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CLERK (Court of Appeals No. 56761-6-I)

SUPREME COURT
OF THE STATE OF WASHINGTON

NCF FINANCIAL, INC.,
a Washington corporation,

Plaintiff/Petitioner,

vs.

ST. PAUL FIRE & MARINE INSURANCE COMPANY,
a Minnesota corporation,

Defendant/Respondent.

**SUPPLEMENTAL BRIEF OF RESPONDENT ST. PAUL FIRE &
MARINE INSURANCE COMPANY**

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TO E-MAIL**

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I. INTRODUCTION

St. Paul Fire & Marine Insurance Company (“St. Paul”) respectfully submits this brief to supplement the materials contained in the Court’s records. As the record shows, the Honorable Michael J. Fox granted St. Paul’s summary judgment and the Court of Appeals unanimously agreed that NCF’s coverage claim for property it leased to Emerald Solutions, Inc. (“Emerald”) that was discovered to be inexplicably missing years later is not covered under the commercial property insurance policy at issue here.

For the reasons set forth in the Brief of Respondent and in this Supplemental Brief, St. Paul, asks this Court to affirm the Court of Appeals.

II. ISSUES FOR SUPPLEMENTAL BRIEFING

1. The St. Paul Policy excludes “property that is missing . . . where there is no physical evidence to show what happened to the property.” NCF’s computer equipment is missing; NCF has no physical evidence to show what happened to it; and NCF does not contend that the policy is ambiguous. Does the disappearance exclusion apply to NCF’s claim?

2. Pursuant to RAP 13.7(b), if the Court reverses the Court of Appeals, it should consider St. Paul’s argument that NCF’s property does not come within the coverage grant for “direct physical loss or damage” or remand to the Court of Appeals for such a determination.

III. STATEMENT OF THE CASE

For its statement of the facts, respondent St. Paul Fire and Marine Insurance Company (St. Paul) incorporates the statement of facts in Court of Appeals' February 20, 2007 Unpublished Decision (hereinafter, "Unpublished Decision") and St. Paul's counterstatement of the case found at pages 6-21 of its Brief of Respondent to the Court of Appeals.

IV. ARGUMENT

A. The Disappearance Exclusion Applies to the Missing Property and is Enforceable.

The Court of Appeals based its decision on an exclusion in the St. Paul policy, which reads as follows:

Exclusions - Losses We Won't Cover

When we use the word "loss" in this section we also mean damage.

* * *

Disappearance - inventory loss. We won't cover loss of property that is missing where the only evidence of the loss is a shortage disclosed on taking inventory, or other instances where there is no physical evidence to show what happened to the property.

CP 183-221.

1. The Exclusion Applies to Property Not Returned to NCF.

As the Court of Appeals noted, NCF does not contend that the policy language is ambiguous and NCF has no idea what happened to the property:

NCF does not argue that the language in the “Disappearance-inventory loss” provision is ambiguous. The Second and Third policies exclude coverage for missing property when there is “no physical evidence to show what happened to the property.” As in Blasiar, there is no physical evidence in the record showing what happened to the missing computer equipment. NCF admits there is no physical evidence about what happened to the missing leased equipment. In NCF's Proof of Loss, it states that “NCF does not know exactly how its property was physically lost or damaged.” NCF also admits it “does not know the dates its property was physically lost or damaged.” Joe Vitulli, NCF's designated CR 30(b)(6) witness, testified that Emerald did not have any information as to what happened to the property. Emerald-Delaware's chief financial officer also testified that he had no knowledge about whether the unreturned equipment was missing before or after the bankruptcy filing.

Unpublished Decision at 6.

NCF's claim for missing equipment falls squarely within the policy exclusion. Washington courts consistently hold that where insurance policy language is clear and unambiguous, the court “must enforce it as written and may not modify it or create ambiguity where none exists.” B&L Trucking & Constr. Co. v. Northern Ins. Co., 82 Wn. App. 646, 656, 920 P.2d 192 (1996) (citing McDonald v. State Farm Fire & Cas. Co., 119 Wn.2d 724, 733, 837 P.2d 1000 (1992)). The policy language in this case is clear and unambiguous — there is no coverage for “property that is missing . . . where there is no physical evidence to show what happened to the property.” CP 220.

