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CERTIFICATION FROM THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON AT SEATTLE
IN

ST. PAUL FIRE AND MARINE INSURANCE COMPANY,

Plaintiff,

vs.

ONVIA, INC., ONVIA.COM, and RESPONSIVE MANAGEMENT
SYSTEMS, in its individual capacity and as class representative of a
purported settlement class,

Defendants.

**BRIEF OF PLAINTIFF ST. PAUL FIRE AND MARINE
INSURANCE COMPANY**

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ORIGINAL

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I. INTRODUCTION

In a liability insurance coverage dispute litigated in the United States District Court for the Western District of Washington, the court found that St. Paul Fire and Marine Insurance Company had no obligation to defend or indemnify its insured in a lawsuit alleging that the insured unlawfully sent unsolicited facsimile advertisements. The District Court further ruled that since St. Paul had no duty to defend or indemnify as a matter of law, its denial was not in bad faith. Now before this Court on certified questions, is the effect of the lack of a duty to defend on the insured's remaining claims for bad faith and violation of the Consumer Protection Act based on St. Paul's alleged delay in processing the claim. Specifically, this Court is asked to determine whether the procedural bad faith and CPA claims can survive a determination that St. Paul had no duty to defend, and if so, what burdens of proof and remedies apply.

II. ISSUES CERTIFIED TO THE SUPREME COURT

(1) Under Washington law, does an insured have a cause of action against its liability insurer for common law procedural bad faith for violation of the Washington Administrative Code and/or for violation of the Washington Consumer Protection Act, even though a court has held that the insurer has no contractual duty to defend, settle, or indemnify the insured?

(2) If the Answer to the first question is "yes," then:

(a) Should the court require the insured to prove that the insurer's conduct caused actual harm, or should the court apply a presumption of harm? and

(b) How should the insured's damages be measured?

III. STATEMENT OF THE CASE

This case comes before this Court on certified questions from the U.S. District Court pursuant to RCW chapter 2.60. The Hon. Robert S. Lasnik ruled that plaintiff St. Paul Fire and Marine Insurance Company ("St. Paul") had no contractual duties to defend, indemnify or settle in connection with a lawsuit against its insured, Onvia, Inc. ("Onvia"), and that none of St. Paul's substantive decisions on the claim were done in bad faith or were incorrect in any respect. Judge Lasnik certified the remaining questions, concerning whether an insurer can nonetheless be held liable for alleged procedural defects in its processing of its insured's claim. The following facts are taken from the District Court's statement of facts accompanying the certified questions.

Onvia, Inc. is a for-profit corporation that sells a service called "DemandStar" that provides businesses with notices of opportunities to bid for government contracts. RMS is a sole proprietorship operating in Washington.

On February 3, 2005, RMS served its class action complaint in Responsive Management Systems v. Onvia, Inc., Superior Court of Washington, for King County, Cause. No. 05-2-04728-3 SEA (the "underlying action"). The complaint alleged that Onvia engaged in "fax

blasting,” or the mass sending of unsolicited advertisements via facsimile, in violation of the Telephone Consumer Protection Act of 1991 (“TCPA”), 47 U.S.C. § 227, the Washington Unsolicited Telefacsimile Act (“WUTA”), RCW 80.36.540, and the Washington Consumer Protection Act (“CPA”), RCW 19.86, *et seq.* The complaint alleged that RMS received an unsolicited facsimile from Onvia. RMS sought to represent a nationwide class of persons who received an unsolicited advertisement from Onvia during the statute of limitations period promoting Onvia’s services.

Onvia had liability insurance issued by St. Paul. On February 24, 2005, Onvia’s insurance broker allegedly tendered the underlying action to St. Paul by sending to St. Paul via facsimile a copy of RMS’s original complaint, a tender letter, and a “General Liability Notice of Occurrence/ Claim of the Underlying Lawsuit” form. St. Paul states that it has no evidence in its file that it received the February 2005 communication but there is evidence that the tender was successfully transmitted by facsimile to St. Paul. St. Paul did not respond to Onvia’s tender letter of February 24, 2005. There is evidence that the February 24, 2005 letter was resubmitted to St. Paul on August 5, 2005. RMS filed a first amended complaint on September 14, 2005. At some point, the date of which is disputed, Onvia sent a copy of the first amended complaint to St. Paul.

