IN THE SUPREME COURT OF THE STATE OF OREGON

WEST HILLS DEVELOPMENT CO.,

Plaintiff-Respondent/
Respondent on Review,

v.

CHARTIS CLAIMS, INC., et al.

Defendants,

and

OREGON AUTOMOBILE INSURANCE CO.,

Defendant-Appellant/
Petitioner on Review.

OREGON AUTOMOBILE INSURANCE CO.,

Third-Party Plaintiff,

v.

QUANTA SPECIALTY LINES INSURANCE CO.,

Third-Party Defendant.

Supreme Court
No. S063823

Court of Appeals
No. A152556

Multnomah County Circuit Court
No. C107384CV

BRIEF ON THE MERITS OF *AMICUS CURIAE* OREGON-COLUMBIA CHAPTER OF THE ASSOCIATED GENERAL CONTRACTORS

(July 2016)

Review of the Decision of the Court of Appeals on Appeal from the Judgment of the Circuit Court for Washington County of the State of Oregon
By the Honorable D. Charles Bailey, Judge

Date of Opinion: August 19, 2015
Author of Opinion: DeVore, J.
Concurring Judges: Ortega, P.J. and Garrett, J.

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STATEMENT OF AMICUS CURIAE

Oregon-Columbia Chapter of the Associated General Contractors ("Oregon AGC") respectfully submits this brief in support of respondent West Hills Development Company ("West Hills"). Oregon AGC is an association of general contractors, subcontractors, and specialty contractors, many of which are based in Oregon, with an interest in protecting the concerns of its commercial insurance policyholders in disputes with insurance companies. For the reasons detailed below, the arguments of petitioner Oregon Automobile Insurance Company ("Oregon Auto") would jeopardize the interests of construction businesses throughout the state of Oregon by drastically undercutting contractors' ability to obtain additional insured coverage. This Court should affirm the Court of Appeals.

Contractors throughout the state of Oregon pay valuable premiums for general liability insurance policies. Those contractors expect, as all insureds do, that the insurance company collecting those premiums will live up to their end of the bargain and provide the coverage they promised to in the event the contractor is sued for work it performed. For contractors, one of the most valuable aspects of these policies is additional insured coverage. General contractors rely on additional insured coverage to provide peace of mind that they will be defended and indemnified in the event of a lawsuit, while their subcontractors count on it to fulfill their contractual obligations. Oregon Auto's position here is a not-so-subtle

attempt to eviscerate additional insured coverage in Oregon. The Court should decline Oregon Auto's invitation.

SUMMARY OF ARGUMENT

Oregon Auto does not contest that West Hills is entitled to insurance coverage upon the actual facts. Rather, Oregon Auto advances the purest of "gotcha" defenses in an effort to avoid its defense obligation. It argues that West Hills is not entitled to additional insured coverage under the policy issued to L & T Enterprises, Inc. ("L & T") because the plaintiff in the underlying lawsuit did not draft the complaint against West Hills to allege each coverage-triggering requirement in excruciating detail. The Court of Appeals correctly rejected Oregon Auto's argument.

The undisputed and basic facts of this case belie Oregon Auto's position that it was not in possession of sufficient information to assess its coverage obligation. West Hills notified Oregon Auto that L & T was its subcontractor on the project that was the subject of the underlying lawsuit, and that L & T agreed in writing to provide West Hills with additional insured coverage for the exact situation here. Although these facts were not alleged in specific detail in the underlying complaint, those facts are absolutely true and uncontested. Rather than undertaking a rudimentary investigation to verify or rebut the accuracy of West Hills's representations (or even giving West Hills the benefit of the doubt and

taking them at face value), Oregon Auto ignored them under the guise of strict adherence to the "eight corners rule" to justify a denial of coverage. Oregon law does not support and cannot be distorted to justify denying coverage simply because the insurance company chooses to stick its head in the sand and ignore its policyholder's pleas for coverage. But that is exactly what Oregon Auto would have this Court sanction.

