IN THE SUPREME COURT OF THE STATE OF OREGON

WEST HILLS DEVELOPMENT COMPANY, an Oregon corporation,

Plaintiff – Respondent – Respondent on Review,

v.

CHARTIS CLAIMS, INC., et al.,

Defendant,

and

OREGON AUTOMOBILE INSURANCE COMPANY, an Oregon company,

Defendant – Appellant – Petitioner on Review.

OREGON AUTOMOBILE INSURANCE COMPANY, an Oregon company,

Third-Party Plaintiff,

v.

QUANTA SPECIALTY LINES INSURANCE COMPANY,

Third-Party Defendant.

Circuit Court No. C107384CV
Court of Appeals No. A152556
Supreme Court No. S063823

Petitioner's Reply Brief on the Merits

August 2016

On Review of a Decision of the Court of Appeals
on Appeal from a Judgment of the Washington County Circuit Court,
by the Honorable D. Charles Bailey, Judge

Decision Filed:	August 19, 2015
Author:	DeVore, J.
Concurring:	Ortega, P.J., and Garrett, J.

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I. Some of West Hills's "Facts" Aren't Actually Facts

West Hills says it's "undisputed" that L & T's negligence caused some of the property damage alleged in the complaint it asked Oregon Auto to defend. Actually, that *was* disputed at the time of the asking. In any event, what matters for duty-to-defend purposes is not what actually happened, but what is alleged on the face of the complaint. And what the homeowners alleged there is that the damage was entirely the result of West Hills's negligence, not L & T's. The complaint didn't even mention L & T. Whether L & T was actually to blame for some damage, as West Hills alleged in a third-party complaint and L & T vehemently denied, is not relevant to whether Oregon Auto owed a duty to defend the complaint tendered to it.[1]

The result is the same under *Shearer's* exception to the face-of-the-complaint rule, which allows some use of extrinsic evidence in deciding duty-to-defend questions. That's because West Hills didn't submit any evidence with its tender to Oregon Auto. The parties stipulated that the complaint was the only

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[1] The homeowners eventually filed an amended complaint that alleged negligence by L & T too. But they didn't drop their allegation that West Hills was liable for its *own* negligence. And, as the Court of Appeals noted, West Hills didn't tender that complaint to Oregon Auto to defend, probably because, by then, it was getting a defense from its own insurers. 273 Or App at 160. An insurer owes no duty to defend an untendered complaint. *Oregon Insurance Guaranty Assoc. v. Thompson*, 93 Or App 5, 760 P2d 890 (1988), *rev den*, 307 Or 303 (1989). And it can't defend someone unasked.

document presented with the tender letter from West Hills's lawyer. ER 9 (¶ 3). To be sure, the letter said that the complaint "implicates work performed by your insured." ER 31. But that's not evidence, it's just argument.[2]

The absence of an allegation (or evidence) of L & T's negligence is why Oregon Auto didn't owe a duty to defend West Hills. Under the endorsement to the policy, West Hills was an insured "only with respect to liability arising out of [L & T's] ongoing operations for [West Hills]." ER 30. West Hills's liability did not arise out of L & T's operations, let alone its ongoing operations, if the claim alleged that *West Hills* was negligent in various respects, including its supervision of subs. If the problem was West Hills's instructions, not L & T's work, then the

[2] The cover letter also asserted that L & T installed some "front porch columns" at Arbor Terraces. The complaint, however, didn't allege problems with the installation of such columns. It *did* allege problems with "weatherproofing" of unspecified "wood posts," ER 40 (¶ 14(e)), and "cladding" of unspecified "columns," ER 41 (¶ 17(f)), but the letter didn't mention those things and, again, didn't produce evidence of them. Relying on the subcontract, West Hills argues that L & T's work included "post wrapping," which, it says, is the same thing as installing columns. Resp BOM 20. But the subcontract wasn't tendered with the complaint, and the cover letter didn't make the post-column, installation-cladding connection that West Hills is, even now, struggling to explain.

West Hills complains that, if Oregon Auto had emphasized the post-column distinction at the trial of this case, it might have presented evidence on the issue *then*. *Id.* It doesn't explain, however, how that presentation would have been relevant to Oregon Auto's decision *a year earlier* not to accept West Hills's tender. The decision whether to defend today can't be based on the evidence tomorrow.

liability arose out of West Hills's operations, not L & T's, and is not covered by this endorsement.[3]

II. The Issues Are Preserved

West Hills claims that Oregon Auto didn't preserve its objection to the *Shearer* exception, because, in the trial court, Oregon Auto relied on *Shearer* to support its argument that West Hills had not produced extrinsic evidence of coverage. Well, of course, it did. In that court, *Shearer* was the law – an on-point decision by a higher tribunal. Oregon Auto couldn't ignore it, because the trial court couldn't. This court, however, is not bound by *Shearer*, so Oregon Auto is free to argue here, as it did in the Court of Appeals, that *Shearer* should be overturned or limited.

