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.,

Defendants,

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.

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

Respondent's Answering Brief

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I. Introduction

Petitioner Oregon Automobile Insurance Company's ("Oregon Auto") brief on the merits is an ambitious undertaking. Oregon Auto hollows out the $28,000 insurance coverage case presented to the trial court, deconstructs, reimagines, and then reconstructs its legal theories, and then asks this court to overrule or reject no less than three seminal decisions on an insurer's duty to defend in Oregon: *Ledford v. Gutoski*, 319 Or 397, 877 P2d 80 (1994); *Fred Shearer & Sons, Inc. v. Gemini Ins. Co.*, 237 Or App 468, 240 P3d 67 (2010), *rev den,* 349 Or 602 (2011); and *Bresee Homes, Inc. v. Farmers Ins. Exch.*, 353 Or 112, 293 P3d 1036 (2012).

The invitation should be declined because there is absolutely nothing broken about Oregon's insurer duty to defend standard, save perhaps that it doesn't go quite far enough in protecting ordinary people and small businesses from professional litigants with unlimited resources. This $28,000 case makes that point. When Oregon Auto asks this court to wipe these decisions from the books, it does not explain why Oregon should make itself the only state in the country to eviscerate the defense coverage marketed, sold, and promised in every general liability insurance policy.

Let there be no mistake: when Oregon Auto asks this court to permit an insurer to deny an insured defense to its insured in cases where the underlying

plaintiff in a liability case does not affirmatively allege ultimate facts on each element of that plaintiff's claims for recovery against the insured defendant ***and also*** ultimate facts on each element of the defendant's recovery against her insurer, even though those facts may have nothing whatever to do with the plaintiff's case, Oregon Auto asks this court for a rule enabling the insurance industry to escape its duty to defend Oregon insureds ***in the overwhelming majority of cases.*** In effect, Oregon Auto would condition an insurer's duty to defend on the ability of accident victims to prosecute the insured's coverage case. Never mind that it's not their fight, that they have no access to the insured's coverage information when they draft their complaints, or that it is wholly inequitable to saddle accident victims with this expense. Oregon Auto's proffered rule represents nothing short of a dramatic windfall to insurers, who would continue to collect premiums for coverage they rarely, if ever, would have to provide.

Every general liability insurance policy makes two fundamental coverage promises: (1) a paid-for defense lawyer if the insured gets sued; and (2) indemnity against an adverse judgment in the event that defense is unsuccessful. This case involves only the first promise, an insured defense, and the importance of that promise cannot be understated. "The long history of cases involving an insurer's duty to defend emphasize the paramount

importance placed by courts on the rights of the insured to a defense of claims brought against them." *Underwriters at Lloyds v. Denali Seafoods, Inc.*, 729 F Supp 721, 724 (WD Wash 1989) *aff'd*, 927 F2d 459 (9th Cir 1991). "The defense may be of greater benefit to the insured than the indemnity. . . . An insurer refusing to defend exposes its insured to business failure and bankruptcy." *Truck Ins. Exch. v. Vanport Homes, Inc.*, 147 Wash 2d 751, 765, 58 P3d 276 (2002); *see also N. Ins. Co. of New York v. Nat'l Fire & Marine Ins. Co.*, 2013 WL 3481553 (D Nev July 12, 2013) (characterizing the "fundamental duty to defend" as "one of the most important benefits for which the insured paid premiums") *vac'd*, 2:11-CV-01672-PMP, 2014 WL 8728538 (D Nev Oct. 6, 2014) (per settlement).

> An insured's desire to secure the right to call on the insurer's superior resources for the defense of third party claims is, in all likelihood, typically as significant a motive for the purchase of insurance as is the wish to obtain indemnity for possible liability. As a consequence, * * * courts have been consistently solicitous of insureds' expectations on this score.

Pruyn v. Agric. Ins. Co., 36 Cal App 4th 500, 515, 42 Cal Rptr 2d 295, 302-303 (1995).

Oregon Auto proposes a rule that would devastate Oregon insureds, both businesses and ordinary citizens alike. And it asks for that rule in a case in which Oregon Auto never maintains that its insured did not purchase the subject coverage. On the contrary, Oregon Auto asks this Court to arm the insurance

industry with a technical pleading "gotcha" that would put the purchased coverage beyond reach.

Oregon Auto's named insured, L&T, agreed to obtain additional insured coverage for West Hills, the general contractor on the Arbor Terrace project. Oregon Auto agreed to provide that coverage in the policies it issued to L&T, expressly listing West Hills by name in its policies. L&T performed work on the Arbor Terrace project—no one disputes that. West Hills was sued as a result of L&T's work—no one disputes that either (Oregon Auto, in fact, paid money on L&T's behalf to resolve its liability in the underlying construction defect action). These are exactly the circumstances in which additional insured coverage operates, and they are precisely the reason why the insurance benefit is bargained for and procured.

And the rules worked exactly as they should in this case. When the Arbor Terrace Homeowners Association sued West Hills for defective construction within L&T's scope of work, West Hills relied on *Shearer* for the only piece of extrinsic evidence that mattered—L&T's subcontract with West Hills, which connected L&T to the project. After that, all remaining questions were resolved by *Ledford*: could the allegations of the HOA's complaint, without amendment, impose liability for conduct covered under Oregon Auto's policies? Inasmuch as the remaining questions were whether property damage

at the project was attributable to L&T's work and, according to Oregon Auto, when that damage occurred, the answer was plainly yes.

II. Summary of Argument

In this insurance coverage proceeding, Oregon Auto seeks review of a decision by the Court of Appeals that affirms the trial court's judgment awarding damages to West Hills based upon Oregon Auto's breach of its duty to defend West Hills in an underlying construction defect lawsuit. This court should affirm both the Court of Appeals and the trial court.

As an initial matter, Oregon Auto makes a number of assertions in its brief on the merits that were not presented to the trial court and therefore are not preserved for this court's review. Indeed, its position in this court is at times diametrically opposite of what it argued to the trial court. Accordingly, this court should summarily reject Oregon Auto's unpreserved contentions.

To the extent that this court reaches the merits of Oregon Auto's arguments, they do not provide a basis for reversal. Oregon Auto's theory on review fundamentally misconstrues the eight corners rule embodied in *Ledford*, the narrow extrinsic evidence rule recognized in *Shearer*, and the relationship between the two. As explained more thoroughly below, these principles are not mutually exclusive; rather, *Shearer* is simply a bridge to *Ledford*. Moreover, as

applied to this case, it becomes manifest that Oregon Auto's duty to defend was triggered by the underlying complaint.

Although Oregon Auto asserts that its "Rule In" theory is a logical extension of the eight corners rule in *Ledford*, it is in fact the opposite of the eight corners rule in *Ledford*. The eight corner's rule embodied in *Ledford* provides that a complaint triggers an insurer's duty to defend if the allegations in the complaint could, without amendment, impose liability for conduct covered under the policy. Potential liability is all that is required—not affirmative allegations that conclusively bring the case within coverage.

To supplement the eight corners rule, the Oregon Court of Appeals in *Shearer* outlined a rule well-recognized in other jurisdictions that evidence extrinsic to the underlying complaint may supplement the allegations and trigger an insurer's duty to defend. Generally, the extrinsic evidence rule outlined in *Shearer* operates as a gap filler to establish an insured's status as such under the policy. The rule is sound and should be adopted by this court.

After application of the rule in *Shearer*, the analysis reverts to *Ledford's* eight corners rule. Under that rule, the underlying complaint against West Hills triggered Oregon Auto's duty to defend. The allegations would enable the possibility of evidence at trial of West Hills' liability arising out of L&T's operations for West Hills, as required by the additional insured endorsement

contained in the policies Oregon Auto issued to L&T. The possibility of covered liability is present regardless of whether the clause "arising out of your ongoing operations" requires property damage "during ongoing operations." If "arising out of your ongoing operations" means what it says – West Hills is entitled to a defense so long as its liability arises out of the subcontractor's work (and provided there is a possibility of property damage occurring at any time within one of Oregon Auto's multiple policy periods).

However, even if that phrase should instead be read as "property damage occurring during your ongoing operations," as Oregon Auto argued below, the complaint clearly allows the possibility of such proof. The absence of affirmative and particular allegations concerning the timing of the alleged property damage does not affect the insurer's duty to defend, so long as the allegations of the complaint would allow for proof of property damage occurring during the period covered by the policy. Accordingly, even under an interpretation of the AI endorsement advanced by Oregon Auto, its duty to defend was triggered by the allegations of the complaint.

As it finds that Oregon Auto had a duty to defend West Hills, the court should reject Oregon Auto's contention that it had no duty to investigate and should further recognize that a special relationship exists between insurer and insured in the duty to defend determination.