Oregon law protects policyholders from exactly this type of abuse by setting forth exceptionally broad standards for determining whether an insurance company owes its policyholder a duty to defend against a lawsuit. The clear rationale in this and other jurisdictions for doing so is that the policyholder takes no part in drafting the complaint against it. Instead, the policyholder is at the whim of an adverse plaintiff. Recognizing this fact, Oregon courts hold there is a duty to defend if the plaintiff's complaint could conceivably impose any potentially covered liability. West Hills's arguments are consistent with this rationale in that the policyholder obtains coverage when the actual and available facts support coverage. Oregon Auto, on the other hand, would raze the foundation of duty to defend precedent in this state. It asks this Court place policyholders at the absolute mercy of plaintiffs, some of whom purposely draft complaints to avoid triggering coverage to take away the seemingly bottomless pockets of the insurance company's litigation budget and leave the policyholder holding the bag for its own defense.

This Court should soundly reject Oregon Auto's call to allow insurance companies to continue doing business in this manner. The facts matter. Insurance companies should no longer be allowed to plead ignorance in an effort to avoid coverage. Instead, they must be required to investigate and evaluate the available information supporting coverage before denying a claim.

When considering a case such as this, it must be remembered that the very purpose of insurance companies is to insure. Any attempt to erode that principle function should be viewed with great reluctance. That hesitancy should be more pronounced when an insurance company, such as Oregon Auto here, is advocating for a systemic approach that would tolerate, or perhaps more accurately endorse, active disregard of information that would trigger coverage.

ARGUMENT

A. A property owner is not required to specifically allege vicarious liability to trigger the insurance company's obligation to defend.

Oregon Auto argues that, in a construction defect case such as this, Oregon law requires the plaintiff to expressly allege that a general contractor was vicariously liable for a subcontractor's negligence to trigger the duty to defend. No Oregon court has ever expressly held that such a heightened standard was necessary to find there is a duty to defend, and Oregon Auto cites no on-point authority from other jurisdictions to support the proposition. The insurance policies at issue here likewise do not contain such a requirement. The duty to

defend is not determined based upon technical defenses to the merits of the underlying claims. Rather, the insurance company's defense obligation is remarkably broad, and is triggered if a complaint could be construed to conceivably impose some potentially covered liability upon West Hills.

Initially, Oregon Auto's argument presumes that the only way to trigger additional insured coverage is based strictly on a theory of vicarious liability. Although not expressly stated, Oregon Auto is presumably relying on the additional insured coverage trigger which provides that the complaint must allege that West Hills could conceivably have "liability arising out of [L & T's] ongoing operations." But the plaintiff in the underlying construction defect lawsuit did not exclusively rely on a theory of vicarious liability against West Hills. Instead, as in many other construction defect matters, the underlying plaintiff alleged that West Hills was negligent, in part, for failing to properly oversee, inspect, and supervise its subcontractors. These allegations are sufficient to trigger additional insured coverage. They present the possibility that West Hills may have "liability arising out of" the actions of L & T. That is enough.

Although pleading requirements have no bearing on Oregon Auto's duty to defend, the underlying complaint nevertheless satisfies Oregon's pleading rules. Oregon Auto's argument is predicated entirely on a case from this Court addressing the requirements for asserting a claim for vicariously liability in a

medical malpractice action. *See Holger v. Irish*, 316 Or 402, 405-09, 851 P2d 1122 (1993). The *Holger* case is inapposite. That case concerned a suit by a patient's estate against a surgeon who operated on the patient. At the completion of the surgery, the nurses assisting the surgeon incorrectly counted the sponges that were used and one was later found in the patient's abdomen. The suit originally named the hospital where the surgery occurred and which employed the nurses involved in the surgery. The estate later settled with the hospital and removed all reference to it in the operative complaint.

In the amended complaint, the plaintiff alleged only that the surgeon was directly negligent "because he, personally, failed to 'check and determine that all sponges * * * were removed.'" *Id.* at 408. This Court held that for plaintiff to recover from the surgeon on a theory of vicarious liability, "plaintiff had to prove," among other things, that the nurses were the surgeon's "employees or agents" or that the surgeon exercised "supervision and control over the nurses." *Id.* Because the amended complaint did not contain any allegations on those points, and instead asserted only the surgeon's direct liability, it did not satisfy the requirements of ORCP 18 A. As noted above, the complaint against West Hills expressly alleges that West Hills was liable for its failure to oversee, inspect, and supervise its subcontractors. Unlike in *Holger*, the complaint against West Hills advised "in what way [West Hills] allegedly was negligent." *Id.* at 407.

