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Supreme Court Case No. 86109-9

SUPREME COURT OF THE STATE OF WASHINGTON

JAMES BIRD,

Respondent,

v.

BEST PLUMBING GROUP, LLC,

Respondent,

v.

FARMERS INSURANCE EXCHANGE,

Petitioner.

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STATE OF WASHINGTON  
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### IDENTITY AND INTEREST OF AMICUS

The Federation of Defense and Corporate Counsel ("FDCC"), formed in 1936, has an international membership of approximately 1,400 lawyers. FDCC members are experienced attorneys in private practice, as well as general counsel and insurance claims executives from around the world. Membership is limited, available solely by nomination, and includes only those who have been judged by their peers to have achieved professional distinction and demonstrated leadership in their respective fields. The FDCC is committed to promoting knowledge and professionalism in its ranks and has organized itself to that end.

This case, on a fundamental level, affects the rights and duties of all insurers who write policies in the State of Washington—a substantial portion of the FDCC's membership. It directly impacts an insurer's right to have a jury decide all of the essential elements of a bad faith claim, among other constitutionally protected rights. The FDCC has a strong interest in preserving the rights of its member companies (as well as other businesses), particularly the right to a jury trial. As such, the FDCC is supportive of the position of Farmers Insurance Exchange ("Farmers") with respect to the issues identified below. Due to its geographic reach, the FDCC brings a unique perspective to the issues presented in this case, in addition to a legacy of experience in the fields of insurance coverage

and bad faith litigation. In short, the FDCC's interest in this case is substantial; more importantly, its insight will be helpful to the Court.

### INTRODUCTION

This case is about the constitutional right of all defendants to have a jury determine whether the essential elements of a claim have been proven, including damages. Under settled Washington law, litigants enjoy a constitutional right to have a jury resolve all civil claims for which a jury right existed at common law. This right is universal, and should apply to all parties at all times. This case, however, poses a significant threat to that right, as the Court of Appeals' decision, *Bird v. Best Plumbing Group, LLC*, 161 Wn. App. 510, 260 P.3d 209 (2011), affords the right to a jury trial only to certain litigants, stripping it from others. Indeed, if the Court of Appeals is affirmed, insurance companies in Washington will no longer have the right to a full jury trial as to liability and damages in all bad faith cases. Instead, damages in an assigned third-party bad faith case will be effectively set by agreement between the plaintiff and the insured; that is, an underlying settlement between the plaintiff and the insured, if determined reasonable, will become the presumptive amount of damages that can be sought from the insurer in a subsequent bad faith action. The unfortunate and troubling result of this Washington procedure is that the damages amount (i.e., the settlement)—which can be determined against

the insurer in an unnecessary adjunct proceeding—is set without a jury ever deciding this essential element of a bad faith claim.

Insurers in Washington should enjoy the same constitutional rights as all other litigants. They certainly should not be expected to write insurance in Washington without the right to ask a jury to determine the damages that plaintiffs can seek in bad faith cases. Moreover, they should not be burdened with having to intervene, usually on short notice, in an expedited reasonableness proceeding in order to have any say at all in the determination of damages. These scenarios directly implicate fundamental due process rights and should not be embraced by this Court. Accordingly, for the reasons set forth below, the FDCC urges this Court to reverse the Court of Appeals and confirm that the constitutional right to a jury trial belongs to all citizens of Washington—including insurers.

#### **ISSUES PRESENTED BY AMICUS**

I. An insurer's right to a jury trial is violated by the trial court's refusal to allow a jury to consider damages in an assigned bad faith claim.

II. An insurer's right to due process is violated by the trial court's denial of a jury trial demand and its imposition of an irrebuttable presumption of harm for purposes of an assigned bad faith claim.