St. Paul sent a letter dated November 4, 2005, denying coverage and defense. On December 15, 2005, Onvia’s general counsel responded to St. Paul’s letter, noting that there were earlier St. Paul policies that the

November 4th letter did not discuss. St. Paul reaffirmed its denial on March 24, 2006.

Between February 2005 and the conclusion of the underlying action, Onvia, represented by its own attorneys, defended itself in litigating the underlying action and in settlement negotiations. While the motion for class certification was pending, Onvia and RMS entered into a settlement agreement in April 2006 whereby Onvia stipulated to class certification, entry of a judgment in favor of the class in the amount of \$17.515 million, and an assignment of its rights against St. Paul to RMS. In exchange, RMS agreed to execute the judgment only against St. Paul. The King County Superior Court found the amount of the settlement reasonable, approved the settlement, and entered final judgment for the settlement amount at a November 17, 2006 final approval hearing.

St. Paul filed this action in the District Court on July 26, 2006, alleging jurisdiction based on diversity of the parties. St. Paul sought a declaratory judgment stating that it had no duty to defend or indemnify Onvia in the underlying action. RMS asserted three counterclaims: (1) breach of the contractual duties to defend, indemnify, and settle; (2) bad faith breach of the duties to defend, indemnify, and settle; and (3) procedural bad faith and violation of the CPA related to St. Paul's handling of Onvia's claim. Onvia was dismissed from this lawsuit by stipulation of the parties and order of the District Court.

The parties cross-moved for partial summary judgment on St. Paul's claims for declaratory relief and on RMS's first two

counterclaims. The District Court granted St. Paul's motion and denied RMS's, holding that St. Paul had no duty to defend, indemnify, or settle the underlying action against Onvia and that St. Paul did not commit bad faith when it refused to defend Onvia. After the District Court's ruling, the only remaining claim was RMS's counterclaim for common law procedural bad faith and for a violation of the CPA. In that claim, RMS alleges that St. Paul's claims handling violated a number of Washington insurance claims handling regulations, which include but are not limited to, allegations that St. Paul committed bad faith by failing to acknowledge notice of the claim and tender of defense for approximately nine months after the claim was tendered in violation of WAC 284-30-330 and WAC 284-30-360; failing to conduct an investigation in violation of WAC 284-30-330 and WAC 284-30-370; and failing to regularly report developments to the insured in violation of WAC 284-30-330(2). RMS alleges that St. Paul is liable for breach of the common law duty of good faith and for violations of the CPA.

St. Paul moved for summary judgment on RMS's remaining counterclaim, arguing that in the absence of a duty to defend, it could not be liable for any delay in processing Onvia's claim. St. Paul also argued that there were no facts that established that Onvia suffered any harm as a result of the alleged delay.

The District Court found that Washington law was unclear on whether RMS could pursue its remaining claims in the absence of any duty to defend or indemnify, and if so, what remedies would be available.

The District Court therefore certified those issues to this Court pursuant to RCW 2.60.020.

IV. SUMMARY OF ARGUMENT

In response to question 1: Where there is no duty to defend, a liability insurer should not be liable for the tort of bad faith or violation of the Consumer Protection Act for the way it processes the insured's claim. The duty to defend is the prerequisite to the insurer's obligations under the policy, and where there can be no breach, there should be no liability for bad faith breach. To hold otherwise would lead to absurd results, creating liability for claims clearly not covered by the insurance agreement.

In response to question 2(a): If there can be liability for bad faith in the absence of a duty to defend, no presumption of harm to the insured should apply. Because the insured was not deprived of any benefits owed under the contract, harm resulting from the insurer's conduct would be very unlikely. It therefore makes no sense to presume that the insured was harmed.

In response to question 2(b): If there can be liability for bad faith in the absence of a duty to defend, the measure of the insured's damages should be the actual expenses the insured incurred as a result of the insurer's bad faith conduct, rather than coverage by estoppel for the amount of an agreed covenant judgment against the insured. When there is no duty to defend, the insurer is not under a duty to do anything that has any tendency to prevent or mitigate the insured's liability to the third party claimant. It therefore makes no sense to apply a remedy (coverage by

estoppel) that has thus far been applied only in situations where the insured did breach a contract obligation (such as the duty to defend or settle) to protect its insured from the risk of liability to the third party claimant.

V. ARGUMENT

A. Answer to Question (1): The Lack of a Duty to Defend Precludes a Claim for the Tort of Bad Faith or Violation of the Consumer Protection Act.