Despite Oregon Auto's reliance on it, *Holger* (along with other Oregon cases addressing pleading standards) does not address the question presented here. Specifically, it does not address whether the allegations in the complaint, liberally construed, could conceivably impose a potentially covered liability upon a policyholder. *See Ferguson v. Birmingham Fire Ins. Co.*, 254 Or 496, 460 P2d 342 (1969) (finding duty to defend on claim for willful trespass because the complaint presented the possibility of liability for a non-willful trespass). This well-established principle applies equally here. The complaint at issue in this case clearly presents the possibility that West Hills could conceivably face liability arising out of L & T's work.

As a practical matter, Oregon Auto would, for the first time, have this Court place policyholders at the absolute mercy of the plaintiffs suing them. Under Oregon Auto's proposed rule, the burden would shift to the plaintiff in the underlying matter to plead all relationships between all potentially responsible parties in exacting detail in order to trigger coverage. As an added hurdle, the plaintiff would be required to specifically allege all coverage-triggering facts based on policies issued to frequently unknown third-party subcontractors that are unavailable to plaintiffs when preparing a lawsuit. That expectation is unreasonable and would turn coverage analysis on its head.

In virtually all construction-related matters, the plaintiff does not have all of the necessary information to specifically plead all necessary facts to trigger insurance coverage, assuming the plaintiff is concerned with coverage at all. The Court of Appeals has appropriately acknowledged this problem. In *Fred Shearer & Sons, Inc. v. Gemini Ins. Co.*, it noted that "an insured's relationship with its insurer may or may not be relevant to the merits of the plaintiff's case" and the plaintiff is not required to plead facts that would "establish the nature of the defendant's relationship to some other party or to an insurance company in order to prove its claim." 237 Or App 468, 476, 240 P3d 67 (2010), *rev den*, 349 Or 602, 249 P3d 123 (2011). Likewise, in this case, the Court of Appeals opined that "[l]ike any plaintiffs, they may have had no motivation to be specific or plead matters significant to insurance coverage, especially when pleading broadly to help them to implicate policy years of multiple insurers." *West Hills Dev. Co. v. Chartis Claims, Inc.*, 273 Or App 155, 166-67, 359 P3d 339 (2015). Given these incontestable facts, this Court should not allow insurance companies to avoid their coverage obligations by unreasonably shifting the issue from "can the complaint, liberally construed, conceivably impose some potentially covered liability upon the policyholder?" to "did the plaintiff specifically plead all of the relationships and other coverage-relevant facts to trigger coverage under this specific policy?" No

other jurisdiction has adopted such a regressive analysis of the duty to defend. This is not the occasion to depart from established precedent.

Finally, the Court should find guidance on this issue in its opinion in *Bresee Homes, Inc. v. Farmers Ins. Exch.*, 353 Or 112, 122, 293 P3d 1036 (2012). There, the Court followed the principles outlined in *Ledford v. Gutoski*, 319 Or 397, 400, 877 P3d 80 (1994), to conclude that, at the duty to defend stage, ambiguous allegations concerning completion of a project must be construed in favor of coverage. *Bresee Homes*, 353 Or at 124. Here, the Court should likewise conclude that ambiguities concerning the relationships between the parties and all the formulations of conceivable liability must be construed in favor of the insured. *Ledford* requires such a result.

B. The Court of Appeals appropriately imposed on insurers a duty to investigate and consider extrinsic evidence when assessing the duty to defend.

Oregon has long adhered to the "eight corners rule" in considering an insurance company's duty to defend. While the rule has been and remains appropriate in most garden variety cases, there are circumstances when it is not. This case, along with the recent decision in *Fred Shearer & Sons, Inc.*, exemplifies the inadequacy of the traditional rule in this context. In both cases, the Court of Appeals correctly recognized that a plaintiff may not have sufficient knowledge or motivation to plead all facts relating to coverage and, in those circumstances, the

insurance company bears an obligation to investigate or consider extrinsic evidence supporting coverage. This Court should join its sister jurisdiction in Washington, which recognizes two logical exceptions to the eight corners rule. As detailed below, Washington law imposes a reasonable requirement on insurance companies to consider extrinsic evidence that clarifies ambiguities regarding coverage or otherwise establishes an insurance company's duty to defend.

