IN THE SUPREME COURT OF THE STATE OF OREGON

WEST HILLS DEVELOPMENT COMPANY, an Oregon corporation,

Plaintiff – Respondent – Respondent on Review,

v.

CHARTIS CLAIMS, INC., et al.,

Defendant,

and

OREGON AUTOMOBILE INSURANCE COMPANY, an Oregon company,

Defendant – Appellant – Petitioner on Review.

OREGON AUTOMOBILE INSURANCE COMPANY, an Oregon company,

Third-Party Plaintiff,

v.

QUANTA SPECIALTY LINES INSURANCE COMPANY,

Third-Party Defendant.

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

Petitioner's Brief on the Merits

June 2016

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

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

Thomas M. Christ, OSB No. 834064
Cosgrave Vergeer Kester LLP
888 S.W. 5th Ave., 5th Floor
Portland, OR 97204
(503) 323-9000
tchrist@cosgravelaw.com

For Petitioner Oregon Automobile Insurance Company

Michael E. Farnell, OSB No. 922996
Emily Sarah Miller, OSB No. 034348
Parsons Farnell & Grein, LLP
1030 S.W. Morrison St.
Portland, OR 97205
(503) 222-1812
mfarnell@pfglaw.com
emiller@pfglaw.com

Peter J. Viteznik, OSB No. 944540
Kilmer Voorhees & Laurick PC
732 N.W. 19th Ave.
Portland, OR 97209
(503) 224-0055
pviteznik@kilmerlaw.com

For Respondent West Hills Development Company

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Rules

I. INTRODUCTION

This insurance dispute arises out of an earlier construction-defect lawsuit involving some townhomes in Sherwood. The plaintiff in this action, West Hills Development Company, or West Hills for short, was the general contractor for the townhomes and a defendant in the earlier action. West Hills tendered the defense of that action to the insurers for the subcontractors who worked on the townhomes, claiming it was an additional insured under their policies. When those insurers declined to defend, West Hills brought this action against them, alleging breach of contract. In time, West Hills settled with all of the insurers except one, Oregon Automobile Insurance Company, referred to hereafter as Oregon Auto. Following a trial on stipulated facts, the circuit court ruled that Oregon Auto owed West Hills a defense in the earlier action and, therefore, was obligated to reimburse West Hills for some of its defense costs. Oregon Auto appealed, seeking reversal, but the Court of Appeals affirmed. *West Hills Development Co. v. Chartis Claims*, 273 Or App 155, 359 P3d 339 (2015). It held that Oregon Auto owed a duty to defend because of "extrinsic evidence" of coverage, meaning evidence beyond the face of the complaint against West Hills in the earlier action. This court allowed review to determine whether the long-standing face-of-the-complaint rule still governs whether an insurer owes a defense in an action.

II. SUMMARY OF MATERIAL FACTS

This case was tried to the court on stipulated facts. No witnesses were called. So the material facts are those contained in the stipulation, ER 8-11, summarized here for the court's convenience:

In 2004, Oregon Auto issued a general liability policy to L & T Enterprises, Inc., dba Russell's Home Improvement, referred to hereafter as L & T. ER 8, ¶ 1; ER 17 (Ex 201, p 1). The policy was renewed annually through 2007. ER 8, ¶ 1 (Exs 202 and 203). It provided that Oregon Auto would pay all sums "the insured became legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies," meaning "bodily injury" or "property damage" that "occurs during the policy period." ER 18. It also provided that Oregon Auto would defend "the insured" against any suit seeking such damages. ER 18 (Ex 201, p 12).

An endorsement amended the definition of "insured" to include West Hills, but only for liability arising out of L & T's "ongoing operations for" West Hills:

"**Schedule**

"Name of Person or Organization:

"West Hills Development Co.

"* * * * *

"**A**. **Section II – Who Is An Insured** is amended to include as an Insured the person or organization shown in the schedule, but

> only with respect to liability arising out of [L & T's] ongoing operations performed for that insured."

ER 30 (Ex 201, p 30) (bold in original).

In 2009, after the policy expired, an association of homeowners in the Arbor Terrace townhomes in Sherwood filed a lawsuit against West Hills and others in Washington County Circuit Court, referred to here as the *Arbor Terrace* lawsuit. ER 8, ¶ 2; ER 33 (Ex 2, p 3). The complaint in that action alleged that West Hills "acted as developer and general contractor for the" townhomes, ER 38 (Ex 1, ¶ 9); that defects in the construction "had resulted in water intrusion and property damage to, among other things, siding, trims, sheathing, framing, and interior finishes," ER 39 and 41 (Ex 2, ¶¶ 12 and 16); and that the homeowners had suffered damages for repair costs, loss of use, and diminution in property value. ER 42 (Ex 2, ¶ 18).

The complaint alleged defects in the siding, the weather barrier beneath the siding, the trim, the flashing, the fasteners, and the sealants. ER 39-41. It also alleged:

> "**Insufficient Weatherproofing.** There is insufficient weatherproofing in some areas, such as at roof-to-wall transitions, and at *wood posts* supporting the soffits, which terminate on concrete grade topping without weatherproofing protection, all of which violate [provisions of the Oregon Structural Specialty Code]."

ER 40 (bold in original; italics added).

The complaint went on to allege a variety of necessary remedies, including replacement of the siding, water barriers, flashing, and windows, re-setting of the doors, and general repair of water-damaged materials and finishes. ER 41-42. It also alleged the need to

"(f) Re-clad *columns* with moisture tolerant assemblies[.]"

ER 41 (emphasis added).

Of particular importance for this case, the complaint alleged that all of the construction defects were the result of West Hills's negligence in various respects. ER 45 *et seq.* (Ex 2, ¶ 39 *et seq.*). It did not mention L & T, which had subcontracted with West Hills to perform some work on the project.

A few months later, West Hills sent a letter to Oregon Auto regarding the lawsuit. ER 8, ¶ 3; ER 31 (Ex 2, ¶ 3). The letter said that, as "an additional insured" under Oregon Auto's policy with L & T, West Hills "hereby tenders the defense and indemnity of this matter to" Oregon Auto. ER 31 (Ex 2, p 1). Included with the letter was a copy of the complaint in the lawsuit, nothing more. ER 9, ¶ 3; ER 33 *et seq.* (Ex 2, p 3 *et seq.*). The letter said that "your insured installed the front porch columns," but offered no evidence in support of that assertion.

