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Appellate Court Records

IN THE SUPREME COURT OF THE STATE OF OREGON

FOUNTAINCOURT HOMEOWNERS' ASSOCIATION and
FOUNTAINCOURT CONDOMINIUM OWNERS' ASSOCIATION,
Plaintiffs,

v.

FOUNTAINCOURT DEVELOPMENT, LLC; et al.,
Defendants.

FOUNTAINCOURT DEVELOPMENT, LLC; et al.,
Third-Party Plaintiffs,

v.

ADVANCED SURFACE INNOVATIONS, INC.,
an Oregon corporation; et al.,
Third-Party Defendants.

VOSS FRAMING, INC., assignee for FountainCourt Homeowners' Association, assignee for FountainCourt Condominium Owners' Association, on behalf of FountainCourt Development, LLC, on behalf of Matrix Development Corporation, and on behalf of Legend Homes Corporation,
Fourth-Party Plaintiff,

v.

DANA CHRISTOPHER; and RED HILLS CONSTRUCTION, INC.,
Fourth-Party Defendants.

AUGUST 2015

FOUNTAINCOURT HOMEOWNERS' ASSOCIATION and
FOUNTAINCOURT CONDOMINIUM OWNERS' ASSOCIATION,
Garnishors-Respondents,
Respondents on Review,

v.

AMERICAN FAMILY MUTUAL INSURANCE COMPANY,
Garnishee-Appellant,
Petitioner on Review.

Washington County Circuit Court No. C075333CV
CA No. A147420
SC No. S062691

RESPONSE BY RESPONDENTS ON REVIEW TO THE BRIEF OF OREGON ASSOCIATION OF DEFENSE COUNSEL AS *AMICUS CURIAE*

Petition for Review of the Decision of the Court of Appeals, on Appeal from a Judgment of the Circuit Court of Washington County entered by the Honorable Marco A. Hernandez, Judge

Decision Filed: August 6, 2014

Judges: Armstrong, Presiding; and Duncan J.; Brewer, J., pro tempore, Affirmed with Opinion

Party Filing Brief: Respondents on Review FountainCourt Homeowners' Association and FountainCourt Condominium Owners' Association

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I. ARGUMENT

Amicus Curiae Oregon Association of Defense Counsel ("OADC") correctly observes that respondents on review FountainCourt Homeowners' Association and FountainCourt Condominium Owners' Association (collectively, "FountainCourt") met their burden of proving that Sideco, Inc. ("Sideco") was held liable to pay damages to FountainCourt because of property damage that occurred during the American Family policy period. OADC acknowledges that this satisfied FountainCourt's *prima facie* burden of establishing coverage under the insuring agreement of the policy.

OADC also correctly points out that American Family failed to meet its burden of proving that any portion of the damages awarded was not covered by reason of a policy exclusion, and that American Family did not challenge that trial court finding on appeal. Instead, American Family tried to shift its burden of proof to FountainCourt, arguing mistakenly that to prove "property damage" FountainCourt needed to (i) eliminate the possibility that the judgment against Sideco included damages to correct defective work and (ii) establish exactly what amount of property damage occurred during the policy period. The Court of Appeals, applying *ZRZ Realty v. Beneficial Fire & Casualty Ins.*, 349 Or 117, 241 P3d 710 (2010), *adh'd to as modified on recons,* 349 Or 657, 249 P3d 111 (2011), and the terms of the insurance policy, rightly rejected those arguments, as OADC

acknowledges: "American Family lost in the Court of Appeals because it failed to prove its side of the case, not because it was somehow precluded from putting on a case." (OADC Brief at 23.)

But OADC is mistaken in contending for a rule that would allow or require relitigation of the underlying liability case to determine the insurer's coverage obligations every time an insurer chooses to defend under a reservation of rights. That is not what *Ferguson v. Birmingham Fire Ins. Co.*, 254 Or 496, 460 P2d 342 (1969), holds or contemplates. Moreover, such a rule would radically rewrite and refashion the indemnity obligations voluntarily undertaken by insurers in exchange for the premiums received from insureds.