The duty to defend precedent in Oregon and Washington is strikingly similar in most respects. Both states have clearly articulated the expansive scope of the duty to defend, which is a decidedly pro-policyholder inquiry that affords coverage where there is any possibility that an insured may be held liable. For example, in Washington, as in Oregon, "[t]he duty to defend is generally determined from the 'eight corners' of the insurance contract and the underlying complaint." *Expedia, Inc. v. Steadfast Ins. Co.*, 180 Wash 2d 793, 803, 329 P3d 59, 64 (2014); *see also Ledford*, 319 Or at 399-400 ("Whether an insurer has a duty to defend an action against its insured depends on two documents: the complaint and the insurance policy."). Both states recognize that the duty to defend arises when complaint, liberally construed, alleges facts that could conceivably impose liability for covered damages. *See Bresee Homes*, 353 Or at 117; *Am. Best Food, Inc. v. Alea London, Ltd.*, 168 Wash 2d 398, 404-05, 229 P3d 693 (2010). They also both acknowledge that any ambiguities regarding the potential for coverage must be

resolved in the insured's favor. *See Bresee Homes*, 353 Or at 117; *Woo v. Fireman's Fund Ins. Co.*, 161 Wash 2d 43, 52, 164 P3d 454 (2007).

Unlike Oregon, however, Washington accounts for the unique circumstances presented in a case such as this by recognizing two exceptions to the eight corners rule, and both of them favor the insured. *Woo*, 161 Wash 2d at 53. First, if coverage is not clear from the face of the complaint but coverage could conceivably exist, the insurer must investigate and give the insured the benefit of the doubt on the duty to defend. *Id.* Second, if the allegations in the complaint conflict with facts known to the insurance company or if the allegations are ambiguous, a court may consider extrinsic evidence when assessing the duty to defend. *Id.* at 54. The extrinsic evidence may only be used to trigger the duty to defend, however, and may not be relied upon by the insurance company to deny a claim for defense. *Id.*

Oregon Auto asks this Court to adopt a rule that is, in effect, the opposite of the Washington standard. It would allow (more appropriately, encourage) an insurance company to ignore and affirmatively avoid discovering facts that establish an entitlement to coverage. Washington courts have rejected this position, holding that such conduct is inconsistent with the broad nature of the duty to defend and the purpose of insurance.

This case presents the appropriate opportunity for Oregon to join Washington and recognize these limited exceptions to the eight corners rule. Here, the underlying complaint was ambiguous with respect to the relationships between the various parties that were necessary to assess coverage.[1] Under the exceptions noted above, Oregon Auto would be required to undertake a basic investigation to determine whether there is information that would resolve the ambiguity in favor of coverage. For example, Oregon Auto could "readily verify this information, whether by reference to its declaration pages, a telephone call to its named insured, or, upon reasonable inquiry, a review of the subcontract." *West Hills*, 273 Or App at 164. In those situations where the underlying complaint is ambiguous or extrinsic evidence contradicts the allegations in the underling complaint so as to otherwise trigger coverage, requiring an insurance company to investigate these issues—or at a minimum, not permitting the insurance company to ignore such information when presented by its policyholder—is entirely reasonable and will result in fewer disputes.

Like Washington courts, the Court of Appeals has recently recognized the need to consider such evidence in cases such as this. In *Fred Shearer & Sons, Inc.*,

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[1] As the Court of Appeals noted, however, the potential ambiguity in the complaint must be resolved in favor of the insured in the event the allegations create the possibility of covered conduct.

the court correctly rejected strict adherence to the eight corners rule when coverage depended, in part, on the relationship of parties:

> The facts relevant to an insured's relationship with its insurer may or may not be relevant to the merits of the plaintiff's case in the underlying litigation. The plaintiff in the underlying case is required to plead facts that establish the defendant's liability; the plaintiff often is not required to establish the nature of the defendant's relationship to some other party or to an insurance company in order to prove a claim. In this case, for example, the Evenstads had no reason to allege that Shearer sold or distributed TransMineral's products in the ordinary course of its business; nor did Walsh need to allege that fact in order to make out its third-party claim against Shearer. * * * [W]e do not see the logic in requiring Shearer to demonstrate that the underlying complaints establish the relationship between TransMineral and Shearer, or, consequently, that Shearer is Gemini's "insured" within the meaning of the policy. * * * Accordingly, we reject Gemini's argument that the trial court erred in entering judgment

237 Or App 468, 477, 240 P3d 67 (2010) (citing with approval *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir 2004) and *Burd v. Sussex Mut. Ins. Co.*, 56 NJ 383. 388, 267 A2d 7 (1970)). The Court of Appeals correctly applied the same principle in this case, relying on the infallible logic in *Fred Shearer & Sons, Inc.* Failing to require consideration of coverage-triggering extrinsic evidence in these situations allows insurance companies to benefit from an ambiguity in the complaint in violation of *Ledford* and its progeny. It is even more egregious when coverage-triggering information presented to the insurance

company can be flatly ignored and coverage denied despite the insurance company's awareness of the coverage-triggering information.