III. "Ongoing Operations" Means Operations that Are Ongoing

The endorsement to the L & T policy does not insure West Hills for liability from *all* of L & T's operations for West Hills. Paragraph A of the endorsement provides, instead, that West Hills is insured "only" for liability arising out of L & T's "ongoing operations." The Court of Appeals assumed this means what Oregon

[3] And that was in dispute at the time of the tender. Indeed, at the trial of this case, a year post-tender, West Hills's lawyer told the judge that the coverage-relevant fact – who was to blame for the construction defects – was "the very essence of the underlying case" and an issue that "will be resolved" there. Tr 22.

Auto contends: that West Hills was insured only for bodily injury or property damage that occurred while L & T was still working on the project. 273 Or at 166. West Hills challenges that assumption. In its view, the endorsement protects against liability for any injury or damage caused by L & T's operations, whenever the injury or damage occurs, even after the work. The endorsement, West Hills says, requires only a *causal*, not a *temporal*, connection between its liability and L & T's operations.

That is not a plausible reading of the endorsement. It covers liability for injury or damage from operations that are "ongoing." You can't have liability for injury or damage until there has been injury or damage, and you can't have injury or damage from operations that are "ongoing" unless the injury or damage happens while the operations are going on. That's what "ongoing" means. *See Webster's Third New Int'l Dictionary* 1576 (2002) ("**ongoing** * * * that [which] is going on: **a :** that [which] is actually in process[.]").

This is how other courts have construed similarly-worded endorsements, many of them promulgated, as this one was, by the Insurance Services Office, or ISO, an organization that develops standard policy language. In *Weitz Co., LLC v. Mid-Century Insurance Co.*, 181 P3d 309, 310-11 (Colo App 2007), for example, the owner of an office building sued the general contractor for construction defects that allowed rainwater to intrude and damage the structure *after* construction. The

general tendered its defense to a subcontractor's insurer, based on an endorsement to the policy that named the general as an additional insured, "but only with respect to liability arising out of [the subcontractor's] ongoing operations for [the general]." *Id.* at 311. The court held that the words "only" and "ongoing operations," when used in conjunction, result in less coverage for the additional-insured general than for the named-insured sub, which was covered for "completed operations." *Id.* at 313-14. The general, the court said, was not covered for the post-construction water damage. *Id.* at 315.

Weitz relied, in part, on ISO's drafting history. *Id.* at 314. Other courts, some relying on the same history, have reached the same conclusion about the similarly-worded endorsements. In *Noble v. Wellington Associates, Inc.*, 145 So3d 714, 719 (Miss App 2013), for example, the court said that "in order for 'ongoing operations' to have any meaning, it cannot encompass liability arising after the subcontractor's work was completed," and that "[b]y limiting coverage to property damage caused by 'ongoing operations,' the policy is clear that once a subcontractor completes its work, coverage ends." *Id.*[4]

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[4] For other cases on point, see *Hartford Ins. Co. v. Ohio Cas. Ins. Co.*, 189 P3d 195, 202 (Wash App 2008) ("the additional insured endorsement limited Roosevelt's coverage to property damage arising out of the subcontractors' work in progress only.") (internal quotation marks omitted); *Zurich Am. Ins. Co. v. Acadia Ins. Co.*, 14-CV-01273-CMA-CBS, 2015 WL 5697320, at *5 (D Colo Sept. 29, 2015) ("ISDC's status as an additional insured ended when DEW's "operations" for it were completed."); *Chatelain v. Fluor Daniel Const. Co.*, 179 So 3d 791, 797

Some courts disagree. For example, in *Tri-Star Theme Builders, Inc. v. OneBeacon Insurance Co.*, 426 Fed Appx 506 (9th Cir 2011), cited by West Hills, the Ninth Circuit, interpreting Arizona law, concluded that liability for property damage "arises out of" the named insured's "ongoing operations" if the damage was caused by those operations. It doesn't matter, the court said, whether the damage occurs after the operations are completed, only that they are the cause.