At issue here is whether a breach of some form of contractual obligation is required for an insured to sue for bad faith or violation of the CPA in connection with an insurer's processing of a liability insurance claim. To succeed in prosecuting a bad faith claim, "the insured must show the insurer's breach of the insurance contract was 'unreasonable, frivolous, or unfounded.'"¹ Here, there can be no frivolous denial of benefits because the duty to defend is the source of and prerequisite to every other duty a liability insurer owes.² While this Court has long

¹ Overton v. Consolidated Ins. Co., 145 Wn.2d 417, 433, 38 P.3d 322 (2002) (quoting Kirk v. Mt. Airy Ins. Co., 134 Wn.2d 558, 560, 951 P.2d 1124 (1998)). See Rizzuti v. Basin Travel Service of Othello, Inc., 125 Wn. App. 602, 622, 105 P.3d 1012 (2005) ("a reasonable basis for denying coverage constitutes a complete defense to any claim that the insurer denied coverage in bad faith or in violation of the CPA.")

² The duty to indemnify cannot arise if there is no duty to defend. See Hayden v. Mutual of Enumclaw Ins. Co., 141 Wn.2d 55, 64, 1 P.3d 1167 (2000) ("The duty to indemnify hinges on the insured's actual liability to the claimant and actual coverage under the policy. The duty to defend, on the other hand, exists merely if the complaint contains any factual allegations which could render the insurer liable to the insured under the policy."); Tyler v. Grange Ins. Ass'n, 3 Wn. App. 167, 172, 473 P.2d 193 (1970) (insurer's "control over the defense" is the source of its duty to settle).

recognized that an “insurer's duty of good faith is separate from its duty to *indemnify* if coverage exists,”³ such that an insurer could face liability for a bad faith breach of the duty to defend⁴ or investigate⁵ potentially covered claims, even those obligations are absent here.

While RMS claimed that St. Paul failed to investigate, the lack of a duty to defend precludes a duty to investigate because the lack of a duty to defend presupposes that the claim can be denied on its face without an investigation.⁶ As this Court has repeatedly stated, for there to be no duty to defend, the allegations against the insured in the complaint alone must show that the claim “clearly not covered by the policy.”⁷ Moreover, as this Court made clear in Truck Insurance Exchange v. Vanport Homes,

³ Coventry Associates v. American States Ins. Co., 136 Wn.2d 269, 279, 961 P.2d 933 (1998) (emphasis added).

⁴ Safeco Insurance Co. of America v. Butler, 118 Wn.2d 383, 823 P.2d 499 (1992) (insurer had no contractual duty to indemnify but was potentially liable for bad faith management of a reservation of rights defense); Truck Ins. Exchange v. Vanport Homes, Inc., 147 Wn.2d 751, 58 P.3d 276 (2002) (insurer breached duty to defend in bad faith and was therefore liable regardless of whether actual coverage existed).

⁵ Coventry, 136 Wn.2d at 279, 961 P.2d 933 (first party claim was not covered but insurer failed to conduct a necessary investigation).

⁶ 14 L. Russ and T. Segalla, Couch On Insurance, 3d p. 198-58 (2007). “In those jurisdictions in which an insurer need consider only the complaint in determining whether it has a duty to defend, the insurer is not required to investigate the underlying facts unless an exception to the rule requires an investigation.” Id. Here, the District Court found, without regard to intrinsic evidence, that the allegations in the complaint did not even come within the insuring agreement of the policy. See Order Regarding Cross Motions for Summary Judgment, attachment 14 to Order Certifying Issues.

⁷ Kirk, 134 Wn.2d at 563, 951 P.2d 1124.

Inc.,⁸ the insurer is not even permitted to rely on an investigation or extrinsic evidence to support a refusal to defend.⁹ The complaint must rule out potential coverage because the insurer must defend if “it is not clear *from the face of the complaint* that the policy does not provide coverage.”¹⁰ The complaint against Onvia created no duty to investigate and it is therefore impossible for St. Paul to have breached this duty in bad faith.

Because the insured that is owed no duty to defend is not entitled to services of any kind under the contract, it cannot be said that the insured did not “receive the full benefit due under its insurance contract,”¹¹ such that a potential bad faith claim exists. As a commentator on Washington insurance law notes, in the absence of a duty to defend, “an insurer has no liability exposure to its insured,”¹² and the mere fact that the insurer has

⁸ 147 Wn.2d at 761, 58 P.3d 276.