This Court should continue where the Court of Appeals left off. It should adopt two limited pro-policyholder exceptions to the eight corners rule when it is inadequate to resolve duty to defend questions in favor of coverage. First, if coverage is not clear from the face of the complaint, but coverage could conceivably exist, the insurer must investigate coverage-triggering information and give the insured the benefit of the doubt on the duty to defend. Second, if the allegations in the complaint conflict with facts known to the insurance company or if the allegations are ambiguous, the insurance company must consider coverage-triggering information when assessing the duty to defend.

C. The additional insured endorsement covers allegations of property damage caused by a contractor's work on the property, regardless of whether the damage occurs during construction or after it is complete.

The contract between a general contractor and its subcontractors frequently requires the subcontractor to include the general contractor as an additional insured on its general liability policy. This contractual agreement benefits the general contractor by providing insurance coverage for any liability that might arise from the subcontractor's negligence. Likewise, subcontractors frequently benefit from the agreement because it often satisfies their contractual obligation to defend or indemnify the general contractor in the event of a lawsuit. Contractors throughout

Oregon have come to rely on this coverage a baseline protection against lawsuits relating to their construction projects.

Like the underlying lawsuit at issue here, many construction-related lawsuits in Oregon concern allegations of continuous and progressive property damage caused by water intrusion. *See, e.g., FountainCourt Homeowners' Ass'n v. FountainCourt Dev., LLC*, 264 Or App 468, 487, 334 P3d 973, *rev granted*, 357 Or 111, 346 P3d 1212 (2014). Given the nature of ongoing water damage, property owners frequently allege that the property damage caused by the contractors continued well after construction was complete. Oregon Auto, along with *amici* Property and Casualty Insurers Association of America and National Association of Mutual Insurance Companies, urges this Court to adopt a narrow interpretation of the scope of coverage available under the additional insured endorsement. They support their proposed interpretation with foreign case law and other insurance industry sources. Under well-established Oregon case law, the cases and materials they cite cannot be considered. *See Hoffman Const. Co. of Ak. v. Fred S. James & Co. of Or.*, 313 Or 464, 836 P2d 703 (1992) (establishing the framework for interpreting insurance policies). A straightforward application of Oregon case law to the provision at issue requires the conclusion that contractors are entitled to additional insured coverage so long as there is a causal connection between its subcontractors' work and the alleged property damage for which the general

contractor may be liable, regardless of when that damage may have actually occurred.

The specific additional insured endorsement at issue here, like many other issued by insurance companies operating in Oregon, provides additional insured coverage for "liability arising out of * * * [the named insured's] ongoing operations." The terms "arising out of" and "ongoing operations" are not defined. Oregon has long recognized that where policy terms are undefined they are to be given "a liberal construction as favorable to the insured as in good conscience will be permitted." *Land v. W. Coast Life Ins. Co.*, 201 Or 397, 401, 270 P2d 154 (1954). The terms are to be construed from the perspective "of the ordinary purchaser of insurance," not internal insurance industry historical perspectives. *Laird v. Allstate Ins. Co.*, 232 Or App 162, 166, 221 P3d 780 (2009). The insurance company suffers the consequences of poor drafting because it wrote the policy. *N. Pac. Ins. Co. v. Hamilton*, 332 Or 20, 29, 22, P3d 739 (2001). In a "popularity contest" between reasonable interpretations, the Court "is not to choose the better of the two interpretations," but must construe the term against the insurance company. *Konell Const. & Demolition Corp. v. Valiant Ins. Co.*, Case No. CV03-412-MO, 2006 WL 1360956 at *4 (D Or May 15, 2006).

Consistent with these principles, Oregon courts have consistently found that the term "arising out of" is expansive in nature and that it is a causal term. It does

not, as petitioner and *amici* suggest, impose a temporal limitation on coverage. Specifically, the plain language of the endorsement does not limit coverage to property damage that occurs while a general contractor and its subcontractors are actually performing work. Such a narrow interpretation is not only inconsistent with the law on policy interpretation, but also conflicts with the expansive nature of the duty to defend.