Oregon Auto claims that it sent a letter to West Hills denying the tender of defense, but West Hills says that it never received it. ER 9, ¶ 5. In any event,

letter or no letter, Oregon Auto did not undertake to defend West Hills. Instead, West Hills defended itself, with help from its own insurers. ER 9, ¶ 6.

As part of that defense, West Hills filed a third-party complaint against L & T, and other subcontractors, alleging that the construction defects were caused by their negligence, not West Hills's. *See* Ex 8. Oregon Auto undertook to defend L & T against *that* complaint, ER 9, ¶ 4, but, again, did not defend West Hills against the homeowners' complaint.[1]

III. SUMMARY OF PROCEEDINGS

West Hills filed this action against Oregon Auto and six other insurers, alleging that each of them owed a duty, along with West Hills's own insurers, to defend West Hills in the *Arbor Terrace* lawsuit. After settling with the others, West Hills continued on against Oregon Auto only, seeking a proportional share, *i.e.*, one-eighth, of its defense costs in the underlying lawsuit, which worked out to $28,884.42. ER 10, ¶ 7.[2]

---

[1] Still later, the homeowners amended their complaint, Ex 6, and then amended it again, Ex 7. But West Hills did not tender those complaints to Oregon Auto to defend.

[2] All but 11 percent of those costs were actually incurred by plaintiff's two insurers, not by plaintiff itself. ER 10, ¶ 7. One of those insurers, however, assigned to plaintiff its right, if any, to recover those costs, *id.*, and the other ratified plaintiff's attempt to recover them. OJIN 107.

At trial, Oregon Auto argued that it owed no duty to defend West Hills in the *Arbor Terrace* lawsuit, because the complaint in that case did not allege that West Hills was liable for property damage arising out of L & T's operations, let alone its "ongoing" operations, and, therefore, did not allege facts which, if proved, would establish that West Hills was an "insured" under Oregon Auto's policy with L & T for purposes of that lawsuit. It also argued that West Hills did not present any "extrinsic evidence" to prove the missing allegations. Tr 48-56; Def. Ore. Auto. Ins. Co.'s Trial Brief (OJIN 110), pp 3-10. The trial court rejected those arguments in a letter opinion that reads, in part, as follows:

> "I have come to the conclusion that this is really a very simple case. Under Oregon law, on the issue of a duty to defend, the court is required to impose such a duty unless it is all but crystal clear that the policy does not impose coverage based on any allegation in the complaint. In this case, I do not read the policy, nor see any evidence supporting any obvious clarity of non-coverage in the complaint; accordingly, [Oregon Auto] has a duty to defend [West Hills].
>
> "The first issue to clear up is whether [West Hills] was an 'insured' under Russell's [sic] Home Improvement (hereafter Russell) Additional Insured policy. To determine if [West Hills] was an 'insured' under the policy the court looks at the policy and the complaint, and if necessary, extrinsic evidence. * * * If the policy can be remotely construed in favor of coverage, then [West Hills] is an 'insured.' That is the case here. One could read the policy to only apply if the property damage alleged[ly] occurred during actual on-going work by Russell. However, one could also read the policy to cover work that was done during on-going operations that lead to the alleged damage. Accordingly, [West Hills] is an 'insured.'
>
> "The next step is to determine whether or not Russell's insurer, Oregon Automobile Insurance Company * * * owed

> West Hills a duty to defend in the underlying lawsuit filed by the Arbor Terrace Homeowners Association * * *. Similar to the analysis above, unless it is clear-cut that the coverage does not include damages alleged in the complaint, Oregon Auto had a duty to defend West Hills. * * *
>
> "The complaint [in the Arbor Terrace lawsuit] included allegations that West Hills supervised subcontractors and there was damage to improperly constructed porch columns. * * * Russell was the subcontractor that worked on the porch columns during the time in which [Oregon Auto] was providing coverage for Russell, and through the additional insured endorsement for West Hills. That means there is a possibility from the complaint that West Hills could be liable for work performed on the porch columns by Russell. That all leads to [Oregon Auto] having a duty to defend."

ER 12-13 (endnote and citations omitted).

In sum, the court found a duty to defend because it didn't find "any evidence supporting any obvious clarity of non-coverage in the [homeowners'] complaint" against West Hills. That complaint, the court noted, alleged that West Hills had "supervised subcontractors" on the Arbor Terrace project and also alleged that there was some "damage to improperly constructed porch columns." The court went on to say that L & T "was the subcontractor that worked on the porch columns," although it didn't explain the basis for that assertion, which, as noted above, isn't alleged in the homeowner's complaint. In any event, the court said, this "all leads to [Oregon Auto] having a duty to defend."

The court then ruled that Oregon Auto owed West Hills a defense in the *Arbor Terrace* lawsuit, and that West Hills was entitled to recover $28,884.42 in

damages from Oregon Auto for its share of the defense costs. *See* Order (OJIN 119), p 2. The court entered a judgment consistent with those rulings, ER 15, and Oregon Auto appealed.

On appeal, Oregon Auto argued, again, that it had no duty to defend West Hills against the homeowners, because their complaint did not allege liability covered by the additional-insured endorsement – in particular, did not allege that West Hills was liable for property damage caused by L & T's negligence, let alone L & T's negligence from "ongoing operations" for West Hills. Oregon Auto stressed that the complaint, on its face, did not identify L & T, did not mention defects in its work, and did not assert that any of the property damage occurred before L & T's operations were completed. *West Hills*, 273 Or App at 161.

The Court of Appeals affirmed. It said that Oregon Auto should have deduced from the complaint, the tender letter, and some other "reasonable inquiry," including perhaps "a telephone call to its named insured" or "a review of the subcontract between West Hills and L & T," that L & T's negligence may have been the cause of the defects alleged in the complaint – the "insufficient weatherproofing" of the "wood posts" and the need to "re-clad" the "columns." 273 Or App at 164-65. (That conclusion was based, apparently, on the court's unsupported assumption that the "wood posts" and the "columns" are one and the same, and also the same as the "porch columns" mentioned in the tender letter, and

that Oregon Auto did not in fact place a call to L & T or otherwise inquire about those matters.) The court thus held that, taken together, the complaint and tender letter "fairly apprised" Oregon Auto that West Hills's liability was based, at least in part, on the negligence of L & T, not of West Hills itself or some other subcontractor, thus triggering Oregon Auto's duty to defend. 273 Or App at 165.