⁹ Id. (holding that it is improper to rely on “investigation” or extrinsic evidence to deny a duty to defend). See also, A. Windt, Insurance Claims and Disputes Third Edition §9:26 (2007) (“Bad faith cannot, in general, be based upon a failure to conduct an investigation prior to denying defense cost benefits because no investigation is necessary”).

¹⁰ Woo v. Fireman's Fund Ins. Co., ___ Wn.2d ___, 164 P.3d 454, 464-465 (2007) (citing Vanport, 147 Wn.2d at 761). See also, id. (“if it is not clear that the complaint does *not* contain allegations that are not covered by the policy, the insurer has a duty to defend.”).

¹¹ Coventry, 136 Wn.2d at 282, 961 P.2d 933.

¹² T. Harris, Washington Insurance Law (2d Ed. 2006) § 16.1.

“issued an insurance policy to an insured does not itself create any responsibility for liability exposure outside the scope of the policy’s coverage.”¹³

The notion of tort liability for doing nothing in the absence of a duty to do anything is absurd. The insured should not receive a windfall simply because (1) it asked for something it was clearly not entitled to and (2) it was not immediately told “no.” The one Washington court to face such a claim summarily rejected it. In Felice v. St. Paul Fire and Marine Ins. Co.,¹⁴ the court held that an insurer – St. Paul – that owed no duty to defend or indemnify would not face bad faith liability solely for delay in telling the insured of its coverage conclusion:

Here, [the insured] alleges St. Paul acted in bad faith basically because it did not notify him of its decision refusing coverage until 2 months after he informed them of the claim. Although we question St. Paul's dilatory response, delay alone does not constitute bad faith because it did not constitute an unfounded and frivolous denial of benefits.^[15]

¹³ Id.

¹⁴ 42 Wn. App. 352, 711 P.2d 1066 (1985).

¹⁵ Felice, 42 Wn. App. at 361, 711 P.2d 1066.

In addition, California courts have long held that the absence of a duty to defend precludes bad faith claims against an insurer. Waller v. Truck Ins. Exchange, Inc.;¹⁶ Buena Vista Mines, Inc. v. Industrial Indem. Co., (“where there is ‘no potential for coverage and, hence, no duty to defend under the terms of the policy, there can be no action for breach of the implied covenant of good faith and fair dealing’”);¹⁷ R & B Auto Center, Inc. v. Farmers Group, Inc., (“when there is no potential for coverage, a cause of action for bad faith in the investigation and processing of a claim will not lie.”).¹⁸

The need to delineate the scope of the tort of bad faith in Washington was illustrated in a recent decision by the Court of Appeals. In Shields v. Enterprise Leasing Co.,¹⁹ Shields rented a car from Enterprise and elected to purchase first party collision damage waiver coverage and first party accidental death and medical benefits coverage from Enterprise, but expressly declined to purchase liability insurance coverage. Shields then rear-ended another driver while operating the

¹⁶ Waller v. Truck Ins. Exchange, Inc., 11 Cal. 4th 1, 44 Cal. Rptr. 2d 370 (1995).

¹⁷ Buena Vista Mines, Inc. v. Industrial Indem. Co., 87 Cal. App. 4th 482, 488, 104 Cal. Rptr. 2d 557 (2001).

¹⁸ R & B Auto Center, Inc. v. Farmers Group, Inc., 140 Cal. App. 4th 327, 353, 44 Cal. Rptr. 3d 426 (2006).

¹⁹ ___ Wn. App. ___, 161 P.3d 1068 (2007).

rental car and sought coverage for the claim against him. Enterprise declined on the ground that Shields had not purchased liability coverage. Shields sued, contending that he was owed coverage and that Enterprise had committed the tort of bad faith and violated the Consumer Protection Act, for among other reasons, failing to timely communicate with Shields. The Court of Appeals held that there was no coverage because Shields did not buy a liability policy and also held that there was no liability for bad faith because Enterprise had promptly denied the claim.

But what would have happened if Enterprise had taken six months to tell Shields that it never sold him a liability insurance policy? Suppose further that Shields had not bought any coverage at all; would Enterprise still, as an insurer, have potential liability for untimely correspondence? Of course, if there is no insurer/insured relationship at all, there could presumably be no good faith obligation or CPA claim under the doctrine this Court announced in Tank v. State Farm Fire & Cas. Co.,²⁰ where it held that a non-insured has no cause of action because it was owed “no *direct contractual obligation* by [the insurers and] [t]hus, there is no direct obligation which [the claimants] may sue to enforce.”²¹

²⁰ 105 Wn.2d 381, 715 P.2d 1133 (1986).