Ferguson was a case about the duty to defend. Helen Ferguson was sued by her neighbors the Guenthers after a laborer hired by Mr. Ferguson to clear brush on the Ferguson lot went beyond the unmarked property line and cut trees on the Guenther lot. Ferguson tendered to her insurance company, which offered to defend subject to a reservation of the right to deny indemnity. Ferguson would not accept that condition and defended at her own expense. Ferguson was held liable, the jury finding that the trespass was not committed intentionally. 254 Or at 500-01. Ferguson sued the insurer to recover the judgment amount plus her costs of defense.

The trial court dismissed, finding that an exclusion for property damage to property over which the insured is exercising physical control was applicable. This Court reversed that interpretation, held the exclusion inapplicable and remanded for a determination of coverage. *Ferguson,* 254 Or at 505, 511-12. The Court held that the insurer had a duty to defend because the complaint without amendment presented the possibility that the insured could be liable for double damages based on non-willful trespass, but the insured could not require the insurer to waive its coverage defenses as a condition to defending. These rulings disposed of the appeal.

The Court did not say that the underlying liability determination should be relitigated on remand. Its discussion about the limits of estoppel where the insurer is defending and there is a conflict of interest between the insurer and the insured was *dictum* and as such has no precedential effect. *Halperin v. Pitts,* 352 Or 482, 492, 287 P3d 1069 (2012).

In the present case, there were no conflicts of interest between American Family and Sideco in the underlying trial. Unlike *Ferguson,* in which the insured could have been liable either for intentional trespass (not covered) or unintentional trespass (covered), Sideco faced potential liability for one thing only: property damage caused by its negligence. There was no conflict between the interests of American Family and Sideco – they shared an identical interest in obtaining a

defense verdict or, failing that, the smallest damage award possible. Respondents on review therefore agree with OADC that nothing in *Ferguson* entitles American Family to relief in this case.

But OADC asserts that in other cases it would be "unfair" for the insurer's coverage obligation to depend to any extent on the judgment rendered in the underlying liability case, if the insurer defended under a reservation of rights. According to OADC it does not matter if there is or is not an actual conflict of interest between the insurer and the insured; the mere fact that the insurer has reserved the right to deny indemnity creates a conflict that should allow the insurer to retry the underlying liability issues at the coverage stage.

Such a rule, if adopted by the Court, would be nothing less than judicial reformation of the standard CGL policy. The policy form provides that the insurer "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." (SER 9, emphasis added.) An insurance policy is a contract of indemnity in which the insurer, in exchange for a premium, promises to pay a liability incurred by the insured. The entire predicate for coverage is the imposition on the insured of a legal obligation to pay damages. But in OADC's altered version of insurance, a liability determination against the insured is merely the qualifying heat; the whole case against the insured has to be proved again – either by the insured itself, who

presumably opposed liability in the underlying case, or by its creditor – before the insurer can be bound. Such a rule would fundamentally alter the insurer's undertaking in the policy to pay those sums that the insured becomes legally obligated to pay for covered liability.

The Court of Appeals recognized that a final liability determination against the insured is an established fact, holding that the question at the coverage hearing is "not whether [the insurer] is *legally bound* by a prior determination but, rather, whether it is bound *by its contract* to pay the amount reflected in the judgment." *FountainCourt Homeowners' Association v. FountainCourt Development, LLC*, 264 Or App 468, 489, 334 P3d 973 (emphasis in original), *rev allowed*, 357 Or 111, 346 P3d 1212 (2014). The policy either covers the liability represented by the judgment or it does not. American Family cannot relitigate whether Sideco is liable for negligently damaging FountainCourt's property; that's been determined and the judgment is final. The coverage question is whether the adjudicated liability of Sideco is covered by the policy. That was a question of law for the court based on a review of the judgment, the underlying verdict, and the terms of the policy. The pleadings may also assist in determining what was adjudicated. *Jarvis v. Indemnity Ins. Co.*, 227 Or 508, 515, 363 P2d 740 (1961). It is not an occasion for a retrial in which the insurer can posit an alternate explanation for the insured's liability. If the insured becomes legally obligated to pay covered

damages, the insurer is on the hook under the policy it issued. If that were not the case, the essential promise of the insurance policy would be illusory.