The court went on to say that Oregon Auto owed a duty to defend West Hills, even if it was insured, as Oregon Auto contends, only for property damage that occurred during L & T's "ongoing operations" for West Hills, meaning while L & T was still working for West Hills, because, the court said, "[t]he complaint does not *rule out* the possibility that damage occurred before L & T finished" its work. 273 Or App at 167 (emphasis in original).[3]

---

[3] West Hills disputed Oregon Auto's interpretation of the "ongoing operations" requirement in the additional-insured endorsement. According to West Hills, the additional insured's liability arises out of the named insured's "ongoing operations" for the additional insured whenever the alleged property damage is *caused* by the named insured's negligence *during* those operations, even if the property damage itself does not occur until long after the operations have ended – as where the careless installation of siding or flashing results in rainwater intrusion years later. In other words, West Hills argued that "ongoing" has a causal, not a temporal, connotation, and, therefore, that the endorsement covers West Hills's liability for defects in construction from L & T's work that resulted in water intrusion after L & T left the jobsite. The Court of Appeals did not decide what "ongoing" meant in this context. 273 Or App at 166. Instead, it assumed that it meant what Oregon Auto said – that the property damage had to occur during the construction. But, as noted, the court concluded that Oregon Auto still had to defend West Hills, because the homeowners' complaint did not rule out the possibility of property damage occurring then.

On review, Oregon Auto contends that the Court of Appeals erred in two respects: first, in holding that Oregon Auto should have looked beyond the face of the complaint against West Hills in determining whether it owed a duty to defend; and, second, in concluding that Oregon Auto owed a duty to defend if the complaint did not *rule out* the possibility of property damage while L & T's operations were ongoing, instead of concluding that Oregon Auto did *not* owe a duty to defend *unless* the complaint *ruled in* that possibility by alleging that the damage did occur then.

IV. QUESTIONS PRESENTED

(1) In deciding whether to defend a complaint, does an insurer owe a duty to investigate the facts beyond those allege on the face of the complaint? In other words, is the insurer required to inquire whether facts outside of that pleading could result in covered liability?

(2) Is an insurer required to defend any complaint that does not *rule out* the possibility of covered liability? Or is it required to defend only when the complaint *rules in* that possibility?

V. PROPOSED RULES

(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.

(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.

VI. ARGUMENT

The Court of Appeals erred in concluding that Oregon Auto was required to look beyond the face of the complaint in determining whether it owed a duty to defend West Hills, and erred again in concluding that it owed a duty to defend if the complaint did not *rule out* the possibility of property damage while L & T's operations were ongoing, instead of concluding that it owed no duty to defend *unless* the complaint *ruled in* that possibility.

A. The Face-of-the-Complaint Rule, and the Face of this Complaint

In *Ledford v. Gutoski*, 319 Or 397, 399, 877 P2d 80 (1994), Oregon's most-often-cited insurance case, this court explained that "whether an insurer has a duty

to defend a lawsuit depends on two documents: the complaint and the insurance policy." The insurer must defend, the court said, "if the claim against the insured stated in the complaint could, without amendment, impose liability for conduct covered by the policy." *Id.* at 399-400. The court elaborated on that point as follows:

> "In evaluating whether an insurer has a duty to defend, *the court looks only at the facts alleged in the complaint* to determine whether they provide a basis for recovery that could be covered by the policy:
>
> > "'If the facts alleged in the complaint against the insured do not fall within the coverage of the policy, the insurer should not have the obligation to defend. If a contrary rule were adopted, requiring the insurer to take note of facts other than those alleged, the insurer frequently would be required to speculate upon whether the facts alleged could be proved. We do not think this is a reasonable interpretation of the bargain to defend. It is more reasonable to assume that the parties bargained for the insurer's participation in the lawsuit only if the action brought by the third party, if successful, would impose liability upon the insurer to indemnify the insured.' * * *
>
> "An insurer should be able to determine *from the face of the complaint* whether to accept or reject the tender of the defense of the action. * * *"

Id. at 400 (citations omitted; emphasis added).

Ledford describes what is often called the "face-of-the-complaint" or "eight-corners" rule, which provides that an insurer's duty to defend a complaint must be found within the four corners of its policy and the four corners of the complaint;

matters beyond those documents are immaterial for duty-to-defend purposes. *See Ferguson v. Birmingham Fire Ins.*, 254 Or 496, 505-06, 460 P2d 342 (1969) ("The insurer's knowledge of facts not alleged in the complaint is irrelevant in determining the existence of the duty to defend and consequently the insurer need not speculate as to what the 'actual facts' of the alleged occurrence may be."); *Blohm v. Glens Falls Ins. Co.*, 231 Or 410, 417-18, 373 P2d 412 (1962) ("[W]e are not permitted to indulge in what the ultimate facts may show which might or might not bring the incident within the liability terms of the policy[.]").[4]

As discussed above, the policy in this case provides that Oregon Auto will defend and pay any claim against an "insured" for "bodily injury" or "property damage," subject to various term, conditions, limitations, and exclusions. ER 18 (Ex 201, p 12). Thus, for duty-to-defend purposes, the threshold question is whether West Hills is an "insured." The policy defines that term to include the "named insured," *i.e.*, L & T, as well as L & T's officers and employees, ER 22 (Ex 201, p 20), but an endorsement amends the definition to include West Hills for certain limited purposes. To be precise, West Hills is an insured "only with respect to liability arising out of [L & T's] ongoing operations performed for" West Hills.

---

[4] The rule has sometimes been called the "four-corners rule," referring to the four corners of *each* of the two pertinent documents – the complaint and the policy. *See, e.g., Fred Shearer & Sons, Inc. v. Gemini Insurance Co.*, 237 Or App 468, 474, 240 P3d 67 (2010), *rev den*, 349 Or 602 (2011).