The problem with that interpretation is that it gives no effect to the word *ongoing*. Operations can't cause anything except while they are ongoing. After they're done, they have no causal effect. Careless driving can't cause an accident once the driving has ended and the car is parked. Thus, under *Tri-Star*'s logic, "arising out of your ongoing operations" means the same as "arising out of your operations." Indeed, it means the same as "arising out of your *completed* operations." Under all three constructs, according to *Tri-Star's* reasoning, there is coverage for operations that set in motion a chain of events which results in injury or damage after the operations are over. That can't be right. It's not reasonable to

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(La App 2015) ("ongoing operations cannot encompass liability arising after the insured's work was completed"); *see also Pardee Construction Co. v. Insurance Co. of the West*, 77 Cal App 4th 1340, 1359-61, 92 Cal Rptr 2d 443 (2000); *Carl E. Woodward, L.L.C. v. Acceptance Indem. Ins. Co.*, 743 F3d 91, 99 (5th Cir 2014); *Evanston Ins. Co. v. Westchester Surplus Lines Ins. Co.*, 451 Fed Appx 672, 675 (9th Cir 2011); *United Fire & Cas. Co. v. Boulder Plaza Residential, LLC*, 633 F3d 951, 959 (10th Cir 2011).

construe the endorsement to have the same meaning when it uses *ongoing* as when it doesn't, or as when it uses the opposite – *completed*.

The holding in *Tri-Star* is not consistent with Oregon's approach to interpreting policies.[5] Oregon courts "assume that the parties to an insurance policy did not intend to create a meaningless provision." *Hoffman Construction Co. v. Fred S. James & Co.*, 313 Or 464, 472, 836 P2d 703 (1992). The only way to give meaning to "ongoing" in paragraph A of this endorsement is to construe it to impose a temporal requirement on coverage – to make West Hills an insured only for property damage that occurs while L & T is still working.

West Hills argues that paragraph A, thus construed, duplicates the exclusion, in paragraph B, for injury or damage "occurring after * * * [a]ll work * * * to be performed by or on behalf of the additional insured(s) at the site of the covered operations has been completed[.]" *See* Resp BOM 42. It's not unusual, however, for policies to take a "belt and suspenders" approach to coverage – to disclaim

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[5] It's also inconsistent with the law of the state the court was trying to apply. A year later, the Arizona Court of Appeals held that the additional insured's liability for a collision arose out of the named insured's "ongoing operations" because the collision "occurred while [the named insured's] work under the subcontract was 'still in progress.'" *Colorado Cas. Ins. Co. v. Safety Control Co., Inc.*, 288 P3d 764, 772-73 (Ariz App 2012); *see also Jaynes Corp. v. American Safety Indem. Co.*, 925 F Supp 2d 1095, 1113 (D Nev 2012) (noting conflict between *Tri-Star* and *Safety Control*); *Interstate Fire & Cas. Co. v. New Hampshire Ins. Co.*, 2013 WL 4759257, *7 (D Ariz 2013) ("Arizona courts have defined liability that arises out of 'ongoing operations' as 'liability that arises while the work is still in progress.'").

certain risks, both in the insuring agreement and in an exclusion. The same concept is expressed in both "positive" and "negative" terms, as if to say "we really mean it." In any event, this argument amounts to a concession by West Hills that, one way or another, if not by paragraph A, then by paragraph B, there is no coverage for post-project property damage. If an auto policy said that it covered injuries suffered in auto accidents, and also said that it *excluded* injuries *not* suffered in auto accidents, it would be strange indeed to construe it to cover a non-auto injury. So, too, here. The endorsement might say the same thing twice. But saying it once is enough.

IV. The Duty to Investigate and the Duty to Defend

As West Hills and its *amici* note, an insurer owes a duty to investigate first-party claims for benefits. But there is no corresponding duty to investigate third-party claims for defense purposes. *See McKee v. Allstate Ins. Co.*, 246 Or 517, 520, 426 P 456 (1967) (insurer owed no duty to defend suit that didn't allege coverage-triggering facts, even after insurer "had made its own investigation and learned" those facts). To rule otherwise would, of course, eviscerate the face-of-the-complaint rule. The duty to defend can't depend "only" on the facts alleged in the complaint, *Ledford v. Gutoski*, 319 Or 397, 400, 877 P2d 80 (1994), *and also* on whatever facts an investigation might turn up.

There are sound reasons not to dump the face-of-the-complaint rule, some of which are discussed in Oregon Auto's prior brief. The most important reason might be the need for a quick and easy decision about whether to defend a new complaint, the answer to which is due in just 30 days. The face of the pleading – what it says – is in hand and indisputable. The words are right there for everyone to see. Usually, those words, taken as true, make clear whether the claim is covered or not – whether, for example, the insured intended to injure the plaintiff.[6] Deciding whether they are true – what the insured actually intended – is a whole different story. The resolution of *that* issue could require months of difficult investigation, especially for an insurer without subpoena power, and could, in the end, require a trial or some other proceeding to resolve disputed facts. The decision to defend can't be left to such a slow, cumbersome, and uncertain process.