OADC points to no policy language to support its contention that the insurer is entitled to relitigate the basis for the insured's liability in a case where the insurer defends under a reservation of rights. If the policy anywhere supported such a contention, it would have been pointed out. Under ORS 742.016(1), "every contract of insurance shall be construed according to the terms and conditions of the policy." The purpose of this provision and the Insurance Code generally is "the protection of the insurance-buying public." ORS 731.008. OADC's invitation to replace the insurer's express obligation to "pay those sums that the insured becomes legally obligated to pay" with an unexpressed obligation to pay some other sum, determined some other way would contravene these basic principles.

Issues *not* determined in the underlying case may of course need to be decided to determine if the policy covers the judgment. Such issues may include, for example, whether the car involved in an accident is a covered vehicle under the policy; whether the person against whom the judgment was rendered is an insured; whether the policy limits have been exhausted by other claims; whether another policy provides primary coverage; whether the property damage took place outside the coverage territory or at an uninsured location; whether the insured knew, before purchasing the policy, that the property damage had occurred; and whether the

insurer received late notice of the claim and was prejudiced by it. These and other like issues may defeat coverage but involve no relitigation of the underlying adjudication of liability; they are external to it. Such defenses to coverage are common.

In the present case, American Family raised various coverage defenses based on policy exclusions at the garnishment hearing but failed to meet its burden of proving any of them. And when it appealed from the supplemental judgment, it did not challenge the court's determination that it had failed to meet its burden of proof but argued instead that the burden should have been placed on FountainCourt to eliminate the possibility that the judgment included damages potentially covered by policy exclusions. The Court of Appeals rejected this bold attempt to reverse the burden of proof. Likewise, at the garnishment hearing the trial court received evidence on whether property damage for which Sideco had been held liable occurred during the American Family policy periods. This was external to the determination by the jury in the underlying action and was a predicate to coverage requiring decision by the court.[1]

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[1] American Family did not dispute that damage occurred during the policy period but instead sought to controvert the jury's finding of property damage, asserting that "physical damage" referenced in the jury instructions was something different from "property damage" under the policy.

Ferguson does not suggest let alone hold that the mere fact that an insurer defends under a reservation of rights creates a conflict that allows the insurer to relitigate the underlying facts whenever the insured is held liable. It recognizes that there are cases "where the interests of the insurer and insured in defending the original action are identical." 254 Or at 510. Such is the present case, in which only a single covered claim of negligence causing property damage was asserted and tried. Accordingly, there is no basis in *Ferguson* or the record of this case for a rule that, every time an insurer elects to defend its insured under a reservation of rights and the insured is held liable for covered damages, the insurer gets to relitigate the facts underlying the insured's liability.[2]

II. CONCLUSION

The Court should reject OADC's request for a rule that would render meaningless for coverage purposes every liability determination against an insured where the insurer defended under reservation of rights. That is not what *Ferguson* held and such a rule would effectively rewrite the express terms of the CGL policy.

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[2] Even in rare cases where a genuine conflict of interest exists between insurer and insured in the conduct of the defense, the ethical quandary OADC posits does not exist. OSB Formal Ethics Opinion No. 2005-121 resolves the problem for the lawyer. In reality, OADC's argument, although nominally presented on behalf of lawyers that defend insured contractors, is aimed at protecting the interests of msurers.

DATED: August 19,2015.

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CERTIFICATE OF COMPLIANCE WITH BRIEF LENGTH AND TYPE SIZE REQUIREMENTS

I certify that the word count of this brief (as described in ORAP 5.05(2)(b)(B)) is 1,920 words, which is within the authorized limit specified in the Court's July 22, 2015 Order Granting Relief from Default and For Extension of Time. In calculating the number of words, I relied on the word count function of my word processing software.

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

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CERTIFICATE OF SERVICE AND FILING

I certify that on August 19, 2015 I served a true copy of this brief on each of the following attorneys by electronic service using the eFiling system (for registered eFilers) and by first-class U.S. Mail, postage prepaid (for non eFilers):

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