ER 30 (Ex 201, p 30). Thus, the question whether Oregon Auto owed a duty to defend West Hills in the *Arbor Terraces* lawsuit turns on another question: whether the complaint in that case alleges liability arising out of L & T's ongoing operations for West Hills. As explained below, the answer to the second question is no and, hence, so is the answer to the first question.

The complaint in the *Arbor Terrace* lawsuit alleged that West Hills was the developer and general contractor of the Arbor Terrace townhomes, which are suffering rainwater intrusion from a variety of defects in construction involving the siding, trim, sheathing, flashing, sealants, and fasteners, collectively referred to as the "building envelope." ER 38-40. The complaint also alleged that the defects were the result of West Hills's "actions and inaction," ER 42 (¶ 18), including its negligence, ER 45 (¶ 39 *et seq.*), and negligence *per se*, ER 49 (¶ 48 *et seq.*). It did *not* allege that L & T's negligence contributed to the property damage, let alone its negligence in "ongoing" operations for West Hills. Nor did it allege that West Hills is vicariously liable for L & T's negligence, which, this court has said, is a theory of recovery that has to be pled specifically. *See Holger v. Irish*, 316 Or 402, 405-09, 851 P2d 1122 (1993). Indeed, the complaint did not even mention L & T. On its face, then, the complaint did not allege liability covered by the additional-insured endorsement – that is, "liability arising out of [L & T's] ongoing operations performed for" West Hills. It follows that Oregon Auto owed no duty

to defend West Hills in the underlying case. *See McKee v. Allstate Ins. Co.*, 246 Or 517, 519-20, 426 P 456 (1967) (insurer owed no duty, under policy covering vicarious-liability claims, to defend claim that didn't allege vicarious liability, even though insurer knew of unalleged facts that would have supported such a claim).

1. The *Shearer* Exception to the Face-of-the-Complaint Rule

In the trial court proceedings, West Hills argued that its liability in the *Arbor Terrace* lawsuit was based, at least in part, on L & T's faulty work on some of the townhomes. The trial court bought that argument. "The [*Arbor Terrace*] complaint," the court said, "included allegations that West Hills supervised subcontractors and there was damage to improperly constructed porch columns." ER 13. And, the court continued, "Russell [*i.e.*, L & T] was the subcontractor that worked on the porch columns * * *." *Id.*

In fact, the complaint did *not* allege that there was damage to "improperly-constructed porch columns." That was not among the defects described in that pleading. *See* ER 39-40 (Ex 2, ¶ 14).[5] More importantly, the complaint did not

[5] The complaint *did* allege problems with the "weatherproofing" of unspecified "wood posts," ER 40 (¶ 14(e)), and the "cladding" of unspecified "columns." ER 41 (¶ 17(f)). But the wood posts and the columns are not necessarily the same thing. Nothing in the complaint says they are. And, in any event, the installation and weatherproofing of posts and columns are not the same thing either. In the typical construction project, the framer installs, *i.e.*, erects, the posts and columns, and the sider weatherproofs them by affixing the cladding.

allege that L & T constructed the porch columns. That fact, if it is a fact, is outside of the complaint, which, again, does not even mention L & T.

At trial, West Hills argued that even if the complaint, on its face, did not connect West Hills's liability to L & T's ongoing operations, a connection was established by "extrinsic" evidence, meaning evidence outside of the complaint, and that such evidence falls within the exception to the face-of-the-complaint rule established in *Fred Shearer & Sons, Inc. v. Gemini Insurance Co.*, 237 Or App 468, 240 P3d 67 (2010), *rev den*, 349 Or 602 (2011). This court, of course, hasn't endorsed the *Shearer* exception to the face-of-the-complaint rule, and there are good reasons not to, discussed below. In any event, the exception is not as broad as West Hills contends and, more importantly, is not so broad as to apply here.

2. *Shearer* Explained

Shearer involved stucco products that Fred Shearer & Sons, Inc. (Shearer) sold and installed on the exterior of a home under construction. When the stucco cracked, the homeowners sued the general contractor, which, in turn, filed a third-party complaint against Shearer. Shearer tendered its defense to Gemini, which insured TransMineral, a distributor of the product. Shearer argued that it was insured under Gemini's policy by virtue of an endorsement (titled "Additional Insured—Vendors"), which amended the term "insured" to include "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." 237 Or App at 472. Gemini did not dispute that Shearer was in fact a vendor of TransMineral products, or that the claim against it arose out of the regular-course sale or distribution of those products. Instead, it made what the Court of Appeals described as "a more technical argument," which is that "it is impossible to tell *from the pleadings in the underlying action or the policy language* that Shearer sold or distributed the stucco product in the ordinary course of business." *Id.* at 474 (emphasis added); *see also id.* at 478 n 9. "In Gemini's view," the court continued, "the four corners of those documents – that is, the pleadings and the insurance policy – exclusively govern whether Gemini owes any duty to defend." *Id.*

The court rejected the argument thus construed, concluding that the face-of-the-complaint rule concerns only whether the complaint alleges conduct covered by the policy. It is "not concerned," the court said, "with the preliminary question: whether the party seeking coverage was actually an *insured* within the meaning of the policy." *Id.* at 476 (emphasis in original). The court explained that "[w]hen the question is whether the insured is being held liable for conduct that falls within the scope of a policy, it makes sense to look exclusively to the underlying complaint," because "[t]hat complaint sets the boundaries of the insured's liability,

and, as the court reasoned in *Isenhart*, '[i]f a contrary rule were adopted, requiring the insurer to take note of facts other than those alleged, the insurer frequently would be required to speculate upon whether the facts alleged could be proved.'" *Id.* (quoting *Isenhart*, 233 Or at 54).