²¹ Tank, 105 Wn.2d at 393-395, 715 P.2d 1133 (emphasis added).

But why should the result be different simply because Enterprise sold Shields a policy that clearly had no applicability to his claim? Liability in that situation would be equally arbitrary.

The lack of a claim for bad faith does not mean that an insurer may mislead or mistreat its insured with impunity. An insurer may be equitably estopped from denying coverage, for instance, if it agrees to defend even though it had no duty to do so, or otherwise causes the insured to rely on the insurer to handle the claim.²² No such issue is raised in the certified questions or the facts of this case.

St. Paul submits that the proper place to draw the line for the outer boundary of the tort of bad faith is where the California courts have drawn it: *there is no claim for breach of the implied covenant of good faith and fair dealing if the claim against the insured, on its face, is clearly not covered.*

²² E.g., Transamerica Ins. Group v. Chubb & Son, Inc., 16 Wn. App. 247, 251, 554 P.2d 1080 (1977) (insurer equitably estopped from asserting non-coverage after assuming control of the case and defending for 10 months without a reservation of rights); see also, Kentucky Nat. Ins. Co. v. Shaffer, 155 S.W.3d 738, 741-42 (2004) (Ky. App. 2004) (holding that although insurer may be equitably estopped from denying coverage after mistakenly defending a clearly excluded claim, it could not be liable for the tort of bad faith).

B. Answer to Question 2(a): If There Is a Cause of Action, the Insured Should Have the Burden of Proving Harm Because Harm Would Be Extremely Unlikely to Result in the Absence of a Duty to Defend.

The District Court's question 2(a) assumes the existence of a cause of action and asks what effect the lack of a duty to defend should have on the burden of proof on the harm element of a cause of action for bad faith.²³ This Court has held that there is no presumption of harm caused by an insurer's bad faith conduct in investigating and adjusting first party cases.²⁴ It has also held that a presumption of harm does exist in third party liability insurance cases involving the bad faith mismanagement of a reservation of rights defense,²⁵ bad faith outright failure to defend,²⁶ or bad faith failure to settle covered claims within policy limits.²⁷ In Mutual of Enumclaw Ins. Co. v. Dan Paulson Construction, Inc.,²⁸ this Court very recently observed that its decisions applying the presumption of harm have

²³ Question 2 pertains only to the tort of bad faith because the burden of proof and measure of damages is well-established for CPA claims. See Industrial Indem. Co. of the Northwest, Inc. v. Kallevig, 114 Wn.2d 907, 920, 792 P.2d 520 (1990) (insured has burden of proving all five elements of CPA claim).

²⁴ Coventry, 136 Wn.2d at 282, 961 P.2d 933.

²⁵ Butler, 118 Wn.2d at 383, 823 P.2d 499; Mutual of Enumclaw Insurance Co. v. Dan Paulson Construction, Inc., slip op. No. 79027-2 (Wash. Supreme Court, Oct. 11, 2007).

²⁶ Kirk, 134 Wn.2d at 558, 951 P.2d 1124; Vanport, 147 Wn.2d at 751, 58 P.3d 276.

²⁷ Besel v. Viking Ins. Co., 146 Wn.2d 730, 49 P.3d 887 (2002).

²⁸ Slip op. at 23 No. 79027-2 (Wash. Supreme Court, Oct. 11, 2007).

been limited to cases of an insurer's bad faith failure to defend, or bad faith mishandling of the insured's defense of the underlying lawsuit against the insured:

Finally, we emphasize that while we are not retreating from *Butler*, neither are we extending it. The presumption of harm has previously been applied where the insurer's bad faith was associated with its underlying defense of the insured.[Footnote citing examples omitted] That limitation is unchanged by our decision today.^[29]

This Court should not extend the presumption of harm to cases where the insurer did not owe a defense and rightfully took no part in the underlying defense of the insured. This Court has examined the rationale for the presumption of harm on several occasions, and none of those rationales support a presumption of harm here.