III. Summary of Material Facts and Proceedings

This is an insurance coverage action arising out Oregon Auto's refusal to defend West Hills in a lawsuit brought by a homeowners association (HOA). The HOA brought construction defect claims against West Hills, as general contractor of the townhomes ("the project"), in a lawsuit entitled *Arbor Terrace Homeowners Association v. Arbor Terrace, LLC, et al.*, Wash. Co. Cir. Ct. Case No. 097449CV ("Underlying Action") and alleged theories of negligence, negligence *per se*, and breach of contract. ER 45, 49; SER 42. West Hills tendered the defense against the Underlying Action to Oregon Auto under the terms of an AI endorsement provided to L&T noting that L&T was a subcontractor on the project that installed porch columns. ER 31-32; SER 76-86. The AI endorsement expressly scheduled West Hills as an additional insured "with respect to liability arising out of [L&T's] ongoing operations performed for [West Hills]." ER 30; SER 11.

The underlying claims against West Hills included allegations directed at the wood columns on the project, including "insufficient weatherproofing to wood posts supporting the soffits" and "Improperly Constructed Porch Columns." ER 40; SER 63. The complaint alleged property damage as a result of the construction defects, including "water damage to trims, exterior sheathing, [and] building frame members[.]" ER 41; SER 63. As a result of the

alleged construction defects and property damage, remedial action was required to "[m]ake repairs to all water damaged materials" and "[r]e-clad columns with moisture tolerant assemblies." ER 41; SER 64.

Oregon Auto refused to defend West Hills in the Underlying Action claiming, among other things, that "the damages that are the subject of the Arbor Terrace Homeowners Association lawsuit arise from completed operations." SER 30. Oregon Auto did not explain the basis for this conclusory statement.

West Hills brought third-party claims against L&T, and Oregon Auto defended L&T against those claims. ER 9 at ¶4. The same adjuster was assigned to review West Hills' tender of defense against the HOA's claims and L&T's defense against West Hills' third-party claims. *Id.* During Oregon Auto's handling of L&T's defense in the Underlying Action, the HOA filed its Second Amended Complaint. *Id.* The Second Amended Complaint left no doubt that the HOA sought damages for "Improperly Constructed Porch Columns." SER 63. Oregon Auto eventually contributed to the settlement of L&T's liability to the homeowners. ER 9 at ¶4.

West Hills later brought this action against Oregon Auto and numerous other AI insurers to recover defense costs—in each insurer's case, $28,884.42

reflecting a portion of West Hills's defense costs incurred defending against the HOA's claims. ER 10 at ¶7. *See* Petitioner's Brief at 1.

At trial, Oregon Auto asserted under its *Shearer*-plus theory that it had no obligation to defend West Hills in the Underlying Action unless and until West Hills produced evidence extrinsic to the underlying complaint that the property damage alleged by the HOA occurred during L&T's ongoing operations at the project. According to Oregon Auto, it was not enough that the complaint could impose liability on West Hills for property damage arising out of L&T's ongoing operations. Instead, Oregon Auto maintained that West Hills was essentially required to indict itself by producing evidence that property damage (that West Hills denied existed in the liability action) occurred during ongoing operations as a result of L&T's operations at the time of tender. SER 90-96; Tr 58.

West Hills responded that the AI endorsement should instead be interpreted as it was written, to confer additional insured protection to West Hills for liability "arising out of" L&T's ongoing operations, a provision making no reference to the timing of property damage. *See* Tr 23. West Hills also argued that the complaint would in any event enable proof of at least some property damage occurring during the period of L&T's work on the project, even though not required to trigger Oregon Auto's duty to defend. Tr 69.

Moreover, West Hills maintained that it could not be required to present proof of the very same property damage West Hills denied existed in the Underlying Action. *North Pacific Ins. Co. v. Wilson's Distributing*, 138 Or App 166, 175, 908 P2d 827 (1995), *rev den*, 323 Or 264 (1996).

The trial court ruled that Oregon Auto's AI endorsement could reasonably be read to apply (1) to property damage allegedly occurring during L&T's ongoing operations or (2) to liability emanating from L&T's ongoing operations and resulting in property damage at any time. ER 12. Because Oregon law requires that ambiguity in an insurance policy be interpreted in favor of the insured, the court ruled that West Hills was an "insured" and that the allegations in the Underlying Action were sufficient to trigger the duty to defend. ER 12-13.

Oregon Auto appealed, but presented an entirely different argument on appeal. Instead of arguing that West Hills was required to produce extrinsic evidence at the time of tender establishing that property damage occurred during L&T's ongoing operations, Oregon Auto asserted its no-*Shearer* theory on appeal. That is, Oregon Auto claimed that West Hills could not produce any extrinsic evidence at all to connect L&T to the allegations in the Underlying Action. Oregon Auto reasoned that West Hills's filing of a third-party complaint against L&T made the coverage-relevant fact of property damage

during L&T's ongoing operations a liability-relevant fact, precluding any reliance on extrinsic evidence. Appellant's Opening Brief at 21. Because the complaint in the Underlying Action did not allege L&T or timing of property damage, Oregon Auto then reasoned that West Hills could not link property damage alleged to L&T's ongoing operations.[1]

The Oregon Court of Appeals affirmed the trial court's decision that the complaint triggered Oregon Auto's duty to defend. *West Hills Development Co. v. Chartis Claims, Inc.*, 273 Or App 155, 359 P3d 339 (2015). In so doing, the court concluded that Oregon Auto's no-*Shearer* argument was not preserved. *Id.* at 164 n 5. The Court of Appeals then rejected the *Shearer*-plus argument that Oregon Auto advanced at trial, noting that an insurer has a duty to investigate a claim tendered to it and verify details provided by prospective insureds. *Id.*at 164. There was no showing that Oregon Auto was not able to verify the assertions in West Hills' tender letter with just a cursory investigation to verify L&T's connection to the project. *Id.* To the contrary, the Court of

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[1] Oregon Auto never addressed the fact that West Hills' tender letter was sent over a month before West Hills filed its third-party complaint in the Underlying Action against L&T. *Compare* ER-31 *with* Ex. 8. Thus, even under Oregon Auto's no-*Shearer* theory, whether property damage arose out of L&T's ongoing operations was not a liability-relevant fact until well after West Hills' tender of the defense to Oregon Auto and extrinsic evidence could establish the duty to defend.

Appeals also noted that "the role of L & T in the project has never been disputed, then or now." *Id.*

Finally, the Court of Appeals determined that a ruling resolving the competing interpretations of the phrase "liability arising out of [L&T's] ongoing operations" was unnecessary because the HOA's complaint alleged that the alleged deficiencies at the project "existed and had already started to cause property damage" when the homeowners bought their units. *Id.* at 167; *see also* ER 39 at ¶13. Accordingly, the HOA's allegations could allow for proof at trial that the damages alleged by the HOA occurred during ongoing operations sufficient to impose liability on West Hills covered under the AI endorsement, regardless of how the phrase was construed. *West Hills*, 273 Or App at 166-67.

Oregon Auto filed a petition for review, which this court granted.

IV. Proposed Rule

1. A reaffirmation of *Ledford v. Gutoski*, 319 Or 397, 877 P3d 80 (1994) : an insurer has a duty to defend if the "allegations of the complaint, without amendment, could impose liability for conduct covered by the policy." Id. at 400.

2. Adoption of the Court of Appeals' rule and reasoning in Fred *Shearer & Sons, Inc. v. Gemini Ins. Co.*, 237 Or App 468, 240 P3d 67 (2010):

in order to obtain its insured defense, an insured may resort to evidence extrinsic to the complaint in connection with coverage-related facts when those facts are wholly divorced from, and not implicated by, the underlying plaintiff's claims against the insured.

3. Under *Hoffman Constr.*, an additional insured endorsement conferring additional insured status with respect to "liability arising out of the [named insured's] ongoing operations" is at the very least susceptible to more than one reasonable interpretation and therefore ambiguous, such that it must be construed against the drafter and in favor of coverage for the insured.

4. Confirmation of an insurer's duty to investigate, and recognition of a special relationship between insurer and insured in the duty to defend determination.

V. Argument

A. Preservation

As an initial matter, Oregon Auto makes a number of assertions in its brief on the merits that were not presented to the trial court and therefore are unpreserved for this court's review. *See, e.g.*, *State v. Wyatt*, 331 Or 335, 343, 15 P3d 22 (2000) ("A party must provide the trial court with an explanation of his or her objection that is specific enough to ensure that the court can identify its alleged error with enough clarity to permit it to consider and correct the error

immediately, if correction is warranted."); ORAP 5.45 ("No matter claimed as error will be considered on appeal unless the claim of error was preserved in the lower court and is assigned as error in the opening brief in accordance with this rule, provided that the appellate court may consider an error of law apparent on the record.").