"The same cannot be said," the court continued, "with respect to whether a party seeking coverage is an 'insured,'" because the facts relevant to "insured" status, including facts relating to the party's relationship to the named insured, might not be relevant to the merits of the West Hills's case in the underlying litigation. *Id.* at 477. In the usual case, the court explained, "[t]he plaintiff in the underlying case is required to plead facts that establish the defendant's liability," but "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." *Id.* The court went on: "In this case, for example, the [homeowners] had no reason to allege that Shearer sold or distributed TransMineral's products in the ordinary course of its business," nor did [the general contractor] need to allege that fact in order to make out its third-party claim against Shearer." *Id.* The court thus concluded that, for duty-to-defend purposes, there was "no 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." *Id.*

3. The problems with *Shearer*

The main problem with *Shearer's* exception to the face-of-the-complaint rule is that, in many cases, perhaps most, it will prove unworkable. The exception worked in *Shearer* only because there was not dispute in that case about what the extrinsic evidence showed. As noted above, Gemini did not dispute the facts that made Shearer an additional insured – that it was a distributor of TransMineral products in the ordinary course of business, including the products installed in the home at issue in that case. *Id.* at 474; *see also id.* at 478 n 9. But what if Gemini *had* disputed those facts? *Shearer* doesn't explain how the dispute would be resolved, and by whom, in deciding whether Gemini owed a duty to defend.

If the door is opened to the use of extrinsic evidence in determining and insurer's defense obligations, then, necessarily, there has to be a procedure for deciding what the evidence proves in cases where the evidence is not as clear cut as it was in *Shearer* or, worse, is in conflict. What happens when there is extrinsic evidence for and against a coverage-relevant fact? In *Shearer*, for example, what if one witness, perhaps even a non-disinterested witness, like Mr. Shearer himself, said that Shearer was a distributor of TransMineral products, but another witness, perhaps someone at TransMineral, said that it was not. Is there supposed to be a mini-trial on the coverage-relevant facts, before the trial in the underlying case in

order to determine whether the insurer must undertake to defend that case; or is the insurer supposed to guess at which witness is right?

It's worth remembering that the face-of-the-complaint rule was designed to avoid just that sort of guesswork. In *Isenhart*, this court noted that "[t]here is some authority for the view that in determining whether it has a duty to defend the insurer must look beyond the allegations of the complaint filed against the insured and if the actual facts are such as to bring the case within the coverage of the policy, the insurer must accept the tender of defense." 233 Or at 54. Nevertheless, the court continued, "[t]he contrary view has been adopted in this state." *Id.* And, upon reflection, the court decided to "adhere to" that "contrary view," because, it said, requiring the insurer to notice facts other than those alleged would force it to "speculate upon whether the facts alleged could be proved," and the court did not think that was "a reasonable interpretation of the bargain to defend." *Id.*; *see also Ferguson*, 254 Or at 505-06 ("the insurer need not speculate as to what the 'actual facts' of the alleged occurrence may be").

Shearer did not have to deal with the problem of uncertainty or conflict in the extrinsic evidence, given the posture of that case and the insurer's "technical argument" there. 237 Or App at 474. This court, however, has to look at the bigger picture and consider the many, future cases in which that problem will inevitably arise.

In Oregon Auto's view, the court should reject *Shearer's* exception to the face-of-the-complaint rule, and not just because the exception doesn't work in cases where, unlike *Shearer*, the parties don't agree on what the extrinsic evidence shows. More than that, *Shearer* seems to be a solution in search of a problem. The face-of-the-complaint rule has been the law in Oregon for at least 60 years, since *MacDonald v. United Pacific Insurance Co.*, 210 Or 395, 311 P2d 425 (1957), if not earlier, and there is no reason to believe that it hasn't served us well all that time. It's a simple rule that is quick and easy to apply. Lawyers and judges are familiar with it, and insurers and insureds have come to depend on it. There is no question but that insurers have relied on the rule to anticipate future defense costs, and anticipated defense costs figure in the calculation of premiums. In short, the rule is baked into Oregon insurance law, and there is no evidence of any systemic problems with it. There is no cause, then, for creating what could turn out to be a huge exception, depending on some yet unsettled questions.[6]

[6] In addition to the question noted earlier – how do you resolve conflicts in the extrinsic evidence? – there are questions about what qualifies as extrinsic evidence for these purposes. For example, does it actually have to be evidence – that is, something admissible in court? The Court of Appeals suggested not, but didn't explain why. *See West Hills*, 273 Or App at 164. Another important question is whether extrinsic evidence is available to contradict "facts" alleged in the complaint and to resolve ambiguities in those facts, or whether it is only available to settle issues on which the complaint is silent.

Stare decisis is an important doctrine in Oregon, as this court recently explained:

> "Stability and predictability are important values in the law; individuals and institutions act in reliance on this court's decisions, and to frustrate reasonable expectations based on prior decisions creates the potential for uncertainty and unfairness. Moreover, lower courts depend on consistency in this court's decisions in deciding the myriad cases that come before them. Few legal principles are so central to our tradition as the concept that courts should '[t]reat like cases alike,' * * *, and *stare decisis* is one means of advancing that goal. * * *"

See Farmers Ins. Co. v. Mowry, 350 Or 686, 698, 261 P3d 1 (2011).

"In the area of commercial transactions," stability and predictability are all the more important, because parties "rely on the rules of law announced by this court to structure [those] transactions, and this court should not upend those expectations without sufficient reason." *Id.* at 700-01. Accordingly, this court, in *Mowry*, declined to overturn a twenty-year-old insurance case, even though it might have decided that case differently if it "[w]ere writing on a blank slate." *Id.* at 700. One reason, the court said was that the case had been relied on by so many insurers in drafting, marketing, and pricing policies.[7] For the same reason, this

[7] Three justices in *Mowry* were concerned about the ruling in the earlier case, but were convinced that it was erroneous, but they, too, declined to overturn it for fear that would "upset the reasonable expectations of [the plaintiff insurer] and, presumably, other insurers." *See* 350 Or at 714 (Durham, J., specially concurring).

court should decline to create an exception to the long-standing and familiar face-of-the-complaint rule.