In *Coventry*, this Court explained that presumed harm does not apply to first party (non-liability) claims because first party claims do not involve the potential conflicts of interests attendant to a liability insurer's duty to defend:

[W]e decline to hold in the first party context a rebuttable presumption of harm exists once an insurer acts in bad faith. While a rebuttable presumption of harm

²⁹ *Id.*

exists as a result of an insurer's bad faith act in the third party context, that is so because insurers have a heightened duty of good faith in such situations. See Tank, 105 Wash.2d at 387, 715 P.2d 1133 ("the potential conflicts of interest between insurer and insured inherent in this type of defense [reservation of rights] mandate an even higher standard: an insurance company must fulfill an enhanced obligation to its insured as part of its duty of good faith"). Because the potential conflict of interest does not exist in the first party context, we do not think a rebuttable presumption of harm is warranted.^[30]

The potential conflict of interest the Coventry court referenced is the type that arose in Tank v. State Farm Fire & Cas. Co.³¹ and Butler, where the complaints against the insureds alleged facts which may or may not be covered depending on the developments in the liability case (i.e., a tort claim that may be based either on covered unintentional conduct or non-covered intentional conduct). The potential conflict of interest arises because the insurer has an incentive to use its control of the defense to influence the resolution of the coverage issues in its favor. A similar potential conflict exists when claims are covered, but there is potential for liability in excess of the policy limits. An insurer may be tempted to disregard the insured's excess exposure and take a case to trial in hopes

³⁰ Coventry, 136 Wn.2d at 281, 961 P.2d 933.

³¹ 105 Wn.2d 381, 715 P.2d 1133 (1986).

that a trial will result in liability less than the policy limits. As the Court of Appeals once stated:

Allowing a company. . .to consider its own interests first would be akin to asking the cat to guard the canary and the company would never be liable for an excess verdict unless it could be said its own interests demanded a settlement and it failed to consider those interests.

The conclusion reached by a growing number of cases is both the interests of the insured and the insurer must be given equal consideration and the only practical test by which to apply this standard is to have the insurer consider the total risk in deciding whether or not to accept a settlement offer, without regard to who is bearing what portion of that risk.^[32]

When the insurer fails to properly consider its insured's interests and an excess judgment results, the insurer is liable for the excess.³³

But when there is no duty to defend, there is no potential conflict of interest. The complaint, on its face, is not covered; nothing the insurer does or fails to do can change that fact. When there is no duty to defend, the case is therefore similar to a first party claim, where the insurer can do nothing to influence developments because the insured's loss occurred

³² Tyler v. Grange Ins. Ass'n, 3 Wn. App. 167, 177, 473 P.2d 193 (1970).

³³ Besel, 146 Wn.2d at 735, 49 P.3d 887 ("We have long recognized if an insurer acts in bad faith by refusing to effect a settlement for a small sum, an insured can recover from the insurer the amount of a judgment rendered against the insured, even if the judgment exceeds contractual policy limits.")

before the claim was tendered. The rationale given in Coventry therefore supports a refusal to extend the presumption of harm to cases where there is no duty to defend.

This Court has also addressed the rationale for the rebuttable presumption of harm in the liability cases where it was applied. In these cases, the Court reasoned that the insurer's alleged conduct put the insured at serious strategic disadvantage with respect to either the defense of the tort claim or the outcome of the coverage dispute by virtue of a wrongful deprivation of an important contract benefit.³⁴ For example, in the case of a wrongful denial of a defense, the insured is presumably at a disadvantage without the insurer's promised assistance, and it is left to the insurer to show that no harm in fact resulted.³⁵ It is the same with the mismanagement of a reservation of rights defense,³⁶ or a failure to accept a reasonable settlement within the policy limits.³⁷ The Court described this rationale in Kirk, where it reasoned that loss of a defense (1) deprives the insured of a strategic advantage in defending the tort claim, and (2) creates a situation where harm is likely but proof is difficult:

³⁴ E.g., Kirk, 134 Wn.2d at 563, 951 P.2d 1124.

³⁵ Id.

³⁶ Butler, 118 Wn.2d at 385, 823 P.2d 499; Paulson, slip op. at 17.

³⁷ Besel, 146 Wn.2d at 738, 49 P.3d 887.