### STATEMENT OF THE CASE

The dispute underlying this case arose after Best Plumbing made cuts to a sewage line on James Bird's property. *Bird*, 161 Wn. App. at 514-15, 260 P.3d at 211. Because of the cuts, a large amount of sewage was discharged onto Bird's land. *Id.* at 515, 260 P.3d at 211. In May 2007 Bird sued Best Plumbing alleging trespass and negligence. *Id.* at 515, 260 P.3d at 212. Farmers was Best Plumbing's liability insurer and defended Best Plumbing.

The parties and Farmers mediated their dispute in November 2008 but did not reach a resolution. *Id.* at 516, 260 P.3d at 212. Later, after Farmers rejected Bird's \$2 million policy-limits demand, Bird and Best Plumbing reached a private settlement—that is, without Farmers' participation or knowledge. *Id.* The settlement was for \$3.75 million and included an assignment of Best Plumbing's claims against Farmers (including any potential bad faith claim), a stipulated judgment, and a covenant by Bird to never execute on the judgment against Best Plumbing. *Id.*

As provided by Washington law, Bird applied to the trial court for a determination that the settlement amount was reasonable. *Id.* Farmers was allowed to intervene, but its request to have a jury assess the damages that would apply in any subsequent claim (that is, the settlement amount)

was denied. *Id.* The trial court conducted a reasonableness hearing and, on October 7, 2009, issued a memorandum ruling that the \$3.75 million settlement was reasonable. *Id.* The amount is, of course, totally arbitrary; it is the result of an agreement between a plaintiff who has every interest in pushing the number as high as possible and an insured who has no interest in the dollar amount at all, but rather, is focused on insulating itself with a covenant not to execute. Under Washington law, however, \$3.75 million will be considered Bird's damages if he ever pursues a bad faith claim against Farmers. Because Farmers will be bound by this "reasonableness" determination, with no jury ever evaluating the damages amount, Farmers brought this appeal.

#### ARGUMENT

I. An Insurer's Right to a Jury Trial Is Violated by the Trial Court's Refusal to Allow a Jury to Consider Damages

A. Washington Law, As Applied by the Court of Appeals

Under existing Washington law, an insured is permitted to assign any claims against its insurer, including a bad faith claim, to the party claiming injury. *See, e.g., Safeco Ins. Co. of Am. v. Butler*, 118 Wn.2d 383, 397, 823 P.2d 499, 507 (1992). The insured can do so, as Best Plumbing did here, without the insurer's knowledge or consent. *Id.* at 399, 823 P.2d at 508. If the claimant can establish the insurer's bad faith,

Washington law imposes a rebuttable presumption of harm (which is an essential element of any bad faith claim). *See id.* at 390, 823 P.2d at 504.

Washington law also permits an insured to negotiate and settle claims directly with the injured party, without involving the insurer, and reach a stipulated judgment with a covenant not to execute. *See, e.g., Besel v. Viking Ins. Co. of Wis.*, 146 Wn.2d 730, 736-37, 49 P.3d 887, 890-91 (2002). When coupled with an assignment, this procedure allows the insured to escape liability, regardless of its actions, and permits the injured party to seek recovery solely and directly from the insurer's pocket. This exact procedure was employed by Best Plumbing in this case to resolve the claims against it without paying anything and without any risk of future liability.

Furthermore, in *Besel*, this Court determined that, in such situations, the amount of the settlement/covenant judgment will be the measure of damages in any subsequent bad faith claim, as long as the settlement was reasonable and free from collusion or fraud. *Id.* at 738-39, 49 P.3d at 891-92. The reasonableness determination is made by the trial court, without a jury.<sup>1</sup> After a reasonableness hearing, the stipulated

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<sup>1</sup> Some courts, including the Court of Appeals below, have purported to rely on RCW 4.22.060 as a statutory basis for conducting reasonableness hearings in connection with covenant judgments and assigned bad faith

damages amount—which was never the subject of proof at any trial—becomes the presumptive damage award on the plaintiff's assigned bad faith claim. *See id.* A jury may evaluate the other elements of bad faith, but no jury will ever consider the damages that will be imposed against the insurer if it is found to have engaged in bad faith conduct.