It's worth noting, by the way, that even though, in this particular case, an insurer is relying on the face-of-the-complaint rule, it is primarily a pro-insured rule. That's because the insurer has no control over the face of the complaint. The complaint is controlled, mostly, by the plaintiff, and the plaintiff, like the insured, wants there to be coverage for the claim, so there will be insurance money to pay any settlement or judgment. Accordingly, most plaintiffs try to plead their way into coverage, and modern pleading rules make that easy to do, because they no longer require verification, *see* ORCP 17 A, or consistency, *see* ORCP 16 C, and they direct the courts to liberally construe all pleadings and disregard all non-substantial defects, *see* ORCP 12 A and B. The insured, too, has some control over the face of the complaint, because, as the defendant in the case, the insured can move the court to strike certain allegations or to make others more definite and certain. *See* ORCP 21 D and E. But the insured, of course, wants coverage and thus won't move against any coverage-triggering allegations, even if groundless. The insurer, on the other hand, is not a party to the case and thus can't do anything about the face of the complaint, even if the "facts" alleged there are demonstrably untrue based on extrinsic evidence that is readily available and incontrovertible. Under the face-of-the-complaint rule, the insurer has no choice but to grin and bear

it and undertake to defend. Even when the complaint is ambiguous – alleging both coverage-triggering "facts" and coverage-defeating "facts" – the insurer still has to defend, because, under the face-of-the-complaint rule, "[a]ny ambiguity in the complaint with respect to whether the allegations could be covered is resolved in favor of the insured." *See Ledford*, 319 or at 400. Thus, more often than not, the face-of-the-complaint rule benefits the insured rather than the insurer.[8]

That's not to say that insurers don't support the rule. They do, not only because it's familiar, but also because it provides certainty for an important part of their job. When a new lawsuit comes in, the first decision the insurer has to make – and make quickly – is whether to defend. Until now, insurers made that decision the way this court has repeatedly said they should – by looking at two documents, the complaint and the policy, often the only documents at hand, and comparing the

[8] For a brief period long ago, the face-of-the-complaint rule was a one-way street. In *Williams v. Farmers Mut. of Enumclaw*, 245 Or 557, 423 P2d 518 (1967), the court held that an insurer could rely on extrinsic facts in refusing to defend a complaint which alleged facts within coverage, but in *McKee*, 246 Or at 519-20, decided a couple months later, the court rejected an argument for "the converse of the proposition: that an insured should also be entitled to plead facts not pleaded in the original complaint and prove, if he can, a version of facts that would fall within the coverage of the policy." The holding in *Williams* was based on the conflict of interest that arises when an insurer defends a potentially uncovered claim under a reservation of rights. 245 Or at 561. That conflict disappeared, however, when *Ferguson* held that neither the insurer nor the insured is precluded by the judgment in a case defended under an ROR. *See Ferguson*, 254 Or at 509-10. To that extent, *Ferguson* modified *Williams*, making the face-of-the-complaint rule apply the same to insurers as insureds. *See Casey v. N. W. Security Ins. Co.*, 260 Or 485, 489, 491 P2d 208 (1971) (explaining *Ferguson's* effect on *Williams*).

allegations of the one to the terms of the other. *E.g.*, *Bresee Homes, Inc. v. Farmers Ins. Exch.*, 353 Or 112, 116, 293 P3d 1036 (2012) ("This court examines two documents to determine whether an insurer has a duty to defend an action against its insured: the insurance policy and the complaint in the action against the insured."); *Marleau v. Truck Ins. Exch.*, 333 Or 82, 89, 37 P3d 148 (2001) ("To answer that [duty-to-defend] question, we must examine two documents: the insurance policy and Parletts' complaint."); *Oakridge Community. Ambulance v. U. S. Fidelity.*, 278 Or 21, 24, 563 P2d 164 (1977) ("Insured's duty to defend depends on two documents: (1) the insurance policy, and (2) the Laskey complaint."). The Court of Appeals decisions in this case and *Shearer* add uncertainty into that process. Now, the insurer has to look beyond those two documents – to what exactly, it's not clear. The insurer also has to consider whatever extrinsic evidence the insured presents, and whatever evidence its own investigation comes up with (more on that below), and any conflict in that evidence has to be resolved somehow – how exactly is also unclear. All of this will delay and complicate what has been – and needs to be – a quick, simple, and predictable process. Accordingly, insurers prefer the old duty-to-defend rules, which do not require a defense when the complaint, on its face, doesn't allege "facts" within coverage.

4. The limits of the *Shearer*

Even if this court were to endorse the *Shearer* exception, it would not help West Hills in this case. The exception is not as broad as West Hills contends, and not so broad as to create a duty to defend in this instance.

The issue in *Shearer*, the court will recall, was whether Shearer was a distributor of the TransMineral's products; if so, then Shearer was an additional insured under an endorsement to Gemini's policy. As it happens, that same issue – whether Shearer was a TransMineral distributor – was not also an issue in the underlying case. Whether Shearer was a distributor within the meaning of the endorsement had nothing to do with whether Shearer was negligent in installing a particular product on the plaintiffs' house. Whatever its relationship to TransMineral, Shearer would still be liable to the plaintiffs if its installation was negligent.

In this case, by comparison, the issue whether West Hills is an insured under Oregon Auto's policy with L & T is wrapped up in the merits of the underlying case. As explained above, the additional-insured issue turns on whether West Hills's liability to the Arbor Terrace homeowners arose out of L & T's negligence, as opposed to West Hills's own negligence or the negligence of other subcontractors, which is the main issue in the underlying case. The Arbor Terrace homeowners alleged that their damages were caused by the negligence of West

Hills, as general contractor, and not the by the negligence, if any, of L & T, which, again, isn't even mentioned in the homeowners' pleadings.[9] West Hills denied that allegation and, by third-party complaint, alleged that the damages were caused not by its negligence but rather by L & T's (among others) and, therefore, that L & T's should indemnify it for any damages owed to the homeowners. Thus, in this situation, unlike in *Shearer*, the coverage and liability issues are essentially the same: Did West Hills's negligence or L & T's negligence cause the construction defects? Was the problem L & T's work, or West Hills's instructions and supervision?