The rebuttable presumption of harm applies to the question before us because a bad faith breach of the duty to defend wrongfully deprives the **insured of a valuable benefit of the insurance contract**, and leaves the insured faced with the difficult problem of proving harm. Without the rebuttable presumption of harm, the insurer could defend its position under the following contract theory-even if there were a duty to defend, our bad faith breach did not cause injury to the insured because ultimate liability was found to be outside the scope of coverage. . . . the insured is still confronted with the difficult task of establishing either: (1) that coverage under the policy would have been available, or (2) that liability against the insured would not have been found if the insured had defended the claim in good faith. The rebuttable presumption of harm must be applied because an insured should not be required to prove what might have happened had the insurer not breached its duty to defend in bad faith; that obligation rightfully belongs to the insurer who caused the breach.^[38]

Again, no analogous reasoning justifies extending the presumption of harm still further to include claims involving allegedly substandard processing in denying a tender. First, Onvia was not deprived of a “valuable benefit of the insurance contract” because it was not entitled to any benefits under the insurance contract. Second, unlike in the situation

³⁸ Kirk, 134 Wn.2d at 563.

where the insured was not defended and should have been, or where an insurer forsakes settlement opportunities, there is no reason to suspect that events would have transpired differently if St. Paul had provided a more timely response. All Onvia could have done with a timely disclaimer is what it actually did do in this case: defend itself. It would be improper to extend the presumption of harm to these circumstances because there is no reason to infer that the presumed fact (harm) is at all likely to follow from the established fact (delay in confirming non-coverage).

Because this Court has not extended the presumption of harm to cases where there is no duty to defend and there is no sound reason for doing so, the Court should require the RMS class to prove that Onvia was harmed in the same manner it requires other insureds to prove harm where there has been no breach of an important contractual duty in connection with its defense of the insured.

C. Answer to Question 2(b): If There Is a Cause of Action, the Insured's Damages Should Be Measured by Quantifying the Actual Harm Directly Caused by the Insurer's Conduct and Not by Reference to the Amount of the Stipulated Judgment.

The District Court's final question relates to remedy, assuming that bad faith and harm can be shown. Here, for reasons similar to those discussed in part B., supra, any remedy should be the same as the remedy that exists in first party cases: the insured's actual damages caused by the

insurer's conduct as this Court announced in Coventry.³⁹ In this instance, damages should be calculated by putting the insured in as good a position as if it had been timely told that it was owed nothing.

In third-party liability cases involving substantive bad faith handling of the insured's lawsuit, such as a wrongful refusal to defend,⁴⁰ a mishandling the insured's defense,⁴¹ or a failure, in bad faith, to settle covered claims within the policy limits,⁴² the insurer that fails to rebut the presumption of harm is estopped from denying coverage and the presumptive measure of the insured's damages is the amount of the insured's settlement or the judgment against the insured.⁴³ It is easy to see why this is the case with respect to a failure to settle. In the failure to settle example, the insured would not have suffered an excess judgment if the insurer had settled within policy limits, so the amount of the excess judgment is the measure of the insured's damages.⁴⁴ Put simply, the insurer had a duty to do something that would have eliminated or reduced the insured's liability exposure and did not do it. Similarly, where the

³⁹ 136 Wn.2d at 279, 961 P.2d 933.

⁴⁰ Vanport, 147 Wn.2d at 761, 58 P.3d 276.

⁴¹ Butler, 118 Wn.2d at 383, 823 P.2d 499; Paulson, slip op. at 20-21.

⁴² Besel, 146 Wn.2d at 730, 49 P.3d 887.

⁴³ Vanport, 147 Wn.2d at 755, 58 P.3d 276.

⁴⁴ Besel, 146 Wn.2d at 735, 49 P.3d 887.

insured is wrongfully denied a defense or its defense is mishandled, the unfavorable judgment or settlement can be traced to the insured's inability to effectively defend the case. For example, in Paulson,⁴⁵ the Court noted that when the insurer, while defending under a reservation of rights, wrongfully interfered in an insured's defense by sending a subpoena and *ex parte* letter to the arbitrator, its conduct caused "increased risk for [the insured's] defense" and possibly prejudiced the arbitrator and the arbitration process.⁴⁶ But when there is no duty to defend, the insurer has no duty to do anything, such as providing a well-handled defense, that would have any tendency to reduce the likelihood of an adverse judgment or settlement. It follows that holding the insurer liable for the judgment or settlement would be merely arbitrary.

This Court's reasoning in Coventry, where it explained the rationale for coverage by estoppel, is again helpful:

We hold coverage by estoppel in the first party context is not the appropriate remedy because, unlike third party reservation of rights cases, the loss in the first party situation has been incurred before the insurance company is aware a claim exists. Furthermore, an insurer is not liable for the policy benefits but, instead, liable for the consequential damages to the insured as a result of the insurer's breach of its

⁴⁵ Slip op. at 20-21 No. 79027-2 (Wash. Supreme Court, Oct. 11, 2007).