This Court first considered the meaning of the term "arising out of" in *Oakridge Comm. Ambulance Serv., Inc. v. U.S. Fid. & Guar. Co.*, 278 Or 21, 563 P2d 164 (1977). The issue in *Oakridge Comm. Ambulance* was whether a liability insurer had a duty to defend its insured in a wrongful death lawsuit, which required the Court to consider the breadth of the term "arising out of." *Id.* at 23. The Court concluded "arising out of" was "of broader significance than the words 'caused by', and [is] ordinarily understood to mean originating from, incident to, or having connection with the use of the vehicle." *Id.* at 25. The Court went on to assess whether there was a causal connection. *Id.*

In a later case, the Court of Appeals expressly clarified that "arising out of" imposes a causal connection:

> The ordinary meaning of the words "arising out of" is very broad. * * * [L]ike the term "related to," "arising out of" connotes a causal connection with its subject and a concomitant broadening in the scope of the subject.

Clinical Research Inst. of S. Or., P.C. v. Kemper Ins. Cos., 191 Or App 595, 601, 84 P3d 147 (2004). "[T]he term 'arising out of' as used in insurance policies generally is understood to broadly mean 'flowing from' or 'having its origin in,' thereby 'indicating that there need be 'a' causal connection, rather than a proximate causal connection." *Ristine ex rel. Ristine v. Hartford Ins. Co. of the Midwest*, 195 Or App 226, 231, 97 P3d 1206 (2004).

Despite the broad language utilized in the policy, Oregon Auto and *amici* argue there is no coverage because the alleged damages did not occur while L & T was actually performing work.[2] This argument ignores the express terms of the policy and Oregon precedent. Here, West Hills's alleged liability was for property damage that resulted from negligent construction of the building. That alleged liability arose from conduct which alleged occurred while operations were ongoing. At the duty to defend stage, it does not matter when the property damage actually presented for purposes of establishing coverage. That inquiry is relevant only at the indemnification stage.

Oregon Auto and *amici* suggest that this interpretation does not properly give effect to the term "ongoing," and that operations cannot cause anything after they have ended. In support, Oregon Auto uses the analogy of careless driving of a

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[2] Even assuming the Court concludes this position is reasonable, it is only one reasonable construction of the provision. The broader construction is also reasonable. As such, the provision must be construed in favor of finding coverage.

vehicle which cannot cause an accident once the car is parked. This narrow view misses the point. For example, imagine an insured that causes a car accident with another driver. As often occurs, the other driver does not immediately suffer any injuries, but injuries present days or weeks after the accident. Under this example, defendant would have this Court find that the bodily injury did not arise from the accident. Such a result is absurd.

Consider also a contractor that negligently installs a component on a building. The contractor's negligent act or omission necessarily occurred during its ongoing operations. As is frequently the case in construction-related matters, however, the property damage resulting from that negligence—*e.g.*, continuous and progressive water damage to the building—may not present for weeks, months, or even years after that act. Although the damage occurred after the contractor's work was done, the liability arose from—*i.e.,* was caused by—conduct that occurred while the contractor was still working. Despite Oregon Auto's argument otherwise, this construction of the additional insured endorsement gives meaning and effect to "ongoing" because it relates to the timing of the act that gave rise to the liability.

Oregon Auto's position that the additional insured endorsement requires a temporal connection, as opposed to a simple causal connection, is not supported by the terms of the policy. Rather, it is based on what it now hopes it had written in

the policy, not what it actually did. As the drafter, Oregon Auto must be clear and cannot benefit from any ambiguity in the terms.

D. A general contractor filing a third-party complaint against one or more of its subcontractors does not eliminate its ability to rely on *Shearer*.

Oregon Auto argues that if a general contractor files a third-party complaint against its subcontractors, then it loses its ability to pursue additional insured coverage if the underlying complaint does not expressly plead the coverage requirements found in the subcontractor's policy. At the outset, it must be noted that in many instances the general contractor does not have the ability to make this election. Instead, if the general contractor's primary insurance company provides a defense, the general contractor "relinquishes control over the defense" and "[i]ts potential monetary liability is in the hands of the insurer." *Georgetown Realty, Inc. v. Home Ins. Co.*, 313 Or 97, 110-11, 831 P2d 7 (1992). As such, it is the liability insurance company that dictates whether a third-party complaint is filed in order to offset the insurance company's ultimate liability. But the decision to pursue additional insured coverage is a right distinctly available to the general contractor.