Shearer itself recognized that extrinsic evidence is not available to prove a fact that is relevant to coverage for the underlying case, if the same fact is also relevant to liability in that case – a fact that will be litigated in the impending trial of that case. For facts that are coverage-relevant but not also liability-relevant, it's possible to look beyond the face of the complaint. But for facts that are both

[9] The complaint alleged that West Hills was liable, in part, for *its* negligence in "[f]ailing to properly coordinate, schedule, oversee, inspect and supervise contractors, subcontractors, and other workers." ER 47 (¶ 44(f)). But that is not the same thing as alleging that West Hills was vicariously liable for the negligence of the subs – a theory of liability that, as noted earlier, has to be pled specifically. *Holger*, 316 Or at 405-09. There is a difference between the sub installing something the wrong way and the general telling the sub the wrong way to install it. That is often the main issue in a construction-defect lawsuits: did the sub make a mistake in following instructions, or were the instructions themselves mistaken?

coverage- *and* liability-relevant, the face of the complaint should control. 237 Or App at 477.

To illustrate this proposition, consider a complaint which alleges that the defendant, driving carelessly, caused an accident in which the plaintiff was injured. It turns out that the defendant has two cars, one insured by Insurer A, the other by Insurer B. The complaint, however, doesn't allege which car the defendant was driving at the time of the accident, because that is irrelevant to the case – the defendant would be liable whichever car he was driving. For coverage purposes, however, *which car* is all-important. In these circumstances, the face-of-the-complaint rule might not prevent a court from relying on extrinsic evidence – the police report, for example – to determine which car was involved in the accident and, hence, which insurer, A or B, covers the loss and must defend. The New Jersey Supreme Court reached that very conclusion in a case that *Shearer* itself cited with approval:

> "[W]hen coverage * * * depends upon a factual issue which will not be resolved by the trial of the third party's suit against the insured, the duty to defend may depend upon the actual facts and not upon the allegations in the complaint. So, for example, if a policy covered a Ford but not a Chevrolet also owned by the insured, the carrier would not be obligated to defend a third party's complaint against the insured which alleged the automobile involved was the Ford when in fact the car involved was the Chevrolet. The identity of the car, upon which coverage depends, would be irrelevant to the trial of the negligence action."

Burd v. Sussex Mutual Insurance Company, 56 NJ 383, 388, 267 A2d 7 (1970) (quoted in *Shearer*, 237 Or App at 477).

The same result would obtain if, in the hypothetical above, the defendant had just one car, which he insured first with A and later with B. If the complaint did not allege the date of the accident, the court could look to extrinsic evidence – the police report, again – to determine which of them, A or B, was on the risk at the time of the loss and thus owed a defense, because that is a coverage-relevant but not liability-relevant fact. The defendant would be liable if he drove carelessly, causing an accident, no matter when that happened.

Problems arise when coverage and liability turn on the same disputed "facts." In that situation, coverage won't be resolved until liability is resolved, and liability won't be resolved until the verdict in the underlying case, by which time there is nothing left to defend. Take, for example, a personal injury lawsuit in which the complaint alleges that the insured acted with the intent to cause harm, which, if true, would mean there is no coverage, because most policies have an exclusion for intentional acts. In that situation, the coverage issue and the liability issue are the same: Did the insured act maliciously, or just carelessly, or not even that? That won't be decided until the jury returns its verdict in the injury case. By

then, however, a determination of coverage would be of little use – the time to defend having passed.[10]

Considerations of this sort led to the face-of-the-complaint rule and should circumscribe *Shearer's* exception to it. Thus, in cases like *Shearer*, where coverage and liability turn on different facts, the rationale for the rule applies with less force and there is less need for restrictions on the use of extrinsic evidence in determining the duty to defend. In such cases, the verdict in the underlying case will not resolve the coverage dispute and, hence, there may be no reason to wait for it. But in other cases, like this one, where coverage and liability turn on the same facts, which are in disputed in the underlying case, the *Shearer* exception shouldn't apply.

In this case, then, West Hills could not rely on extrinsic evidence – assuming it had any; remember: it didn't offer any with its tender of defense – to establish coverage-relevant facts for duty-to-defend purposes. It was limited, instead, to the

---

[10] It's unlikely that the intent-to-harm issue could be decided in a coverage action while the injury action is still pending and defensible because the coverage action is usually filed after the injury action and might not even be justiciable if filed beforehand, when there is nothing yet to defend. *See State Farm Fire & Cas. v. Reuter*, 294 Or 446, 448, 657 P2d 1231 (1983) (action to determine insurer's duty to defend presents a justiciable controversy when there is an action that needs defending); *compare Hale v. Fireman's Fund Ins. Co., et al.*, 209 Or 99, 302 P2d 1010 (1956) (action to determine insurer's duty to indemnify is not ripe before judgment or settlement of claim against insured); *see also Menasha Forest Products Corp. v. Curry County Title, Inc.*, 234 Or App 115, 227 P3d 770 (2010), *aff'd in part, rev'd in part on other grounds*, 350 Or 81, 249 P3d 1265 (2011) (explaining *Reuter* and *Hale*).

allegations of the complaint, and those allegations did not connect West Hills's liability to L & T's negligence, which, as explained above, is the key to coverage under the additional-insured endorsement. Therefore, even under *Shearer*, Oregon Auto owed no duty to defend West Hills.

That conclusion is supported by this court's decision in *Bresee Homes*. That case, like this one, arose out of an action against a contractor for alleged defects in constructing a house, allowing rainwater to intrude and damage the structure. The contractor was insured under a policy that, in usual fashion, "consist[ed] of a broad insuring agreement stating the insurer's promise to pay specified damages and to defend the insured against claims brought against the insured to recover those damages," followed by "[a] list of exclusions from coverage." 353 Or at 117. One of the exclusions, contained in an endorsement, applied to property damage "included in the 'products - completed operations hazard,'" *id.* at 121, meaning property damage occurring away from the contractor's premises and after its work had been completed or abandoned. *Id.* at 118-19.

This court held that the insurer owed a duty to defend the contractor, because the complaint did not allege "whether the claimed damages * * * occurred before or after the completion of [the contractor's] work." *Id.* at 122. The court explained: "From all that appears from a reading of the complaint, the described property damage occurred, or could have occurred, when [the contractor's] work

was neither completed nor 'deemed complete' under the 'products-completed operations hazard,' as defined in the policy." *Id.*

The court went on to reject the insurer's reliance on extrinsic evidence to prove what would be a coverage-defeating fact under the exclusion – *i.e.*, that the property damage occurred after the contractor left the jobsite. *Id.* at 124-25. That fact, the court explained, was irrelevant to the duty-to-defend inquiry, not only because it was outside the complaint, but also because it was an issue in the underlying case: "When [the contractor] tendered the [homeowners'] complaint for defense, the factual question of whether the claimed damages had occurred before or after completion of [the contractor's] work was an issue that the litigation between the [homeowners] and [the contractor] might determine[.]" *Id.* at 123-24.