B. Insurers Have a Right to a Jury in Bad Faith Cases

The Washington State Constitution guarantees the right of all litigants to a jury trial. WASH. CONST. art. 1, § 21. This Court has consistently interpreted the right as extending to all civil claims for which there was a right to a jury in 1889, the year the Constitution was adopted. *Brown v. Safeway Stores, Inc.*, 94 Wn.2d 359, 365, 617 P.2d 704, 708 (1980). For causes of action that did not exist in 1889, the Court looks to then-existing proceedings that are analogous to the current action to determine if the parties have a right to a jury. *Endicott v. Icicle Seafoods, Inc.*, 167 Wn.2d 873, 884, 224 P.3d 761, 767 (2010).

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claims. *See Bird*, 161 Wn. App. at 517, 260 P.3d at 212-13 (discussing RCW 4.22.060). The statute, which is part of a Chapter titled "Contributory Fault," does not support this application. Rather, it deals with settlements in the joint-tortfeasor context and establishes a process for courts to ensure fairness in how damages are apportioned. This case demonstrates the unfortunate consequence of extending the statute without giving full consideration to the possible ramifications—the complete abrogation of significant constitutional rights.

An action for bad faith handling of an insurance claim sounds in tort. *Safeco Ins.*, 118 Wn.2d at 389, 823 P.2d at 503. “Claims of insurer bad faith are analyzed applying the same principles of any other tort: duty, breach of that duty, and damages proximately caused by any breach of duty.” *St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.*, 165 Wn.2d 122, 130, 196 P.3d 664, 668 (2008) (internal quotation omitted). In order to establish bad faith, the claimant must show that the insurer breached the insurance agreement in an “unreasonable, frivolous, or unfounded” way. *Id.*

There is no doubt that the right to a jury trial attached to tort claims in 1889. *See Endicott*, 167 Wn.2d at 884-85, 224 P.3d at 767 (“An action centered on negligence is analogous to the basic tort theories that existed when the [C]onstitution was adopted, and the constitutional jury trial right applies.” (internal quotations omitted)). There is similarly no doubt that a jury should determine damages. *See Sofie v. Fireboard Corp.*, 112 Wn.2d 636, 645, 771 P.2d 711, 716 (1989) (noting that “the measure of damages is a question of fact within the jury’s province”). Moreover, as early as 1903, this Court confirmed that a jury—not a judge—should resolve disputes related to obligations assumed or imposed under a contract. *See Durand v. Heney*, 33 Wn. 38, 41, 73 P. 775, 776 (1903). Because a bad

faith claim is a tort that arises out of the alleged breach of a contract, there can be no doubt that the constitutional jury trial right attaches.<sup>2</sup>

C. Insurers' Right to a Jury Extends to Assigned Bad Faith Cases and the Determination of Damages

There is nothing about the Washington procedure allowing assignment of bad faith claims that should impact an insurer's right to a jury trial. Once the right to a jury trial attaches it belongs to all litigants, including insurers, and cannot (and should not) be abrogated by an assignment of claims from the insured to another person or entity. The Court of Appeals confirmed this truism recently in *Unigard Insurance Co. v. Mutual of Enumclaw Insurance Co.*, 160 Wn. App. 912, 250 P.3d 121 (2011).