The preservation requirement is firmly established in this court's jurisprudence. *See, e.g., State v. Laundy*, 103 Or 443, 509-10, 206 P 290 (1922) (identifying preservation rule and citing earlier cases); *State v. Mergorden*, 49 Or 259, 269, 88 P 306 (1907) (same). The purpose of the preservation requirement, as this court has explained, is "to advance goals such as ensuring that the positions of the parties are presented clearly to the initial tribunal and that parties are not taken by surprise, misled, or denied opportunities to meet an argument." *Northwest Natural Gas Co. v. Chase Gardens, Inc.*, 328 Or 487, 500, 982 P2d 1117 (1999) (internal quotation marks omitted; quoting *Davis v. O'Brien*, 320 Or 729, 737, 891 P2d 1307 (1995)). Indeed, the Court of Appeals recently observed: "Compliance with ORAP 5.45 is not a matter of mere form; it is crucial to [a court's] ability to review trial court rulings for error and to determine whether the appellant's claims of error were preserved below." *Village at North Pointe Condo. Assn. v. Bloedel Constr.*, 278 Or App 354, 359, ___ P3d ___ (2016).

As explained more thoroughly below, there are a number of contentions that Oregon Auto advances in this court that were not raised before the trial court. More problematic for Oregon Auto, however, is that its position in some instances is the exact opposite of what it argued to the trial court. Accordingly, this court should reject Oregon Auto's unpreserved arguments to ensure procedural fairness and judicial efficiency. *See Peeples v. Lampert*, 345 Or 209, 223, 191 P3d 637 (2008) ("A party that does not preserve an issue, when it is reasonably possible to do so, is not entitled to appellate review of it, meaningful or otherwise.").

1. Oregon Auto's *Shearer*-plus, no-*Shearer*, and "Rule In" theories.

A review of Oregon Auto's position at trial demonstrates that it has, in some respects, fully reversed course. Oregon Auto's no-*Shearer* theory in this court rests on the circular proposition that West Hills is not entitled to a defense under the "eight corners" rule because liability for L&T's conduct was a ***coverage fact*** not pled in the HOA complaint, and West Hills is not entitled to obtain a defense through extrinsic evidence under *Shearer* because L&T's conduct became a ***liability fact*** by virtue of West Hills' third party complaint. A claim that evidence extrinsic to the HOA complaint is off limits to establish West Hills' additional insured status is exactly the opposite theory Oregon Auto argued to the trial court.

In a section of its trial brief entitled "Standards for Determining Duty to Defend," Oregon Auto argued that extrinsic evidence was not only available to West Hills to establish the duty to defend, but also necessary to establish the duty:

> Ordinarily, the determination whether an insurer owes a duty to defend is governed by the four-corners rule. * * * But where, as here, the question is whether a person qualifies as an additional insured under a policy, that determination depends on evidence extrinsic to the allegations of the complaint. *Fred Shearer & Sons, Inc. v. Gemini Ins. Co.*, 237 Or App 468, 478-79, 240 P3d 67 (2010). A person who claims to be insured must submit evidence to the insurer to establish that contention.

SER 90. In another section of its trial brief entitled "Ambiguous Allegations Are Not Construed Against OAIC," Oregon Auto argued:

> This only makes sense. *Shearer* requires an insurer to consider extrinsic evidence to determine if a person is "insured" precisely because a complaint may not allege the facts required to establish coverage. Because *Shearer* establishes a process—submission of extrinsic evidence –that allows resolution of ambiguity, a party to an insurance dispute governed by *Shearer* should not be permitted to rest on ambiguity. Rather, that party should be obligated to offer evidence to establish coverage.

SER 94.

Oregon Auto persisted in its *Shearer*-plus theory at trial, arguing that West Hills was required to present evidence extrinsic to the complaint of property damage existing at the time of L&T's "ongoing operations" (referred to as "Russell's" during argument):

> So if we take that context for Shearer and the holding of Shearer and apply it to this case, we have a requirement that West Hills establish in order to trigger AI coverage, that it is being sued for liability arising out of Russell's ongoing operations. The only information that West Hills provided to meet that requirement was the complaint in the liability suit and a cover letter, which purported to say Russell's did work for us and some of the work is at issue in this case.

Tr 53.[2]

Apparently abandoning its earlier interpretation of *Shearer*, Oregon Auto's position in this court focuses on the complaint "ruling in" coverage. For instance, Oregon Auto asserts in its brief on the merits, to trigger the duty to defend, "*the complaint* has to allege that some damage occurred before L&T finished the job." (Pet. BOM 37; emphasis added; footnote omitted). Its position before the trial court was just the opposite:

> The HOA had absolutely no reason to allege the involvement of subcontractors, their ongoing operations or anything else. So West Hills can't really say that the claim by the HOA implicitly alleged any of those facts, even under the four corners rule. It really has to go beyond the four corners of that complaint that was filed against it to establish all of the other attendant facts that it needs to make itself an additional insured.

Tr 63.

In short, Oregon Auto asked the trial court to apply an overly-expansive version of *Shearer's* extrinsic evidence rule and now faults the trial court for

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[2] "Tr" refers to the Transcript of Proceedings on November 29, 2011.

applying *Shearer* at all. Not only were Oregon's "Rule In" and no-*Shearer* theory not advanced to the trial court, they are the polar opposite of its theory that was argued to the trial court. Accordingly, this court should reject Oregon Auto's claims in this court as unpreserved. *See State v. Walker*, 350 Or 540, 552, 258 P3d 1228 (2011) (in determining whether an argument has been preserved for review the appropriate focus "is whether a party has given opponents and the trial court enough information to be able to understand the contention and to fairly respond to it.").

2. Framing versus siding

Oregon Auto also raised for the first time in its Petition for Reconsideration of the decision by the Court of Appeals (and repeats in its brief on the merits in this court), a factual position and argument that L&T was engaged in framing, not siding. According to Oregon Auto, L&T could not have been responsible for faulty weatherproofing alleged by the HOA because, in its view, framers do not perform weatherproofing. *See* Pet BOM 35-36.

No such argument was never made to the trial court and is therefore unpreserved for review. Oregon Auto even acknowledges as much in its Petition for Reconsideration. *See* Petition for Reconsideration 4 ("Oregon Auto recognizes that the record in this case does not speak to some of these points[.]"). Oregon Auto's framing verses siding argument is a red herring, but

nonetheless Oregon Auto cannot assert an unpreserved factual argument for the first time after the opinion of the Oregon Court of Appeals in this case, much less present it to this court on review.[3]

In short, many of Oregon Auto's contentions are wholly unpreserved for this court's review and therefore should be rejected.[4] To the extent there are

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[3] Aside from being unpreserved, Oregon Auto's framing verses siding argument is refuted by the evidence in the record. The subcontract provided the "Subtrade" for L&T on the project as "Fencing, Decks and **Post Wraps** and Railing." SER-85 (emphasis added). The subcontract further delineates the post wraps to "Square Post Wrap" and "Tapered Post Wrap" for purposes of pricing. SER-86. Moreover, at trial, Oregon Auto never suggested that L&T's scope of work did not include weatherproofing the front porch columns. *See* Tr 71-72 (discussing fact that L&T was required to wrap and waterproof the columns on the project). If Oregon Auto wished to argue that "Post Wrap" did not mean wrapping and weatherproofing the columns, but instead just framing the columns, then it should have taken that position below so that the parties could have presented evidence as to the scope of work for the court to receive.

Moreover, Even if L&T framed but did not wrap the columns, a contention which is clearly not supported in the record, framing is relevant to weatherproofing. For example, whether and how framing terminates at concrete grade potentially could affect weatherproofing—an allegation included in the complaint in the underlying action. *See* ER-40 at ¶14(e). In any event, Oregon Auto cannot raise such a factual-based theory for the first time on appeal without an expert or any evidentiary support and expect the issue to be adequately presented or preserved.

[4] In its briefing to the Court of Appeals, Oregon Auto also argued that the AI endorsement required more than just the possibility that West Hills could be liable because of property damage arising out of L&T's ongoing operations. For the first time on appeal, Oregon Auto posited that West Hills could only qualify as an additional insured within the meaning of the AI endorsement if West Hills was ***liable*** to the homeowners ***during*** L&T's ongoing operations—as opposed to its initial theory that the property damage must occur during ongoing operations. Oregon Auto Op Br 25-26. Whether Oregon Auto has

preserved arguments for review, this court should reject them for the reasons articulated below after examination of the arguments presented to the trial court. *See Rains v. Stayton Builders Mart, Inc.*, 359 Or 610, 616, ___ P3d ___ (2016) ("Because of preservation arguments raised on appeal and review, the issues before us require an examination of the specific arguments presented to the trial court.").

B. The Eight-Corners Rule and Extrinsic Evidence

Oregon Auto's theory on review fundamentally misconstrues the eight-corners rule embodied in *Ledford*, the extrinsic evidence rule recognized in *Shearer*, and the relationship between the two. The rules are not mutually exclusive—*Shearer* is simply a bridge to *Ledford*.