Notwithstanding the discussion above, Oregon Auto would have this Court impose upon general contractors a Hobson's choice: either pursue additional insured coverage or file a third-party complaint to offset its liability—but not both. According to Oregon Auto, these options are mutually exclusive. Either way,

insurance companies benefit by conceivably reducing their own exposure by half (or more), while general contractors like West Hills suffer. Oregon Auto relies on *Fred Shearer & Sons, Inc.* to support its theory, while at the same time arguing to reject its holding. No Oregon court has ever adopted the theory advanced by Oregon Auto. This Court should reject it outright.

Oregon Auto states that in this duty to defend case, the coverage and liability issues are the same. (Appellant's Opening Brief at 27). That is not accurate. Oregon Auto's perceived "coverage" arguments are not duty to defend issues. They are duty to indemnify issues. For example, Oregon Auto contends the issues are: "Did West Hill's negligence or L & T's negligence cause the construction defects? Was the problem L & T's work, or West Hill's instructions and supervision?" (Id.). At the duty to defend stage, those inquiries are not relevant. Rather, the issues are whether the underlying complaint could conceivably impose liability against West Hills arising out of L & T's work, and if it is not clear from the allegations, is there extrinsic evidence to support West Hills's claim for additional insured coverage. The ultimate determination of whether West Hills is *actually* liable for L & T's work is a liability determination for the ultimate fact finder. At the duty to defend stage, however, the question of whether West Hills is or is not liable for L & T's work does not matter. Oregon Auto conflates these concepts, and that mistake is fatal to its argument.

Additionally, although Oregon Auto advocates for a bright-line rule on the exclusion of extrinsic evidence on issues concerning coverage and liability, Oregon law does not—and should not—extend that far. In some situations, there is a sound reason for disallowing the introduction of extrinsic evidence when that evidence places the policyholder in a conflicted position: either put forth evidence to trigger coverage and therefore admit liability in the liability case or move forward with defending the liability case which may jeopardize coverage.

Oregon Auto's example of a personal injury suit involving allegations of intentional acts is a good demonstration of this point. In that instance, if the policyholder must introduce evidence that it did not act with the intent to injure, it may require the policyholder to admit that it caused the injury negligently. When it does, the policyholder admits to liability in the personal injury action. Conversely, if it is forced to produce evidence refuting accusations that he or she acted maliciously, but does not because the policyholder does not want to forfeit liability in the personal injury action, the policyholder may forfeit coverage. For this reason, courts in many jurisdictions (including Oregon), require the insurance company to defend based on the possibility that the policyholder acted negligently. The determination of whether the policyholder *actually* acted with intent to injure is reserved for the fact finder (or in some instances a later occurring trial with the insurance company). *N. Pac. Ins. Co. v. Wilson's Dist. Serv., Inc.*, 138 Or App

166, 908 P2d 827 (1995) ("What [the insurance company] has attempted to do here is to litigate * * * [the policyholder's] liability * * * in the underlying tort action, putting [the policyholder] in the conflictive position of being required to abandon their denial of liability in that action in order to come within the exception to the policy exclusion. * * * An insurer cannot put its insured in that position.").

E. This Court must address the current incentive for insurance companies operating in Oregon to deny the duty to defend.

Insurance companies consistently contend that in Oregon, unlike the vast majority of other jurisdictions, policyholders may not bring tort-based claims if the insurance company incorrectly denies the duty to defend. To date, Oregon courts have largely agreed. *See Farris v. U.S. Fid. & Gaur. Co.*, 284 Or 453, 587 P2d 1015 (1978) (holding that no tort claim is available to a policyholder arising out of a liability policy unless the insurance company accept the duty to defend). The courts in this state have also concluded that Oregon's Unfair Claims Settlement Practices statute, ORS 746.230, contains no private right of action. *Id.* at 458.