While no Washington court other than the Court of Appeals in this case has interpreted the “Disappearance - inventory loss” exclusion, a

number of courts in other jurisdictions have found these exclusions unambiguous and have granted summary judgment in favor of insurers where the claims involved unexplained losses. For example, in Blasjar, Inc. v. Fireman's Fund Ins. Co., 76 Cal. App. 4th 748, 90 Cal. Rptr. 2d 374 (1999), a California court found the disappearance – inventory loss exclusion unambiguous and barred coverage where there was no physical evidence to explain how certain telephone system components stored in a warehouse had disappeared. The policy exclusion in that case barred coverage for “property that is missing, but there is no physical evidence to show what happened to it, such as shortage disclosed on taking inventory.” Id. at 751. In affirming summary judgment in favor of the insurer, the court stated:

It is clear from the language of the exclusion as a whole, and from its context in the Policy, that a “shortage disclosed on taking inventory” is used as an example of a situation where “[p]roperty . . . is missing, but there is no physical evidence to show what happened to it” An inventory by itself does not show what happened to any property. It only establishes what property is on hand at a point in time, allowing a comparison to property on hand at other times and to records of property acquired and sold. This construction of the “shortage disclosed on taking inventory” clause is consistent with the purpose of the exclusion: to exclude unexplained losses.

Id. at 756-757. Additional authorities are discussed at pages 26-29 of St. Paul's Brief of Respondent. As the Court of Appeal's recognized, NCF's reliance on cases such as Miller v. Boston, 218 A.2d 275 (Pa. 1966), is off point because those cases involved different policy language

which the court found to be ambiguous, while NCF does not even contend that St. Paul's policy language is ambiguous. Unpublished Opinion, at 6.

St. Paul's policy language simply does not cover property that is missing when there is no physical evidence to show what happened to the property. NCF's property is missing, and it admits that it has no idea what happened to the property.

2. NCF Does Not Have Greater Rights Than the Named Insured.

NCF contends without textual support that “[t]his provision is in a preprinted insurance policy, which contemplates only two parties to the agreement, named the Insurer and the Named Insured. . . .” and that the exclusion should only apply to the named insured who “has control over its property.” Petition for Review at 7. NCF therefore asks the rhetorical question, “how should this exclusion apply to an additional insured which is a Lessor (NCF) or a Lender such as a Bank?” The answer is, “the same way it applies to the named insured, because the policy makes no distinction between the two.” Rather, the exclusion sets forth an exclusion for missing property, without regard to who was last known to be in possession of it.

NCF's citation to Washington cases holding that when one insured engaged in excluded conduct, coverage is not precluded for additional insureds is not on point because the exclusion here is neither defined in terms of the conduct of the insured nor excludes coverage by reference to any particular insured. NCF incorrectly relies on Standard Fire Ins. Co. v.

Blakeslee, 54 Wn. App. 1, 771 P.2d 1172 (1989), and Unigard Mut. Ins. Co. v. Spokane Sch. Dist. No. 81, 20 Wn. App. 261, 579 P.2d 1015 (1978), to argue that the St. Paul commercial property insurance policy exclusions do not apply to NCF. All the court held in those cases is that an intentional act which causes a loss to be excluded from liability coverage for one named insured will not be imputed to an additional insured. E.g. Unigard, 20 Wn. App. 261, 266, 579 P.2d 1015, 1019 (1978) (“where coverage and exclusion is defined in terms of “the insured,” the courts have uniformly considered the contract between the insurer and several insureds to be separable, rather than joint). These cases have nothing to do with the property insurance coverage or the exclusions at issue here because the disappearance exclusion is neither defined in terms of the conduct of the insured nor excludes coverage by reference to any particular insured. Instead, coverage turns on whether or not there is physical evidence of what happened to the missing property.

3. There Is No Public Policy Justification for Rewriting the Exclusion.

NCF argued for the first time at pages 11 and 12 of its Petition for Review that this case should be decided based on its public policy implications or its supposed impact on the banking industry. First, even if bankers (or NCF) would be disappointed by the insurance policy’s terms, that is no reason to rewrite the contract. As this Court stated in its most recent discussion of exclusions in first party policies: “[t]he contention that exclusions from coverage in all-risk insurance policies generally

violate public policy is not supported by Washington law. The 'reasonable expectation' doctrine has never been adopted in Washington, and there is no reasonable expectation that no exemptions to coverage exist." Findlay v. United Pacific Ins. Co., 129 Wn.2d 368, 378, 917 P.2d 116 (1996). The Court's went on to state that

We have repeatedly held that an insurer, as a private contractor, is ordinarily permitted to limit its liability unless to do so would be inconsistent with public policy. When such public policy exists, it will ordinarily be found in a regulatory statute.

Findlay, 129 Wn.2d at 379 (citing American Home Assurance Co. v. Cohen, 124 Wn.2d 865, 873-74, 881 P.2d 1001 (1994)).

The speculative nature of NCF's policy argument illustrates the wisdom of the Court's approach in Findlay. NCF argues that banks lend money on the assumption that if the collateral simply disappears with no explanation while it is in the debtor's possession, the debtor's insurer will compensate the bank if the debtor defaults on the loan. NCF does not explain how it knows this. If this assumption is disappointed, the argument continues, banks will be unwilling to loan money, thus, ultimately "undermin[ing] the ability of borrows to acquire credit," or that "[t]he cost of lending would undoubtedly rise" in order to account for the uninsured risk of disappearance. Of course, NCF neglects to mention that the cost of insurance will undoubtedly rise if insurer are forced to cover risks that are clearly excluded by the policies.