The Court of Appeals described the *Unigard* facts as resembling "a pattern frequently seen in litigation over bad faith by an insurance

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<sup>2</sup> Notably, the Court of Appeals never disputed below the existence of a jury trial right in bad faith actions. Rather, it avoided the issue entirely by considering, in a vacuum, whether a jury was necessary solely for a reasonableness hearing (that is, unconnected to any context or cause of action). The Court of Appeals concluded that, because reasonableness hearings are statutory equitable proceedings, no jury trial right attaches. *Bird*, 161 Wn. App. at 517-24, 260 P.3d at 213-16. The Court of Appeals, however, failed to consider the undeniable jury trial right associated with bad faith claims and also ignored that a reasonableness hearing employed in this way strips from the jury any evaluation of the stipulated damages in a subsequent bad faith action.

company.” *Id.* at 919, 250 P.3d at 125. Using generic terms, the Court of Appeals summarized the facts as follows: “A defendant is sued and seeks coverage. The defendant’s insurer refuses to defend. The defendant enters into a settlement agreement with the plaintiff.” *Id.* In connection with the settlement, “[t]he defendant stipulates to entry of a judgment and assigns to the plaintiff any claims against the insurer in exchange for the plaintiff’s promise not to execute the judgment against the defendant.” *Id.* Noting that this arrangement is called a “covenant judgment,” the Court of Appeals continued: “The plaintiff, now standing in the defendant’s shoes, sues the insurer for bad faith and related claims, seeking to recover the agreed settlement amount. If the insurer is liable for bad faith and the covenant judgment is reasonable, the presumptive measure of damages is the amount in the covenant judgment.” *Id.* at 919, 250 P.3d at 126.

This scenario, as summarized, is strikingly similar to the arrangement in this case reached by Bird and Best Plumbing.<sup>3</sup> In *Unigard*, as here, the insured and the injured party reached a settlement without involving the insured’s carrier. *Id.* at 917, 250 P.3d at 125. The insured then assigned his rights against the insurer. *Id.* As the Court of

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<sup>3</sup> Farmers, of course, did not refuse to defend. It participated in the defense and retained counsel for Best Plumbing.

Appeals observed, however, there was one key difference in *Unigard*: the parties settled, and the insured assigned his rights, but they never agreed to a covenant judgment. *Id.* at 919, 250 P.3d at 126 (“This case follows the pattern except there was no covenant judgment. [The insured] did not admit liability or stipulate to a judgment amount. He merely assigned . . . his rights against [the insurer].”). Without a covenant judgment, the Court of Appeals noted, the settlement amount could not qualify as the presumptive measure of damages. *Id.* Moreover, the trial court had already awarded summary judgment in favor of the claimant on the existence of bad faith. *Id.* at 917, 250 P.3d at 125. Accordingly, the sole issue remaining for trial—a *jury* trial—was the amount of damages. *Id.* at 917-18, 250 P.3d at 125.

The trial court held a jury trial on damages, and the Court of Appeals affirmed the jury’s award. *See generally id.* at 928-29, 250 P.3d at 130. *Unigard* shows, therefore, that an insurer is not only entitled to a jury trial in an assigned bad faith claim, it is entitled to a jury trial when the only issue remaining in an assigned bad faith claim is the amount of damages. Under *Unigard* a jury trial is warranted here, to ensure that Washington law is consistently and applied fairly to all businesses and to safeguard the constitutional right of all litigants to have a jury determine damages.

D. The Existence of a Covenant Judgment Should Not Eviscerate the Jury Trial Right

As noted above, Washington law provides a constitutional right to a jury trial in bad faith cases. As also noted above, the jury trial right extends to assigned bad faith claims. It even extends to bad faith claims that are assigned when the only issue remaining for trial is the amount of damages. *See id.* According to the Court of Appeals, however, the jury trial right somehow evaporates once the insured and the party claiming injury agree to a covenant judgment. That is the only factual difference between this case (in which plaintiff Bird and insured Best Plumbing agreed to a covenant judgment) and *Unigard* (in which the plaintiff and the insured did not include a covenant judgment as part of their settlement and assignment of claims). Yet, in *Unigard* there was a jury trial on damages, while in this case the Court of Appeals concluded no such right exists.<sup>4</sup> It is hard to imagine a more arbitrary distinction—one that allows