Under *Shearer*, the insured may cite to extrinsic evidence to establish a coverage-relevant fact immaterial to the underlying plaintiff's liability claim against the insured and, therefore, not implicated by the underlying complaint. Insured status is the recurring example, the issue in *Shearer* and in this case. Because underlying plaintiffs have no cause to allege a defendant's relationship with its insurer, that gap in the duty to defend analysis must be bridged with reference to facts outside the pleading. Once the insured status gap is bridged, *Ledford's* eight corners rule then proceeds to operate as it always has to

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abandoned this position is not clear, but in any event that new theory was unpreserved as well. *See* West Hills Ans Brief at 18-20.

determine whether the complaint, without amendment, could impose liability covered under the policy—for example, whether West Hills could be liable for property damage arising out of L&T's ongoing operations. It does not matter that these facts may also bear on West Hills' insured status; what matters is that these facts were implicated by—in fact perfectly bound up with—the HOA's liability claims against West Hills.

It is not an either/or choice—*Ledford* and *Shearer* work together.

1. The Eight-Corners Rule

Oregon Auto seeks to refashion in the most restrictive way possible Oregon's eight corners rule, a rule long established here and in virtually every other state. "The insurer has a duty to defend if the complaint provides *any basis* for which the insurer provides coverage." *Ledford*, 319 Or at 400 (emphasis in original). "Any ambiguity in the complaint with respect to whether the allegations could be covered is resolved in favor of the insured." *Id.* An insurer has a duty to defend if the "allegations of the complaint, without amendment, ***could*** impose liability for conduct covered by the policy." *Id.* (Emphasis added.)

A complaint does not have to allege every fact relevant or necessary to coverage. *See Bresee*, 353 Or at 125 (complaint silent on timing of property

damage triggered insurer's duty to defend because it did not rule out possibility that insured could be liable for damage occurring during ongoing operations).

> Where the complaint does not state facts sufficient to bring the case clearly within or without the coverage, the general rule is that the insurer is obligated to defend if there is, potentially, a case under the complaint within the coverage of the policy. In other words, in case of doubt as to whether or not the allegations of a complaint against the insured state a cause of action within the coverage of a liability policy sufficient to compel the insurer to defend the action, such doubt will be resolved in the insured's favor.

Blohm v. Glens Falls Ins. Co., 231 Or 410, 415-16, 373 P2d 412 (1962) (quoting 29A Am.Jur. 567, Insurance, § 1454; quotation marks omitted).

Consistent with these precepts, the insurer's duty to defend was triggered in *Ferguson v. Birmingham Fire Ins. Co.*, 254 Or 496, 507, 460 P2d 342 (1969), where the complaint alleged an uncovered intentional trespass because plaintiff could alternatively prove a covered accidental trespass. *See also Abrams v. Gen. Star Indem. Co.*, 335 Or 392, 400, 67 P3d 931 (2003) (duty to defend against allegation of uncovered intentional conversion because pleading, without amendment, enabled proof of covered negligent conversion).

If Oregon Auto were correct about Oregon's eight corners rule, *Ferguson* and *Abrams* would have been decided differently. Oregon Auto mistakes *Ledford* when it focuses solely on the complaint's written word as opposed to the liability potentially resulting from it.

> To trigger the duty to defend, a complaint needs only to make allegations with which a claim covered by the policy ***may be proven***. The insurer is charged with the responsibility to recognize the insured's exposure that the complaint presents.

West Hills, 273 Or App at 162 (emphasis added).

2. *Shearer*'s Bridge to *Ledford*

The Court of Appeals in *Shearer* understood that *Ledford*'s eight corners rule was not intended as a weapon in the hands of insurers. The insurer in *Shearer* sought to trap the insured within the four corners of the complaint as to coverage facts wholly divorced from the plaintiff's liability claims against Shearer, namely the threshold question of whether Shearer was an additional insured on its stucco supplier's policy. Recognizing the cognitive disconnect between insured status and insured conduct, the court bridged the gap.

First some context. In *Shearer*, homeowners hired a general contractor to perform repairs on their home. *Shearer*, 237 Or App at 470. The general contractor subcontracted with Shearer to apply stucco, a product Shearer obtained from TransMineral. *Id.* TransMineral's insurer, Gemini, issued a policy providing additional insured coverage to persons selling or distributing TransMineral's products in the regular course of their business. *Id.* at 473-74. The stucco later cracked, resulting in the homeowners' action against the general contractor, which in turn filed third-party claims against Shearer and TransMineral. *Id.* at 471. Gemini refused to defend Shearer on the basis that it

was not possible to determine from the allegations in the homeowners' complaint whether Shearer sold or distributed TransMineral's stucco in the ordinary course of its business. *Id.* at 474. Because the complaint did not allege Shearer's insured status, argued Gemini, Shearer was not entitled to a defense. *Id.*

The court rejected the insurer's technical pleading argument, distinguishing allegations of ***conduct*** relevant to the insured's liability from allegations of ***insured status*** not relevant to the insured's liability. *Id.* As to the latter, the court recognized that the eight corners rule does not always answer the duty to defend question. *Id.* at 477.[5] In such cases, extrinsic evidence can be referenced to establish the coverage-relevant fact and connect the defendant to the policy, thereby avoiding a forfeiture of promised coverage. *Id.*

In so doing the *Shearer* court joined Oregon with many other jurisdictions allowing the use of information extrinsic to a complaint to trigger an insurer's duty to defend. *See, e.g.*, Windt, 1 Insurance Claims and Disputes § 4:3 (6th ed.) (citing cases). The Washington Supreme Court articulated the rule this way:

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[5] Homeowners insurance offers another prime example. Such policies typically provide liability coverage to any permanent resident of the named insureds' household if the resident is a relative or person under the age of 21. A liability plaintiff may have no reason to allege a defendant's place of residence, age, or familial relationships.

> There are two exceptions to the rule that the duty to defend must be determined only from the complaint, and both the exceptions favor the insured. If coverage is not clear from the face of the complaint but may exist, the insurer must investigate the claim and give the insured the benefit of the doubt in determining whether the insurer has an obligation to defend. . . . Similarly, facts outside the complaint may be considered if "'(a) the allegations are in conflict with facts known to or readily ascertainable by the insurer or (b) the allegations of the complaint are ambiguous or inadequate.'"

Truck Ins. Exch., 147 Wash 2d at 761 (emphasis added) (citations omitted).[6]

3. The Interplay between *Ledford* and *Shearer*

Once *Shearer* bridges the pleading gap, the analysis reverts to *Ledford*. This is important because "coverage facts" and "liability facts" often cannot be neatly separated. Often they are bound up together. When this happens, *Ledford* determines the duty to defend.

Consider the endorsement in *Shearer*, not unlike the endorsement in this case:

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[6] Oregon Auto asks this court to disavow *Shearer* on the basis that its gap filling rule is unworkable in instances where the extrinsic evidence is disputed. The extrinsic evidence used in *Shearer* and in this case—*i.e.*, the named insured's connection to the project—was undeniable and therefore undisputed, and disputes over these and similar facts would be the rare exception. Nonetheless, there are two ready answers to the hypothetical problem Oregon Auto raises. First, treat the gap filling fact just as if it had been alleged by the underlying plaintiff. If the gap filling fact creates the possibility of covered liability, the insurer must defend. Alternatively, if that doesn't satisfy, the insurer can do what insurers do across the country: accept the defense subject to a reservation of the right to file a declaratory judgment action to resolve the disputed fact. Oregon courts are well-equipped to handle such things.

> The endorsement at issue (titled "Additional Insured—Vendors") provided coverage to "all vendors of [TransMineral]," but "only with respect to 'bodily injury' or 'property damage' arising out of 'your products' * * * which are distributed or sold in the regular course of the vendor's business," subject to certain exclusions.

Shearer, 237 Or App at 472. Two elements establishing Shearer's additional insured status were not alleged in the liability action because they were not necessary to Shearer's liability: 1) the identity of TransMineral as the vendor of the stucco, and 2) distribution or sale of the stucco in the regular course of Shearer's business. *See id.* at 477 ("[T]he Evenstads had no reason to allege that Shearer sold or distributed TransMineral's products in the ordinary course of its business[.]"). Because those facts were not relevant to Shearer's liability in the underlying action, extrinsic evidence could be considered to satisfy those requirements of the additional insured endorsement. *Id.*

However, the endorsement contained a third requirement that ***was*** relevant to Shearer's liability: Shearer's additional insured status turned on "'bodily injury' or 'property damage' ***arising out of '[TransMineral's[products***.'" *Id.* at 472 (emphasis added). Because property damage arising out of TransMineral's stucco was the essential liability question, the court rightly recognized the confluence of insured status and liability, leaving both questions

to *Ledford*: whether the allegations of the complaint, without amendment, could impose liability for conduct covered by the policy.[7]. *Id.* at 471 & 479-85.

