the policyholder to the insurer because "[t]o place the burden of proving reasonableness of a settlement on a policyholder 'would discourage settlement so necessary to the orderly disposition of cases.'" *VanPort, supra*, 147 Wn.2d at 765.

In fact, *no* reasonableness hearing occurred in *VanPort Homes* because the trial court held the parties' settlement *per se* reasonable, as a result of the insurer's bad faith. *Id.*, at 759.<sup>7</sup> The Court of Appeals reversed, "declining to find that the damages were *per se* reasonable" and remanded so that a reasonableness hearing could be held in the trial court. *Ibid.* This Court expressly *reversed* the Court of Appeals and instead ordered that judgment be entered against the insurer. *VanPort Homes*, *supra*, 147 Wn.2d at 766.

*VanPort Homes* thus does *not* require a reasonableness hearing, *per se*, if the insurer has indeed acted in bad faith *and* fails to establish fraud or collusion in the settlement. Mutual of Enumclaw, in fact, offered *no* evidence of fraud or collusion in this case, other than the mere existence of a covenant judgment, and the covenant judgment was *substantially less than* the Martinellis total claim against the insured. Even now, Mutual of Enumclaw has not identified any evidence to suggest that the settlement is not reasonable.

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<sup>7</sup> Petitioners' evidence of reasonableness in the trial court conformed to the evidence which this Court approved in *VanPort Homes*. CP 26-27,29-30,38-40,168-173,179-187.

Petitioners' analysis of *VanPort Homes* is also entirely consistent with this Court's prior holdings that insurers have no specific right to participate in reasonableness hearings. *Elovich v. Nationwide Ins. Co.*, 104 Wn.2d 543, 553-556, 707 P.2d 1319 (1985)(UIM); *Lenzi v. Redland Co.*, 140 Wn.2d 267, 276-81, 996 P.2d 603 (2000). **Insurers instead have two primary due process protections:** (1) defeat the allegations that it breached the duty of good faith (so that no presumption of reasonableness arises); or, (2) overcome the presumption of reasonableness with evidence of fraud or collusion. See, *Howard v. Royal Specialty Underwriting, Inc.*, 121 Wn. App. 372, 380, 89 P.3d 265 (2004)("full opportunity to defend itself in the bad faith action"); *VanPort Homes, supra*, 147 Wn.2d at 764-66 (rebut presumption of reasonableness). Mutual of Enumclaw had both of those opportunities here. Its failure to defeat its insureds' bad faith claim, or to rebut the presumption of reasonableness with evidence of fraud or collusion, after notice and an opportunity to be heard is not a denial of due process of law.

The Court should therefore re-affirm its commitment to the presumption of reasonableness established in *VanPort Homes*, by

maintaining the burden on the insurer *guilty of bad faith*, to come forward with evidence of fraud or collusion. See, e.g., *Riehl v. Foodmaker, Inc.*, 152 Wn.2d 138, 147, 94 P.3d 930 (2004)(*stare decisis* standard).

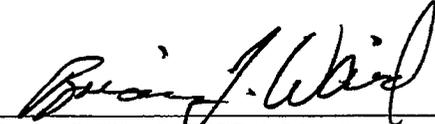
### CONCLUSION

The Court should adopt the reasoning of BIAW concerning the duty of insurers to fully, fairly and promptly communicate with insureds during the course of the reservation of rights defense. The Court should also re-affirm the presumption of reasonableness established in *VanPort Homes*.

Respectfully submitted this 4th day of June, 2007.

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