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<sup>4</sup> To justify its decision, the Court of Appeals relied heavily on this Court's decision in *Schmidt v. Cornerstone Investments, Inc.*, 115 Wn.2d 148, 795 P.2d 1143 (1990). *See Bird*, 161 Wn. App. at 518-20, 260 P.3d at 213-14. As an initial matter, as this Court noted, the parties in *Schmidt* did not properly raise the jury trial issue on appeal. Moreover, and more importantly, *Schmidt* did not address the critical issue in this case: an insurer's right to have a jury determine damages in a bad faith case. In *Schmidt* (which was not an insurance case at all, much less a bad faith case), a jury trial was held and the jury set the amount of damages. *Schmidt*, 115 Wn.2d at 156, 795 P.2d at 1146. The reasonableness hearing

an insurer's constitutional right to a jury trial to be negotiated away by two other parties without any involvement or knowledge of the insurer.<sup>5</sup>

If the Court of Appeals is affirmed in this case, constitutional rights in the State of Washington will be fundamentally altered for the worse. The Court of Appeals' decision allows two parties to agree to take away constitutional rights that belong to another. Even more problematic, this new rule has a disparate application, because it only impacts insurance companies. The FDCC urges this Court to correct the Court of Appeals'

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was simply to facilitate the allocation of damages among the settling and non-settling defendants; *Schmidt* held that a jury was not required for this simple task. *Id.* at 161, 795 P.2d at 1149. Again, the right to have a jury determine damages was not before the Court in *Schmidt*. Here, however, that right plainly belonged to Farmers. The Court of Appeals allowed that right to be taken away by Bird and Best Plumbing through their agreement to a covenant judgment. This key procedural and factual distinction renders *Schmidt* inapplicable for purposes of this case.

<sup>5</sup> A simple but familiar analogy can be helpful: In *Schmidt* (the case relied upon by the Court of Appeals), a jury determined the size of the pie and the reasonableness hearing concerned only how the pie was sliced among the various defendants. In other words, the reasonableness hearing concerned only allocation. In this case, however, there was no jury. Moreover, allocation is not an issue. The size of the pie was set by Bird (with an interest to make it as big as possible) and Best Plumbing (whose interest was in making sure it was not responsible for the pie, regardless of its size). Bird asserts that Farmers is responsible for the whole pie, the amount of the settlement. This outcome is based on a "reasonableness" hearing that gave Farmers, at best, a truncated opportunity to address the proper size of the pie and no ability to present the damages issue to a jury. Replacing a jury with this type of procedure is an affront to the Washington Constitution.

disregard for the constitutional rights of all parties. Washington should remain a jurisdiction where constitutional rights are extended to all citizens equally, including insurers, and applied consistently across the board.

II. An Insurer's Due Process Rights Are Violated by the Trial Court's Denial of a Jury Trial Demand and Its Imposition of an Irrebuttable Presumption of Harm

A. The Process Afforded Farmers, As Applied by the Court of Appeals

Unless this Court reverses, Washington law will allow an end run around the guarantee of jury trials, without any regard for notions of due process. As explained in detail above, the settlement and covenant judgment between Bird and Best Plumbing establishes the damages to be awarded to Bird if he proves the existence of bad faith. If a trial court says that the settlement is reasonable, the presumptive damages amount becomes effectively irrebuttable and cannot be challenged in a subsequent bad faith action. *See Besel*, 146 Wn.2d at 738-39, 49 P.3d at 891; *Mut. of Enumclaw Ins. Co. v. T & G Constr., Inc.*, 165 Wn.2d 255, 263, 199 P.3d 367, 380-81 (2008). In fact, reasonableness hearings carry preclusive effect, such that an insurer is estopped from raising issues in a later bad faith claim that could have been raised, but were not, at the reasonableness hearing stage. *T & G Constr.*, 165 Wn.2d at 263, 199 P.3d at 381 (“The

insurer is bound to what might, or should, have been litigated as well as to what was actually litigated.” (internal quotation omitted)).