It should be noted that Oregon's federal courts anticipated *Shearer* years ago. For example, in *Hoffman Const. Co. of Oregon v. Travelers Indem. Ins. Co.*, CIV. 05-456-AA, 2005 WL 3689487 (D Or Nov. 28, 2005) Judge Aiken acknowledged extrinsic evidence connecting the named insured to the dispute, and then performed an eight corners analysis to determine Travelers' duty to defend its additional insured:

> ***Similar to the facts at bar, in Tudor, the named insured was not sued, and was not alleged in the complaint to have done anything tort-worthy.*** Tudor argued that it had no duty to defend or indemnify Wright against McRobbie's lawsuit which only alleged negligence by Wright. Nonetheless, the court concluded that ***the complaint raised by implication the possibility that the nonparty named insured might have been at fault in a way that triggered coverage under the additional insured endorsement.*** *Tudor*, at p. 3. Here, Bremmer's allegations against Hoffman appear premised upon vicarious liability, or liability related to its duties of general supervision. Like *Tudor*, the amended complaint at bar fails to allege who was actually responsible for the temporary steps. This ambiguity weighs in Hoffman's favor. Bremmer's allegations raise the possibility that Hoffman will be found faultless, or will be deemed only vicariously liable, while Bremmer's injuries will be deemed to be ATG's fault, or to have risen from ATG's work. This creates the possibility that Hoffmans' liability ultimately will be covered under the policy, within the limits of ORS § 30.140(2). The possibility that Bremmer's claims against Hoffman will be

[7] Requiring Shearer to establish its insured status by producing extrinsic evidence on this element would of course require Shearer to admit property damage and its cause—to essentially admit liability—something no insured can or should be expected to do. *See Wilson's Distributing*, 138 Or App at 175.

> covered obligates Travelers to defend Hoffman. The duty to defend is triggered whenever there is a possibility that any claims might be covered.

Id. at *4 (citing *Tudor Insurance Co. v. Wright,* Cv No. 04-480-ST) (emphasis added). *Shearer* simply articulated a longstanding practice.

C. *Shearer* and *Ledford* Applied in This Case

This case is a rerun of *Shearer* (which explains Oregon Auto's first theory in the trial court). An endorsement in Oregon Auto's policy issued to L&T expressly scheduled West Hills as an additional insured "with respect to liability arising out of [L&T's] ongoing operations performed for [West Hills]." ER-30; SER-11. As in *Shearer*, L&T's connection to the Arbor Terrace project was not an element of the HOA's claims against West Hills; understandably, therefore, it was not alleged. L&T's connection to the project, *i.e.*, its role as one of West Hills' subcontractors on the project, was the only factual gap between the HOA's complaint and Oregon Auto's AI endorsement. As such, and pursuant to *Shearer*, West Hills could point to its subcontract with L&T to bridge the pleading gap.

But the question of whether West Hills was subject to liability "arising out of [L&T's] ongoing operations" landed dead center in the middle of the HOA's case against West Hills. Having denied its liability to the HOA, West couldn't very well be asked to establish its liability for L&T's defective work in

order to obtain an insured defense. The race would have been run at that point. Instead, the trial court and the court of appeals correctly crossed over into *Ledford*.

Under the eight corners rule, the HOA's allegations against West Hills clearly could impose liability covered by the AI endorsement. Even under Oregon Auto's extra-textual interpretation of the clause "arising out of [L&T's] ongoing operations," which substitutes the phrase "property damage during" for the phrase "arising out of," the complaint included allegations that would allow for proof of property damage occurring before L&T's work on the project was complete. Specifically, the complaint alleged "insufficient weatherproofing to wood posts supporting the soffits" and "Improperly Constructed Porch Columns" ER-40; SER-63, which, among other alleged defects, caused "water damage to trims, exterior sheathing, [and] building frame members . . . ." ER-41; SER-63. All of this, alleged the HOA, required remedial action to "repair[] all water damaged materials" and "[r]e-clad columns with moisture tolerant assemblies." ER-41 & SER-64.

Oregon Auto argues that its duty to defend was not triggered because the HOA's complaint did not allege property damage during L&T's ongoing operations; yet, it admits that the allegations of the complaint ***could*** impose liability on West Hills for property damage during L&T's ongoing operations.

Opening Brief at 38 ("[T]he complaint did not allege that property damage occurred during L & T's ongoing operations. Of course, it didn't allege the opposite: that property damage did not occur then. * * * ***It's possible, then, that some did.***") (emphasis added). Under *Ledford*, that possibility triggered Oregon Auto's duty to defend. *See Bresee Homes, Inc.*, 353 Or at 123 (holding that complaint's silence on timing of property damage triggered insurer's duty to defend because it did not foreclose the possibility that property damage occurred during ongoing operations insured by the policy).[8]

D. An Insurer's Duty to Investigate

Unable to dispute West Hills' gap filling fact, Oregon Auto argues instead that it should be able to ignore it because an insurer does not have a duty to investigate. The assertion is a curious one, in that Oregon Auto's denial letter states that in response to West Hills' tender it "conducted an investigation of this matter," SER-26, and concluded that the claim should be denied because "[t]he damages that are the subject of the Arbor Terrace Homeowners Association lawsuit arise from completed operations." SER-30. The HOA's complaint of course nowhere alleges that fact. One can only conclude, then,

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[8] In fact, the only allegations of timing in the complaint clearly would allow for property damage during L&T's ongoing operations. *See* ER 39 at ¶13 ("When the Owners purchased their units at Arbor Terrace Townhomes, they did not know that the deficiencies in the building envelope and other components existed and ***had already started to cause property damage.***").

that Oregon Auto believes it is free to investigate facts outside the complaint for purposes of denying a defense, but it has no corresponding obligation to investigate facts outside the complaint to confirm a defense.[9] Positions like these scream for the bad faith tort remedy Oregon insureds have yet to enjoy.

Like every contract, insurance policies contain an implied covenant of good faith and fair dealing. *McKenzie v. Pacific Health & Life Ins. Co.*, 118 Or App 377, 381, 847 P2d 879 (1993) ("The duty of good faith is a contractual term that is implied by law into *every* contract." (emphasis in original)). "The implied covenant [of good faith and fair dealing] serves to protect the objectively reasonable contractual expectations of the parties." *Stevens v. Foren*, 154 Or App 52, 58 (1998). In the insurance context, that includes an insurer's duty to investigate. *Am Star Ins. Co. v. Allstate Ins. Co.*, 12 Or App 553, 564-65, 508 P2d 244 (1973) ("In construing the common clause in insurance contracts requiring cooperation of the insured with his insurance company, our Supreme Court has held that the insurance company has an affirmative duty to conduct a 'good faith and diligent investigation'"); *see also* Eugene R. Anderson, et al., *Insurance Coverage Litigation*, § 3.04, at 3-47 (The duty to investigate is "an independent one, arising from the implied covenant of

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[9] Notably absent from this denial letter, moreover, is any mention of the fact that the HOA's complaint did not connect L&T to the project. That came later, obviously. Unfortunately, insurance coverage is all too often a moving target.

good faith and fair dealing, which is deemed to exist in every insurance policy."). "Failure to investigate a claim is bad faith because the decision not to pay a claim, or not to settle a claim against a policyholder, must be an 'honest and intelligent' judgment. In order to make a judgment that is 'honest and intelligent,' a 'reasonably diligent effort must be made to ascertain the facts.'" Anderson, *Insurance Coverage Litigation*, §11.10[C], at 11-65 (quoting *Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co.*, 157 A2d 319, 322-23 (NJ 1960)).

In Oregon, this duty is contractual and statutory. ORS 746.230(1)(d) (prohibiting insurers from refusing to pay claims without conducting a reasonable investigation based on all available information); *see also Galicia-Orozco v. County Mut. Ins. Co.*, No. CV 09-1401, 2010 WL 2507528, at *3 (D Or) (holding the breach of ORS 746.230 can give rise to breach of the contractual duty of good faith and fair dealing).

Oregon Auto knew about L&T's role in the Arbor Terrace project. The adjuster who denied West Hills' claim handled L&T's defense against West Hills' third party claims. ER 9 at ¶4. In that capacity the adjuster received the subcontract and each iteration of the HOA's complaint.[10] ER 09 & SER 76-88.

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[10] This fact puts the lie to Oregon Auto's claim that it did not receive the HOA's amended complaints. "If notice from any source was sufficiently timely so that the insurer could adequately investigate and protect itself, thereby suffering no prejudice, the insurer is bound to fulfill its policy obligations." *Lusch v. Aetna Casualty & Surety Co.*, 272 Or 593, 599, 538 P2d 902 (1975).