Meanwhile, what about the insured's duty to investigate? West Hills was the party that wanted something from Oregon Auto – coverage. It could have conducted its own investigation and included with its tender of defense the extrinsic evidence that it now argues *Oregon Auto* would have found if *it* had investigated. Indeed, it would have been easier for West Hills to come up with coverage-relevant extrinsic evidence since it was a party to the events described in the underlying case. It was involved in the construction, and it signed the

[6] Any ambiguity in the allegations is construed the insured's favor, *Ledford*, 319 Or at 400, and thus doesn't delay the decision whether to defend.

subcontract with L & T. If, as West Hills now contends, that document is relevant to coverage, West Hills could have presented it with the tender.[7]

If this court decides to abandon the face-of-the-complaint rule and require insurers to consider extrinsic evidence in deciding whether to defend, it should limit the evidence to that which is presented by the insured.

V. Who is Really at Whose Mercy

The Associated General Contractors, as *amicus curiae*, opposes a continuation of the face-of-the-complaint rule because it believes the rule leaves "policyholders at the absolute mercy of plaintiffs, some of whom purposely draft complaints to avoid triggering coverage [and thus] take away the seemingly bottomless pockets of the insurance company's litigation budget and leave the policyholder holding the bag for its own defense." AGC Br 3. Actually, plaintiffs almost always draft their complaints to *trigger* coverage under the defendant's policy and thus compel the insurer to defend. They do that not to save the defendants some money, but to make some for themselves. They know that insurers will sometimes pay to settle a case in order to quit having to pay to defend

[7] The insurer's duty to investigate is based, West Hills says, on the implied covenant of good faith and fair dealing that inures in all contracts. That covenant, however, runs both ways.

it. (This, of course, is why the Oregon Trial Lawyers Association filed an *amicus* brief in support of West Hills's position.)

As explained in Oregon Auto's prior brief, modern pleading rules make it easy to plead a claim into coverage, while the discovery rules make it easy to figure out how. ORCP 36 B(2)(a) requires defendants to disclose "the existence and contents" of any insurance policy covering the claim, as well as any letter from the defendant's insurer denying coverage or reserving rights. These documents give plaintiffs a road map for finding coverage.[8] There is no merit, then, to West Hills's assertion that plaintiffs "cannot know the terms of their putative defendant's insurance coverage." Resp BOM 44. In fact, they can, and they usually do.

That is why complaints in construction-defect cases now omit many coverage-relevant dates, including the date of construction. It's not as if the plaintiffs don't know when their house was built. Of course they do. But they also know that if they don't allege that date, they can trigger a defense under policies that expired earlier. Those pre-construction insurers won't be able to deny a defense on the ground that no damage occurred during their coverage.[9]

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[8] In addition to Rule 36, plaintiffs in construction defect cases also have the benefit of the website maintained by the Construction Contractors Board, which shows the insurance history for all licensed contractors.

[9] Plaintiffs lawyers in CD cases are especially savvy about coverage. For proof of that, the court need look no further than the cover of AGC's brief. The same law firm that is representing the general contractors in this court and arguing

In practice, the face-of-the-complaint rule doesn't leave insureds at the mercy of plaintiffs trying to avoid coverage. If anything, it leaves insurers at the mercy of plaintiffs trying to *find* it.

VI. OTLA'S "Heads I Win, Tails You Lose" Proposal

OTLA "agrees with" the face-of-the-complaint rule, but urges the court to modify it "slightly." Under OTLA's re-formulation, the face of the complaint still controls the duty to defend, but only if it results in a defense being owed. If not, OTLA says, extrinsic evidence "tending to *establish* coverage" can be considered, but not extrinsic evidence "tending to *defeat* coverage." OTLA Br 14 (emphasis in original).

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for a broader duty-to-defend rule represented the homeowners against the general contractor in the underlying case. The firm recently filed a complaint which seems to have been written with this case in mind; it alleged that "the property damage to the Homes arose and/or occurred through the *ongoing operations* of the Subcontractors." *Dinucci et al. v. West Hills Dev. Co., et al.*, Clackamas Co. Cir. Ct. No. CV14110280, Second Amended Complaint, ¶15 (emphasis added).

West Hills's lawyer wasn't giving away secrets when he said this to the trial judge while explaining complaints in CD cases:

> "What we typically have from our plaintiffs' lawyers – and when I say plaintiffs, I'm not talking about me, I'm talking about the folks who litigate construction defect actions on behalf of HOAs and homeowners – they allege property damage and they do not allege dates. Okay. They to this so that they don't box themselves in." Tr 7.