B. The Preclusive Effect of the Process Can Be Disastrous

The nature of reasonableness hearings and the potential preclusive effect can have a devastating impact on an insurer’s limited ability to defend against allegations of bad faith and certainly would obliterate the jury trial right guaranteed by the Washington Constitution. As noted above, after a reasonableness determination, the settlement amount becomes the presumptive damages award as long as the settlement was free of collusion and fraud. *See Besel*, 146 Wn.2d at 738-39, 49 P.3d at 891-92. Collusion and fraud, however, are among the factors to be considered by the trial court under *Glover v. Tacoma General Hospital*, 98 Wn.2d 708, 658 P.2d 1230 (1983). Accordingly, questions relating to collusion and fraud are (or certainly could be) considered by the trial court at a reasonableness hearing. The bad faith claimant, then, has an argument that, if the settlement passed muster at the reasonableness stage, the claimant must have successfully carried its burden on both collusion and fraud, leaving nothing for a jury to consider and no ability for the insurer to contest those matters either. If the preclusive effect described in *T & G Construction* is then applied in full measure, the reasonableness hearing could be the beginning and the end of any consideration of collusion and

fraud. In other words, the opportunity described in *Besel* for an insurer to later challenge a settlement on the basis of collusion or fraud would be rendered illusory by the non-jury reasonableness proceeding.

C. The Process Arbitrarily Replaces the Jury

In the context of covenant judgments, the reasonableness hearing truly supplants the role of the jury in setting and awarding damages. Perhaps more alarming, it does so in a completely arbitrary way. As noted above, insurers have a right to a jury trial in bad faith cases even if the claim is assigned and even if the only issue remaining for trial is the amount of damages. *Unigard*, 160 Wn. App. at 928-29, 250 P.3d at 130. The Court of Appeals below significantly limited that jury right, preserving it for insurers only if the insured and the injured party did not agree to a covenant judgment.

*Unigard* makes perfect sense and represents an appropriate application of the right to a jury trial in a bad faith case. The only way to reconcile *Unigard* with the Court of Appeals' decision in this case, however, is to make the existence of a covenant judgment between third parties dispositive of an insurer's jury trial right. In other words, unless the Court of Appeals is reversed, Washington law will permit a promise between two individuals not to execute on a judgment to take away constitutional rights belonging to another. According to the Court of

Appeals, the only process available to Farmers is the prospect of intervening in the reasonableness proceeding, with very short notice and little time to prepare, and convincing the trial judge not to approve the settlement. There is no reason and no basis for setting bad faith damages in an expedited manner and without a jury, as in *Bird*. Moreover, if the purpose of reviewing the reasonableness of settlements truly is to ensure fairness and prevent collusion, there is similarly no reason that courts and juries should not be well informed and able to give full consideration to the issues (including the issue of damages), and every reason to avoid hasty decisions in which one party is at a disadvantage.

The procedure employed by the Court of Appeals also allows the answer to one question, "Is the settlement amount fair as between the plaintiff and the insured," to answer a completely separate question, "What is the appropriate recovery for any bad faith on the part of the insurer." The answer to these two questions may not always be the same, but the Washington "reasonableness" proceeding allows one to necessarily and unfairly answer the other in the insurance bad faith context without the involvement of a jury. The rule, quite simply, strips insurers of the ability to challenge damages before a jury in favor of a proceeding in which the insurer may not be involved and of which the insurer may have

no knowledge. From the perspective of insurers, this rule is the epitome of unfairness and deprivation of due process.

In short, the rule applied in *Bird* does not provide any process for the insurer, much less "due process." Constitutional rights deserve better protection and the citizens of Washington, as well as all insurers writing policies in Washington, deserve more.

#### CONCLUSION

For the foregoing reasons, the FDCC urges this Court to reverse the Court of Appeals and confirm the constitutional right to a jury trial for all litigants.

This, the <sup>rd</sup>22 of December, 2011

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