Oregon Auto, moreover, paid money to settle the claims against L&T. ER 9 at ¶4. Oregon Auto, therefore, is not asking for a rule that it has no duty to investigate as much as it is asking for a rule that it can ignore the information it has--that it can open its eyes as to one insured and remain willfully blind as to another. No insurer can play hide-and-seek with its duty to defend.

West Hills asks this court to rule that insurers may not do this, and to ensure that insurers stop doing this, to recognize a special relationship between insured and insurer in the duty to defend determination.

E. Oregon Auto's Other Technical Pleading Argument--Vicarious Liability

Oregon Auto posits that its duty to defend was not triggered because the HOA did not explicitly allege a claim of vicarious liability against West Hills for the negligence of L&T. This argument is a red herring for several reasons.

First, Oregon Auto's additional insured coverage obligation does not turn on vicarious liability. The AI endorsement requires only that West Hills' liability "aris[e] out of [L&T's] ongoing operations." The complaint alleged West Hills' duty to supervise and oversee the work of its subcontractors. ER 46 at ¶42. It alleged that West Hills failed "to properly coordinate, schedule, oversee, inspect, and supervise contractors, subcontractors, and other workers." ER 47 at ¶44(f). It alleged that West Hills failed "to notify contractors, subcontractors, or other workers of improper construction means and methods,

so that reasonable steps could be taken to correct such issues." ER 48 at ¶44(i) (emphasis added). Plainly, these are allegations arising out of the work of West Hills' subcontractors, including L&T.

Second, insurers cannot hide behind technical pleading requirements:

> [T]his court has recognized that a complaint need not plead a claim in perfect form to provide notice to the insurer. Indeed, if the complaint is unclear, but "may be reasonably interpreted to include an incident within the coverage of the policy, [then] there is a duty to defend."

Marleau v. Truck Ins. Exch., 333 Or 82, 91, 37 P3d 148 (2001) (quoting *Blohm*, 231 Or at 416.). "[N]either the failure to identify correctly the claims nor the failure to state them separately defeats the duty to defend." *Id.* ; *see also Portland Gen. Elec. Co. v. Liberty Mut. Ins. Co.*, 112 F Supp 3d 1160, 1166-67 (D Or 2015) (absence of reference in complaint to fault of named insured nonetheless triggered insurer's duty to defend under additional insured endorsement because additional insured could be vicariously liable for named insured's negligence under the allegations of the complaint); *Hoffman Const. Co. of Oregon*, 2005 WL 3689487, at *4 (same).

Third, Oregon Auto reads too much in *Holger v. Irish*, 316 Or 402, 851 P2d 1122 (1993), which is not an insurance case. *Holger* concerned a medical malpractice lawsuit by a patient's estate against a surgeon who operated on the patient and allegedly left a sponge in the patient's abdomen. *Id.* at 405-09.

After settling with the hospital, the estate brought suit against the surgeon, carefully and purposefully avoiding vicarious liability, alleging that "he, ***personally***, failed 'to check and determine that all sponges * * * were removed.'" *Id.* at 408 (emphasis added). The complaint made no mention of nurses or any other agent for whom the surgeon might be responsible.

Finally, Oregon Auto forgets that the HOA brought a breach of contract claim against West Hills, which, like the HOA's negligence claim, prayed for 100% of the HOA's repair cost damages. *See, e.g.*, SER 42-43 at ¶¶ 21-25. As with the HOA's negligence claim, the breach of contract claim exposed West Hills to liability because of property damage "arising out of [L&T's] ongoing operations."

F. A *Hoffman* View of Oregon Auto's Additional Insured Endorsement

In its Opening Brief, Oregon Auto pays scant attention to the interpretative analysis of the AI endorsement that consumed much of the briefing below and, according to Oregon Auto's denial letter, was the basis of its disclaimer of coverage. Denials on this basis are commonplace, however, and the interpretive issue is an important one, a fact animating *amici* Property Casualty Insurers Association of America and National Association of Mutual Insurance Companies. The problem with the *amicus* brief, however, is that it nowhere mentions the analytical construct this court has employed since 1992

to interpret policy language. *See Hoffman Const. Co. v. Fred S. James & Co. of Or.*, 313 Or 464, 836 P2d 703 (1992).

Oregon courts "determine the intention of the parties based on the terms and conditions of the insurance policy." *Hoffman Const. Co.*, 313 Or at 469. Where policy terms are unambiguous, they are enforced as written. *Groshong v. Mut. of Enumclaw Ins. Co.*, 329 Or 303, 308, 985 P2d 1284 (1999). However, where policy terms are susceptible to more than one interpretation, Oregon courts undertake a sequence of analytical steps to determine the meaning of the language. *Hoffman Constr. Co.*, 313 Or at 469-71. Courts first determine whether the competing interpretations are plausible when viewed in light of the immediate context of the policy language and in the broad context of the policy as a whole. *Id.* If only one interpretation continues to be reasonable after contextual review, that interpretation controls. *Id.* If, however, both interpretations continue to be reasonable, the policy language is deemed ambiguous and will be construed in favor of coverage for the insured. *Id.* Because insurers have unfettered power to draft policy language as they see fit, courts burden them with the consequences of poor drafting. *See N. Pac. Ins. Co. v. Hamilton*, 332 Or 20, 29, 22 P3d 739 (2001) ("It is the insurers' burden to draft exclusions and limitations that are clear" and "the court does not permit the party who drafted the term or phrase to benefit from the obscurity").

Oregon Auto's AI endorsement confers on West Hills insured status "with respect to liability ***arising out of*** [L&T's] ongoing operations performed for [West Hills]." (Emphasis added.) Given these words and the various arguments Oregon Auto and *Amici* have made based upon them, three points become immediately clear. First, if the clause was genuinely intended to mean what Oregon Auto and *Amici* say, it is difficult to imagine a more poorly drafted sentence. Although Oregon Auto wrote "liability arising out of [L&T's] ongoing operations," it asks the court to read "liability for property damage occurring during L&T's ongoing operations." That is not what the endorsement says, however, and the office of the judge is not to insert what has been omitted or to omit what has been inserted. ORS 42.230.

Second, neither Oregon Auto nor *Amici* can persuasively argue that the clause is not at least ambiguous. Oregon Auto has variously argued that it means (1) property damage during L&T's operations and (2) the unit owners' purchases and standing as plaintiffs during L&T's operations. For their part, Amici seem to be arguing that the clause means additional insured coverage will attach only if the liability action is commenced during L&T's operations. Given these candidates, can West Hills' reading of the clause to mean liability arising out of L&T's work really be deemed unreasonable?

And third, insurers have the unilateral and exclusive right to fix the problem. Instead of mobilizing the amicus machine each time this unfortunately drafted endorsement is challenged, why not simply rewrite it to say what the insurers claim they mean?

In any case, the phrase "arising out of" is exceptionally broad:

> The ordinary meaning of the words "arising out of" is very broad. . . . "The words 'arising out of' when used in [an automobile liability provision providing coverage for damages 'arising out of the ownership, maintenance or use of the automobile'] are of broader significance than the words 'caused by,' and are ordinarily understood to mean ***originating from, incident to, or having connection with*** the use of the vehicle." ... Thus, like 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. Oregon, P.C. v. Kemper Ins. Companies, 191 Or App 595, 601, 84 P3d 147 (2004) (emphasis added) (citations omitted). "Originating from, incident to, or having connection with" are not words of temporal limitation -- they do not mean "occurring during." *See* Turner, Insurance Coverage of Construction Disputes § 42:8 (2d ed.) ("Construed in isolation, as it must be, there is little discernible difference between 'liability arising out of your work' and 'liability arising out of your ongoing operations.'")

[A]s one commentator has observed:

> The key phrase—"arising out of the Named Insured's ongoing operations" (which is not defined)—addresses only

> the type of activity (ongoing operations) from which the ... [additional insured's] liability must arise in order to be covered, not when the injury or damage must occur. In other words, this language does not state that injury must occur, or liability must arise, *during* the Name Insured's ongoing operations, but rather requires only that the liability arise "*out of*" the ongoing operations, which may require only a minimal causal connection between the liability and the "ongoing operations." .. At the very least, there is an argument that the endorsement's undefined language is ambiguous and should be construed against the drafter. * * *
>
> Under these circumstances, construing the words "ongoing operations" to exclude damage that arose from conduct performed by Golden West *while its operations were ongoing* requires a parsing so abstruse as to be inconsistent with "what the ordinary person's understanding of the policy would be."