In other words, OTLA is content to play the game the way it has always been played, looking solely at the allegations of the complaint, provided the insured wins. If the insured loses – if the face of the complaint *doesn't* oblige the insurer to defend – then OTLA wants to scrap that result and start a new game in which *only* the insured can win because, in that game, extrinsic evidence is allowed only to prove that the claim is covered, not that it isn't. For example, if the complaint in an auto case doesn't allege which car the defendant was driving – the one he insured or the one he didn't – the defendant could use the police report to prove that, in fact, it was the insured car and, hence, the insurer owes a defense. But the insurer couldn't use the same report to prove that, in fact, it was the uninsured car and, therefore, it doesn't owe a defense. OTLA doesn't offer a rationale for this one-way approach to the duty to defend.

Nor does it explain how to resolve the impasse when the face of the complaint is silent about some coverage-relevant fact and there is no extrinsic evidence "tending to establish coverage," maybe just evidence "tending to avoid" it. What happens then? OTLA doesn't say. The bench and bar need an answer.

VII. Ruling In Coverage Versus Ruling It Out

The rule-in test for the duty to defend, discussed in Oregon Auto's prior brief, is pretty simple: If the policy covers, say, liability for injury in an auto

accident during a certain period of time, the insurer owes no duty to defend a complaint which does not allege liability for injury in an auto accident during that period of time. West Hills's alternative, rule-out test – the insurer must defend unless the complaint alleges that the injury was *not* suffered in an auto accident or did *not* occurring during that period – is inconsistent with long-standing case law, including, for example, *Ledford*, where the court said: "If the facts alleged in the complaint against the insured do not fall *within* the coverage of the policy, the insurer should *not* have the obligation to defend." 319 Or at 400 (citation omitted) (emphasis added).

The rule-out standard is also inconsistent with the policy language, which says that Oregon Auto "will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage" to which this insurance applies," and will "defend any 'suit' seeking those damages." ER 18. If a complaint does not allege facts within coverage, it is not a suit seeking damages to which this insurance applies, but rather one seeking damages to which this insurance does not apply.

Besides consistency with the case law and the policy, the rule-in standard has another advantage: it will lead to complaints that fairly allege the relevant facts. The rule-out standard, by comparison, would result over time in complaints with fewer and fewer allegations, as the drafters try to avoid the risk of

inadvertently pleading a coverage-defeating fact. As noted, that's already happening in CD cases, where the complaints are now dateless. If that trend were to continue, we might get to the point where complaints say nothing more than "defendant injured plaintiff" – no *when*, *where*, or *how* – because, under a rule-out standard, every insurer the defendant has ever had, under whatever type of policy, auto, homeowners, malpractice, general liability, would have to defend. None could rule out coverage based on those allegations.

In this case, the complaint against West Hills didn't allege facts within coverage. It didn't allege that West Hills was liable for damage which occurred while L & T was still working. It did allege that some damage had occurred by the time the homeowners purchased their units. ER 39. But it didn't say when the homeowners, described variously as "foreseeable future plaintiffs," "secondary purchasers," and "subsequent owners," ER 36, 45, and 46, purchased their units in relation to the end of L & T's work. Accordingly, the complaint did not rule in coverage, and Oregon Auto owed no defense.

VIII. Conclusion

The current duty-to-defend rules, which require a defense only when the complaint, on its face, alleges facts within coverage, are simple, familiar, efficient, and workable, not to mention consistent with the policy and 50-plus years of

precedent. The alternatives proposed by West Hills and supporters are none of those things. The court should follow those rules and reverse the decisions below.

Respectfully submitted,

s/ Thomas M. Christ

Thomas M. Christ, OSB 834064

For Oregon Automobile Insurance Company

Certificate of Compliance with ORAP 5.05(2)

Brief length

I certify that this brief complies with the 4,000 word-count limitation in ORAP 5.05(2)(b)(i)(E) and that the word count of this brief, as described in ORAP 5.05(2)(a), is 3,999 words.

Type size

I further certify that the size of the type in this brief is not smaller than 14 point for both the text of the brief and footnotes as required by ORAP 5.05(4)(f).

s/ Thomas M. Christ

Thomas M. Christ

Certificate of Filing and Service

I certify that I electronically filed the attached Reply Brief on the Merits with the State Court Administrator, using the Oregon Appellate eFiling system, on August 12, 2016.

I further certify that, on that same day, I served a copy of the attached Brief on the Merits on the following lawyers, using the electronic service function of the eFiling system:

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