NCF's argument is improbable conjecture. There is no evidence in the record or elsewhere that banks expect or believe that they have

coverage as an additional insureds for collateral that simply disappears. In fact, bankers may be in a better position than insurance companies to assess and charge for the risk that the collateral will simply “disappear.” The risk of unexplained “disappearance” of collateral is probably governed by the same factors that determine the borrower’s overall credit risk; it is something that is more likely to happen with a fly-by-night company than with an established company with a solid track record of responsible business practices. The bank would likely only expect insurance to cover fortuitous risks that are not predicted by the insured’s credit rating, such as the risk of accidental, physical destruction of the collateral. But whether insurers or bankers should bear the risk of missing collateral is for the market to address, not the judicial system.

Because there is no statute, regulation, or any other source of law that requires insurers to cover the risk of unexplained disappearance of property, there is no public policy justification for failing to enforce the exclusion as written. The exclusion should therefore be enforced as written; and as written, it clearly and unambiguously precludes coverage for the missing equipment.

B. The Court of Appeals Correctly Rejected NCF’s Speculative Arguments for Theft Coverage.

NCF attempted to persuade the trial court and the Court of Appeals that a genuine issue of fact existed over whether Emerald’s employee’s stole the missing equipment, thus triggering employee theft coverage. The Court of Appeals described the “evidence” of theft as follows:

NCF claims the following circumstances create a material issue of fact about whether the equipment was stolen by Emerald's employees: a large number of employees were laid off; Emerald stated under oath no loss or theft occurred within 12 months of the filing of its bankruptcy; and there were three reports of theft in 2000 despite Emerald's security measures.

Unpublished Opinion at 7. As the Court of Appeals pointed out, this is pure speculation¹ and does not amount to "physical evidence to show what happened to the property." *Id.* This speculation is insufficient to escape the effect of this exclusion because, as the nonmoving party, NCF "may not rely on speculation or on argumentative assertions that unresolved factual issues remain." *White v. State*, 131 Wn.2d 1, 9, 929 P.2d 393 (1997).

C. The Court of Appeals May Also Be Affirmed on the Ground that Property that Was Not Returned Does Not Fall within the Policy Coverage Grant.

The Court of Appeals based its ruling on the disappearance exclusion and declined to address St. Paul's alternative argument that the NCF cannot meet its burden of proving that its claim for missing property does come within the grant of coverage for

Covered Causes Of Loss

NCF suggests (based on a recitation of inadmissible hearsay) that a jury may find that covered property sent to over thirteen locations from 1999 through 2001 was lost due to theft by employees or others in Portland "sometime after November 2001." CP 1070. This is not physical evidence of what happened to the property — it is merely speculation about what could possibly happen to the property if, in fact, it was at a certain locations at the requisite time. To be sure, this speculation about the loss amounts to nothing more than a concession that there is no physical evidence to show what happened to the missing property.

We'll protect covered property against risks of direct physical loss or damage except as indicated in the Exclusions - Losses We Won't Cover section.

CP 219.

The Court of Appeals did not address this argument because it held that the exclusion applied and that it therefore did not need to reach the issue. Unpublished Opinion at n.9. Pursuant to RAP 13.7(b), if the Court reverses the Court of Appeals, it should consider St. Paul's argument on this issue, which is found at pages 38-42 of its brief to the Court of Appeals, or remand to the Court of Appeals for such a determination.

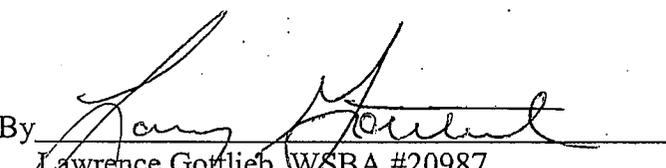
V. CONCLUSION

The Court of Appeals correctly held that the disappearance exclusion bars NCF's claim for property that is simply missing with no explanation. This Court should therefore affirm the Court of Appeals on that basis, or if it does not, it should either affirm the Court of Appeals on the alternative basis that the NCF claim does not fall within the grant of coverage or remand the case to the Court of Appeals for a determination of that issue.

DATED this 1st day of May, 2007.

BETTS, PATTERSON & MINES, P.S.

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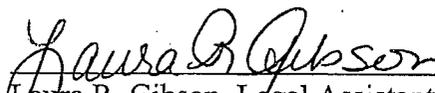
I certify that on the 1st day of May, 2008, I caused a true and correct copy of this *Supplemental Brief of St. Paul Fire and Marine Insurance Company* and *Proof of Service* to be filed with the Supreme Court and served via Washington Legal Messenger on the following:

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