In a confounding twist of logic, the only instance where an insurance company may actually be liable for extra-contractual damages occurs when it does the right thing and accepts a claim for defense:

> When the relationship involved is between contracting parties, and the gravamen of the complaint is that one party caused damage to the other by negligently performing its obligations under the contract, then, and even though the relationship between the parties arises

> out of the contract, the injured party may bring a claim for negligence if the other party is subject to a standard of care independent of the terms of the contract. * * * When a liability insurer undertakes to 'defend,' it agrees to provide legal representation and to stand in the shoes of the party that has been sued. The insured relinquishes control over the defense of the claim asserted. Its potential monetary liability is in the hands of the insurer. That kind of relationship carries with it a standard of care that exists independent of the contract and without reference to the specific terms of the contract.

Georgetown Realty, Inc., 313 Or at 106. Thus, a policyholder is limited to contractual damages where the insurance company incorrectly denies a claim, but may recover additional damages where the insurance company steps up and provides a defense. Such a result is patently unjust.

The contract-only paradigm created by Oregon law encourages insurance companies to take "free shot" denials, such as in this case. Consider the issue from the perspective of the insurance company: Should we accept the defense, incur the defense costs associated with litigating the case, and risk exposure to bad faith damages? Or should we simply deny the claim and take a shot at litigating the contractual issue? In many situations, insurance companies in this state opt to deny coverage and risk exposure for contractual damages only. Under current law, they are actually incentivized to make that election. Unfortunately, the contractors and other policyholders of this state are too often left to pay for their own defense because of the insurance company's internal decision to limits its risk. This result

certainly does not comport with this Court's pro-policyholder guidance regarding the duty to defend.

Other jurisdictions have instituted measures to take away an insurer's incentive to deny the duty to defend. In Washington, for example, an insurance company risks liability for common law bad faith and coverage by estoppel, which create a strong incentive for the insurance company to act in good faith and protects the insured from bad faith conduct. *Safeco Ins. Co. of Am. v. Butler*, 118 Wash 2d 383, 394, 823 P2d 499 (1992). This Court should likewise institute incentives for insurance companies operating in Oregon to act in good faith, or at the very least take away the incentive to deny otherwise valid claims.

Insurance companies are more than happy with this current scheme, but have not stopped there. One of the only remedies available to policyholders in such situations is the ability to recover statutory attorney fees under ORS 742.061. But insurance companies in this state are actively attacking a policyholder's ability to recover such fees, even when the insurance company is ultimately wrong. For instance, under *McGraw v. Gwinner*, 282 Or 393, 400, 578 P2d 1250 (1978), if an insurance company files a declaratory judgment action against its policyholder seeking a declaration that there is no duty to defend its policyholder, but ultimately loses on that issue, the policyholder is not entitled to recover its fees incurred in that litigation. Moreover, under *Triangle Holdings, II, LLC v. Stewart Title Gaur.*

Co., 266 Or App 531, 538-40, 337 P3d 1013 (2014), *rev granted*, 357 Or 164, 351 P3d 52 (2015), if an insurance company ultimately pays insurance benefits owed to its policyholder while there is an insurance coverage action pending, but before a money judgment is entered, the insurance company may escape liability for the policyholder's attorney fees.

When the incentive to deny these claims is coupled with the potential inability to recover attorney fees, insurance companies have a profound economic incentive to deny claims. Unless this Court adjusts the playing field to remove these incentives, there is little reason to suspect that insurance companies will adjust their practices. And the policyholders of this state will continue to suffer.

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CONCLUSION

For the reasons set forth herein, Oregon-Columbia Chapter of the Associated General Contractors respectfully requests that the Court affirm the Court of Appeals.

Dated: July 14, 2016

Respectfully submitted,
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CERTIFICATE OF COMPLIANCE

I certify that (1) BRIEF ON THE MERITS OF *AMICUS CURIAE* OREGON-COLUMBIA CHAPTER OF THE ASSOCIATED GENERAL CONTRACTORS complies with the word count limitation in ORAP 5.05(2)(b), and (2) the word count of this brief, as described in ORAP 5.05(2)(a), is 7,564 words.

I certify that the size of 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).

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CERTIFICATE OF FILING

I hereby certify that I electronically filed the foregoing BRIEF ON THE MERITS OF *AMICI CURAIE* OREGON-COLUMBIA CHAPTER OF THE ASSOCIATED GENERAL CONTRACTORS with the State Court Administrator for the Supreme Court of the State of Oregon by using the appellate electronic filing system on July 14, 2016.

CERTIFICATE OF SERVICE

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

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