Tri-Star Theme Builders, Inc. v. OneBeacon Ins. Co., 426 F App'x 506, 510-11 (9th Cir 2011) (citations omitted) (emphasis in original);[11] *see also Jaynes*

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[11] Oregon Auto previously relied, and *amici* now rely, on ISO drafting history to support their interpretive arguments. *See* Amicus Brief at 6-7. Even assuming West Hills had been invited to participate in ISO's deliberations—it obviously was not—extrinsic evidence of contractual intent is not relevant to insurance policy interpretation in Oregon. *See Hoffman Const. Co.*, 313 Or at 469; *see also Rhiner v. Red Shield Ins. Co.*, 228 Or App 588, 593, 208 P3d 1043, 1045 (2009) ("In all events, the interpretation of an insurance policy is a question of law that is confined to the four corners of the policy without regard to extrinsic evidence."), *rev den*, 347 Or 348 (2009). The Ninth Circuit has also recognized that insureds are not parties to these "negotiations":

> The intent of the insurance industry draftsmen . . . is not controlling....Such evidence "might be persuasive if the controversy ... were between two insurers," . . . or if it suggested that the language reflected the *mutual intent* of the parties.

Corp. v. Am. Safety Indem. Co., 925 F Supp 2d 1095, 1099 (D Nev 2012), *vac'd* (Dec. 3, 2014) (per settlement); *McMillin Const. Servs., L.P. v. Arch Specialty Ins. Co.*, 2012 WL 243321 at *3 (SD Cal 2012); *Marathon Ashland Pipe Line LLC v. Maryland Cas. Co.*, 243 F3d 1232, 1238 (10th Cir 2001) ("[T]he common and ordinary meaning of this phrase [ongoing operations] is simply those things that the company does").

Even if the phrase "arising out of ongoing operations" could reasonably be read to mean "property damage occurring during ongoing operations," that interpretation must be disregarded if an ordinary insured could also understand the language to mean liability or property damage whenever occurring but arising out of the subcontractor's construction activities. It is entirely reasonable here for West Hills to interpret the phrase "arising out of [L&T's] ongoing operations" to cover liability or property damage occurring after completion of L&T's operations at the project but that arise out of those operations.

This reading is further supported by the context of the AI endorsement, which contains the following exclusion:

> This insurance does not apply to "bodily injury" or "property damage" occurring after:

Tri-Star Theme Builders, Inc. v. OneBeacon Ins. Co., 426 F App'x 506, 512 (9th Cir 2011) (citations omitted).

> (1) All work, including materials, parts or equipment furnished in connection with such work, on the project (other than service maintenance or repairs) to be performed by or on behalf of the [West Hills] at the site of the covered operations has been completed; * * *.

ER-30. The use of this exclusion immediately after the coverage grant shows that Oregon Auto was aware of the term "occurring" and chose to include that term in the exclusion but not in the grant. More telling, the exclusion clearly recognizes the possibility of additional insured coverage for property damage occurring after completion of L&T's work on the project. If the exclusion only precludes coverage for property damage occurring after ***all work*** "by or on behalf of" West Hills has been completed – which includes all general contractor work by West Hills and all work by every subcontractor inside and outside the buildings -- Oregon Auto clearly contemplated coverage under the AI endorsement for time periods after completion of L&T's work but before completion of West Hills' and the other subtrades' work.

Oregon Auto's interpretation of the endorsement also renders the exclusion superfluous. If Oregon Auto's coverage responsibility were limited to liability or property damage ***occurring during*** L&T's operations pursuant to the AI endorsement's coverage grant, there would be no need for a separate provision excluding coverage for property damage ***occurring after*** completion of all work by or on behalf of West Hills.

In fact, the endorsement's explicit language that West Hills' liability "aris[e] out of," and not "during," L&T's ongoing operations renders somewhat curious the following passage of Oregon Auto's brief to the Court of Appeals: "Thus, plaintiff's liability to the homeowners did not arise *during* L&T's operations even if it arose *out of* those operations." Opening Brief to the Court of Appeals at 27 (emphasis in original). The liability identified by Oregon Auto in the quote above is the liability required to trigger the AI endorsement—that is, liability ***arising out of*** L&T's ongoing operations for West Hills. If Oregon Auto wished to restrict its coverage to liability occurring ***during*** L&T's ongoing operations for West Hills, then it should have written its endorsement differently.

G. The Very Meaningful Problems with Oregon Auto's Proposed Rules

Oregon Auto's proposed rules are taken in reverse order.

Proposed rule number 2:

> An insurer is not required to defend a complaint simply because it does not *rule out* the possibility of covered liability. It is required to defend only when the complaint *rules in* that possibility. (Emphasis in original.)

First a threshold clarification. This court has already enunciated a "rule-in" duty to defend standard. That *is* the rule of *Ledford*: if the "allegations of the complaint, without amendment, could impose liability for conduct covered by the policy," the possibility of covered liability is clearly "ruled in." Oregon

Auto's "rule-in" and "rule-out" labels present a false dichotomy—they are opposite sides of the same coin. What Oregon Auto is really asking for is an explicit-unequivocal-affirmative-allegations-rule, and Oregon Auto requests that this exacting standard be imposed upon a party who has no relationship with, or claim against, Oregon Auto.

Why do insurers want this rule and how would it work? Insurers want it for at least two reasons. First, insurers will save enormous sums of money. An auto accident victim, a wrongfully discharged employee, or the owner of a water-damaged home cannot know the terms of their putative defendant's insurance coverage, which means the explicit-unequivocal-affirmative-allegations-rule will seldom, if ever, be satisfied. Translation: less money spent litigating ***on behalf of*** insureds means more money available for litigating ***with*** insureds.

Second, Oregon, unlike its sister states Washington and California,[12] does not (yet) recognize a tort claim based on an insurer's unreasonable refusal to defend its insured. Insurers in Oregon believe that a refusal to defend, however unreasonable and arbitrary, can never be more than a mere breach of contract. *See Farris v. U.S. Fid. & Gaur. Co.*, 284 Or 453, 587 P2d 1015 (1978); *Nw.*

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[12] *See, e.g., Kirk v. Mt. Airy Ins. Co.*, 134 Wash 2d 558, 563, 951 P2d 1124, 1127 (1998); *Amato v. Mercury Casualty Co.*, 53 Cal App 4th 825, 831, 61 Cal Rptr 2d 909 (1997).

Pump & Equip. Co. v. Am. States Ins. Co., 144 Or App 222, 226, 925 P2d 1241, 1243 (1996). Indeed, it is the acceptance of the defense itself, insurers believe, that creates the only tort-based protection Oregon insureds have. *See Georgetown Realty, Inc. v. Home Ins. Co.*, 313 Or 97, 110-11, 831 P2d 7, 14 (1992).

The result is not unpredictable. Insurers ably advised know that the best way to manage and minimize their exposure is to reject the insured's tender of defense. The insurer avoids the fiduciary duties that come with acceptance of the defense, and all the disappointed insured can do is sue for damages capped at the promised benefit. It's a free shot, in other words. Most insureds simply go away; those who do not go away will never get more than the defense coverage promised in the first place. Meanwhile, the insured is left to fund two lawsuits, the one the underlying plaintiff has against him, and the one he has against his insurer. Critically, an insured cannot "cover" an insurer's breach of contract; risk transfer agreements are not available post-loss.[13]

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[13] In this, insurance contracts are fundamentally different than other contracts, a fact for which current Oregon law fails to account. It is not a matter merely of the cost of substitute insurance, i.e., any additional premium, in the way an ordinary contract dispute would be about the increased price of widgets purchased from a "cover supplier." Here, because no insurer will write a policy to cover a loss that already exists, there can be no "cover supplier." The harm from the breach therefore isn't the premium gap but rather 100% of the bargained for benefit.

Oregon Auto's explicit-unequivocal-affirmative-allegations-rule would deprive insureds of even this meager recourse. They would be left with a contract claim they cannot win. For their part, insurers would enjoy the twin benefits of substantially reduced costs and the sanctioned avoidance of any fiduciary obligation.

How Oregon Auto's explicit-unequivocal-affirmative-allegations-rule would work is illustrated by this case. Despite being included by name as an additional insured in Oregon Auto's policies issued to L&T, West Hills would not be entitled to a defense unless the HOA investigates and alleges three different cases: (1) the HOA's case against West Hills; (2) West Hills' case against L&T; and (3) West Hills' case against Oregon Auto. That the HOA must allege its claims against the party from whom it seeks recovery—here, general contractor West Hills--is of course perfectly appropriate. But Oregon Auto complains that the HOA's complaint does not specifically identify L&T as one of West Hills' subcontractors or allege that property damage at the project is attributable to L&T. In order to know this, however, the HOA would need West Hills' project file in hand before drafting the complaint and commencing the action. Forget that the HOA has no way to compel its production pre-suit. In effect, Oregon Auto would have the HOA develop West Hills' third party claims against its subcontractors.