⁴⁶ Id.

contractual and statutory obligations. In third party reservation of rights cases, though, coverage by estoppel is an appropriate remedy because the insurer **contributes to the insured's loss by failing to fulfill its obligation in some way.**^[47]

This Court therefore held that the insured's remedy was not the amount of its non-covered claim but instead was limited to "its expenses as a result of [the insurer's] bad faith acts and ensuing tort and CPA damages."⁴⁸ Because St. Paul's alleged failure to act could not have "contribut[ed] to the insured's loss," coverage by estoppel is an inappropriate remedy. As the policyholder's assignee, the RMS class should be entitled to no more than the actual damages remedy this Court approved in Coventry. Hypothetically, if the alleged delay caused Onvia to incur some extraordinary expense in attempting to obtain a response from St. Paul, that expense should be the extent of any recovery.⁴⁹ But because Onvia would have had to defend and/or settle the claim against it even if St. Paul had timely responded, it makes no sense to hold that the amount of the settlement Onvia reached is relevant to the calculation of damages.

⁴⁷ Coventry, 136 Wn.2d at 284-285, 961 P.2d 933.

⁴⁸ Id.

⁴⁹ Again, this is assuming a viable cause of action exists. Such expenses should not be recoverable as a matter of law for the reasons discussed in part A.

This is consistent with longstanding Washington law. In Hayden v. Mutual of Enumclaw Ins. Co.,⁵⁰ a liability insurer had declined a tender of defense, citing a particular exclusion; when a coverage suit followed, it resisted the coverage claim by relying on another exclusion. The insured's assignee claimed that the insurer's procedural misstep in citing a different exclusion was a violation of WAC 284-30-380, requiring an insurer to cite an exclusion supporting its denial of a claim. The assignee argued that the insurer's failure to comply with this regulation precluded or estopped it from defending on the grounds of the uncited exclusion. This Court disagreed.

This Court held that where, as in this case between St. Paul and the RMS class, the insurer has neither acted in bad faith nor prejudiced the insured, the violation of an insurance regulation does not give rise to an estoppel or preclusion to rely upon the uncited coverage defense. This Court said that the insurance regulations did not provide for a preclusion or estoppel remedy, and further, even if a CPA claim were invoked on the regulation's violation, the appropriate remedies did not include preclusion or estoppel.⁵¹

⁵⁰ 141 Wn.2d 55, 1 P.3d 1167 (2000).

⁵¹ 141 Wn.2d at 62-63. Although there was no claim of bad faith in Hayden as there was here, Hayden is still instructive. Here, the substantive bad faith claim has already been dismissed, and these certified questions do not re-introduce the claim. So, for all practical purposes, both cases involve alleged procedural missteps by the insurer.

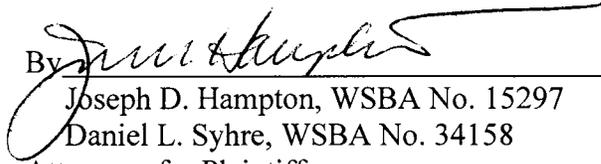
This is consistent with this Court's ruling in Coventry, *supra*. Claims handling errors committed by an insurer may support, at most, a claim for proximately-caused damages. They do not mushroom into full-blown estoppel, which is reserved for circumstances of bad faith; that is, where the insurer's denial has been "frivolous, unreasonable or unfounded." The remedy afforded by Coventry more than suffices to compensate insureds who may have been harmed by an insurer's tardy response.

VI. CONCLUSION

The policies underlying the duty of good faith and the Consumer Protection Act do not support windfall recoveries for delays in responding to claims that are clearly not covered. Instead, these causes of action are designed to protect an insured's legitimate expectations of performance, be it defense, investigation or settlement, owed under the contract. For that reason, St. Paul respectfully requests that the Court answer the first question in the negative. In the alternative, St. Paul requests that the Court answer the second question by holding that an insured not owed a duty to defend must prove harm resulting from the mishandling of its claim and that the insured's damages are limited to the actual damages suffered as a result of the insurer's conduct.

Respectfully submitted this 12th day of October, 2007.

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CERTIFICATE OF SERVICE

I am a citizen of the United States and a resident of King County. I am over 18 years of age and not a party to this action. My business address is One Convention Place, Suite 1400, 701 Pike Street, Seattle, WA 98101-3927.

On the date indicated below, I caused the attached document to be served via legal messenger upon:

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DATED this 12th day of October, 2007, at Seattle, Washington.



Pamela L. Iverson

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