Oregon Auto also complains that the HOA's complaint does not specifically allege West Hills' insured status under Oregon Auto's policies issued to L&T, that is, according to Oregon Auto, it does not allege that West Hills' liability arose out of L&T's work on the project and resulted in property damage occurring before the project was complete. In order to know this, however, the HOA would need not West Hills' files but rather L&T's files, a party it is not suing. Forget as well that the HOA has no subpoena power pre-suit. In effect, Oregon Auto would have the HOA develop West Hills' coverage claim against Oregon Auto.

Underlying liability plaintiffs cannot and will not do these things, nor should they be expected to try. Oregon Auto's proposed rule gifts a free pass to insurers. A defendant's third party and coverage claims are not the plaintiff's problem. And visiting this additional expense upon plaintiffs is inequitable in the extreme, particularly as many underlying plaintiffs have no attorney fee recovery right. And even if a plaintiff is lucky enough to have a fee claim, the at-risk party in development of the coverage case would be the insured defendant and not the insurer! The upside for insurers in Oregon Auto's proposed rule is palpable.[14]

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[14] As a practical matter, Oregon Auto's proposed rule would inevitably foster the kind of inter-litigant collaboration to which insurers uniformly object. They

Oregon Auto's argument about the impact of West Hills' third party claims against L&T hems in insureds even further. Oregon Auto suggests that West Hills' filing of a third-party complaint against L&T somehow foreclosed West Hills' access to the *Shearer* rule because that complaint put at issue L&T's liability, thus rendering it both a coverage-relevant and liability-relevant fact. As such, the argument goes, *Shearer*'s narrow extrinsic evidence exception is inoperable, relegating West Hills to the explicit-unequivocal-affirmative-allegations-rule under which, conveniently, no defense would be owed.

In other words, an insured must choose between (1) asserting third-party claims against an allegedly at-fault third party and forgoing its entitlement to an additional insured defense, or (2) relying on extrinsic evidence to trigger an additional insured defense and forgoing its third-party claims against the allegedly at-fault third party in the liability action. According to Oregon Auto, the insured cannot have both. That is not Oregon law, however. An insurer cannot force its insured to choose between its claims and defenses in the liability case, on the one hand, and its insurance coverage on the other. *Wilson's Distrib. Serv., Inc.*, 138 Or App at 175. This court should adopt *Wilson's Distributing* as the inarguable law of this state.

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call it collusion. This would invariably become a fallback basis for denying claims.

A consistent theme emerges from Oregon Auto's brief: insureds simply cannot get there from here. West Hills respectfully asks this court to reject that proposition.

Proposed rule number 1:

> In deciding whether to defend a complaint, an insurer owes no duty to investigate the facts beyond those alleged on the face of the complaint. In other words, the insurer is not required to inquire whether facts outside of the pleading could result in covered liability.

As explained earlier in the brief, insurers do in fact have a duty to investigate, a duty recognized in both statute and case law. Further, Oregon Auto's request for a statement from this court that no such duty attaches in connection with *Shearer's* limited extrinsic evidence rule is clearly problematic, as the facts of this case powerfully demonstrate.

Oregon Auto cannot be faulted for lack of boldness. Its explicit-unequivocal-affirmative-allegations and no-extrinsic evidence rules would make Oregon an island, alone among the fifty states. And here, Oregon Auto asks for this court's license to remain willfully blind. As mentioned above, the very same Oregon Auto adjuster handled the coverage claims of L&T and West Hills. That adjuster undertook and controlled the defense of L&T, though he denied a defense to West Hills. What's more, that adjuster paid settlement monies on L&T's behalf. Obviously, this adjuster knew all about L&T's connection to the Arbor Terrace project; in fact, he was one of a handful of

persons to know with absolute certainty the single piece of extrinsic evidence fixing West Hills' entitlement to an insured defense under *Shearer*.

The same holds true for the HOA's amended complaints. Oregon Auto says West Hills cannot rely on them because West Hills did not send them to Oregon Auto. Whether that is true is not at all clear—as part of its third party practice West Hills clearly sent the amended complaints to L&T, who was being defended by Oregon Auto. Sending an amended pleading to the party receiving the insured defense versus the party providing the insured defense should be a distinction without a difference. In either case, the amended pleading sits conspicuously in the insurer's file, and that is the point. An insurer cannot ignore actual notice of claims against its insured. *See Zimmerman v. Allstate Prop. & Cas. Ins. Co.*, 354 Or 271, 281, 311 P3d 497 (2013) (holding in a separate but related context that insurers "operate under a duty to inquire"), and *Lusch v. Aetna Casualty & Surety Co.*, 272 Or 593, 599, 538 P2d 902 (1975) ("If notice from any source was sufficiently timely so that the insurer could adequately investigate and protect itself, thereby suffering no prejudice, the insurer is bound to fulfill its policy obligations.").

No insurer should rightfully play the ostrich. Oregon Auto cannot pretend to un-see or un-know what it has seen and what it knows. These are bedrock good faith and fair dealing principles, and there is presently no

incentive to honor them. For these reasons, the court should confirm every insurer's duty to investigate and recognize a special relationship between insurer and insured in the duty to defend determination.

Finally, a few comments about Oregon Auto's stated concern that, absent these proposed rules, insurers will be unfairly victimized by their insureds. With no citation to this record or any other, Oregon Auto posits that complaints not affirmatively alleging the date on which bodily injury or property damage occurs must mean it is "theoretically possible that [the injury or damage] occurred at any point in time." Opening Brief at 40. Therefore, the concern goes, every liability insurer the insured ever had from the beginning of time could be called upon to provide the insured a defense. *Id.* at 40-41. Respectfully, Oregon Auto is tilting at windmills.

Insureds do not tender claims on 2015 construction projects to their 1985 insurer, mostly because it is a waste of time and energy. The insurer will deny the claim, and the insured will not sue on that denial. Contractual good faith and fair dealing is a two-way street, and all complaints have filing dates. The statute of ultimate repose therefore presents an unavoidable deadline. ORCP 17 and ORS 20.105, moreover, provide compelling disincentives to the patently meritless claims Oregon Auto theorizes.

This case makes the point. As Oregon Auto has noted, the complaint in the underlying action did not allege the timing of property damage. Neither, for that matter, did West Hills' third-party complaint against numerous subcontractors. These third-party defendants in turn alleged claims against fourth-party defendants. This case even had a fifth-party and sixth-party defendant. *See* SER 55-56. If the indiscriminate tendering of complaints was a genuine problem, this record would provide an ideal springboard for the argument. Indeed, if Oregon's duty to defend rule, in place at least since this court's since 1969 decision in *Ferguson*, was being systematically abused by insureds, this court would have heard about it by now.[15]

On the opposite side of the ledger, by comparison, Oregon Auto's proposed rule would mean in this case that neither West Hills nor a single downstream defendant would be entitled to an insured defense. Despite purchasing defense coverage, every insured would pay its own way in the case. The competing equities are imbalanced, to say the least.

I. Conclusion

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[15] It bears repeating that Oregon Auto has never contended that it was not "on the risk" while the project was being built or after the project was complete- – the time when property damage could have occurred. Nor has Oregon Auto suggested that West Hills sought coverage from insurers whose policies had expired prior to construction of the project. The stated concern is completely hypothetical and, respectfully, strained beyond the breaking point.

West Hills respectfully asks this court to rule that Oregon Auto's arguments on appeal were not preserved. Alternatively, West Hills asks this court to do the following:

1. To reaffirm Oregon's eight corners rule as formulated in *Ledford* and to decline Oregon Auto's invitation to transform the rule so that an insured defense is beyond the insured's reach;

2. To adopt the Court of Appeals' reasoning and result in *Shearer*;

3. To hold that the clause "liability arising out of [L&T's] ongoing operations" is at least ambiguous under *Hoffman* and must therefore construed against Oregon Auto and in favor of coverage for West Hills;

4. Number 3. above notwithstanding, to hold that Oregon Auto owed West Hills a duty to defend; and

5. To confirm every insurer's duty to investigate and, owing to the extraordinary nature and critical importance of insurance, to recognize a special relationship between insurer and insured in the duty to defend determination;

On all accounts, West Hills respectfully asks that the judgments of the trial court and court of appeals be affirmed.

Date: July 14, 2016

Respectfully submitted,

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Certificate of Compliance with ORAP 5.05(2)(b)

Brief Length

I certify that (1) this brief complies with the 14,000 word limit for answering briefs in ORAP 5.05(2)(b)(i), and (2) the word count of this brief, as described in ORAP 5.05(2)(a), is12,885 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)(g).

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CERTIFICATE OF FILING AND SERVICE

I hereby certify that on July 14, 2016, I filed the original RESPONDENT'S ANSWERING BRIEF with the Appellate Court Administrator at the following address:

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I certify that on July 14, 2016, I served a true copy of RESPONDENT'S ANSWERING BRIEF via United States Postal Service, first class mail, unless served electronically, as indicated, to the following parties at the addresses set forth below:

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