So, too, here. In this case, the coverage-relevant fact is whether West Hill's liability in the *Arbor Terrace* lawsuit arose out of L & T's ongoing operations. But that "fact" was not alleged in the complaint tendered to Oregon Auto. What is more, that very "fact" was an issue in that very lawsuit. As explained above, West Hills alleged, in a third-party complaint, that the property damage to the Arbor Terraces townhomes was not the result of its negligence, as the homeowners alleged in the complaint in chief, but rather the negligence of L & T and other subs. In their answers, however, L & T and the other subs denied that allegation,

putting in issue whether West Hills's liability arises out of L & T's negligence or its own.

In this case, as in *Bresee Homes*, the coverage-relevant fact is not just outside of the complaint in the underlying case, it is also an issue in that case. Thus, even under *Shearer*, extrinsic evidence could not decide the duty-to-defend question.

5. The duty to investigate

The Court of Appeals went even farther in this case than it did in *Shearer*. As explained above, *Shearer* held that, in deciding whether it owes a duty to defend, an insurer should consider extrinsic evidence, at least with respect to facts that are relevant to coverage but not also to liability. In this case, however, the court said that the insurer has to more than that – it has to go out and find extrinsic evidence. The court explained that, when a complaint is tendered to an insurer to defend, the insurer must do more than just examine it and the policy, even though that is just what this court has said in many other cases. *Bresee Homes*, 353 Or at 116; *Marleau*, 333 Or at 89; *Ledford*, 319 Or at 399; *Oakridge Community Ambulance*, 278 Or at 24. In addition, the Court of Appeals said, the insurer must investigate whether the claim is covered by, for example, placing a phone call to the insured (presumably to take a statement about the claim) and obtaining and

reviewing relevant contracts. 273 Or App at 164. Most insurers do that anyway, in the ordinary course of reviewing a new claim, and there is no proof that Oregon Auto didn't do it here. The court seems to be saying, however, that an insurer has a duty to investigate and, for duty-to-defend purposes, will be charged with whatever information an investigation would disclose. *Shearer* itself didn't go that far. It didn't have to, because, as explained above, Gemini and Shearer did not dispute that Shearer was a distributor of TransMineral products and thus and additional insured under the Gemini policy.

Nor did *Shearer* change the usual burden of proof in an insurance dispute. In such a case, that burden is on the putative insured – the party seeking coverage – to prove that it is entitled to a defense or other benefits under the policy.[11] If *that* party contends that facts outside of the complaint trigger coverage – facts that, under *Shearer*, the insurer can validly consider in determining its defense obligations – then it's *that* party's burden to obtain and present evidence of those facts. It's not the insurer's burden to go looking for it. For the Court of Appeals to hold otherwise in this case is not only contrary to well-established insurance law, *see* note 10 above, it's also contrary to the usual rules governing burdens of proof;

---

[11] The initial burden of proving coverage is on the insured. If that burden is met, the insurer then has the burden of proving that an exclusion applies. *Compare Stanford v. American Guaranty Life Ins. Co.*, 280 Or 525, 527, 571 P2d 909 (1977) (insurer has the burden to prove an exclusion), with *Lewis v. Aetna Insurance Co.*, 264 Or 314, 316, 505 P2d 914 (1973) (insured has the burden to prove coverage).

in all other situations, the obligation to produce evidence of a disputed fact is on the party that will benefit from proof of the fact, not the party that will be burdened by it.

In this case, West Hills, the party seeking coverage, had the burden to find and present extrinsic evidence that Oregon Auto's insured, L & T, was responsible for at least some of the damage alleged in the complaint against West Hills – a complaint that, of course, doesn't mention L & T. But, as the parties stipulated, the only thing West Hills offered with its tender of defense, besides the complaint itself, was the cover letter from its lawyer, ER 2, ¶3, and the letter, of course, is just argument, not evidence. Nothing in *Shearer* suggests that argument alone is sufficient to create coverage – that West Hills could bootstrap itself into coverage just by asserting the existence of the coverage-relevant facts that were omitted from the complaint against it.

In any event, the only "fact" the letter asserts is that "your insured" – L & T – "installed front porch columns" at Arbor Terrace. That assertion doesn't connect L & T to the complaint against West Hills, because the complaint didn't allege problems with the installation of "front porch columns." It *did* allege problems with the "weatherproofing" of unspecified "wood posts," and the "cladding" of unspecified "columns." As noted earlier, however, the "front porch columns" are not the "wood posts" mentioned in the complaint. Nor are they the mis-clad

"columns" also mentioned there. Nothing in the letter proves that they are. Moreover, installing a column is not the same as cladding it. One is the job of the framer, the other of the sider. So if, as the cover letter asserted, L & T "installed" the "porch columns," then it was not necessarily responsible for the "insufficient weatherproofing" of the "wood posts" or the need to "re-clad" the "columns."

Oregon Auto recognizes that the record in this case does not resolve these questions. *But that's exactly the point.* West Hills did not support its tender of defense with extrinsic evidence that the columns are the posts and the installation is the weatherproofing. And that is why Oregon Auto was not obligated to accept West Hills's tender and undertake its defense, even if Oregon Auto was required to look beyond the face of the homeowners' complaint.

B. "Ruling Out" Coverage Versus Ruling It In

The additional-insured endorsement to the L & T policy does not cover all liability arising out of L & T's operations – "only" liability arising out of its "ongoing" operations for West Hills. Oregon Auto contends that this limits the additional-insured coverage to liability for bodily injury or property damage that occurred while L & T was still working at the Arbor Terrace jobsite. The Court of Appeals assumed that to be true, 273 Or at 166, but went on to hold that Oregon Auto still owed a duty to defend West Hills, because "[t]he complaint does not *rule*

out the possibility that damage occurred before L & T finished" the job. *Id.* at 167 (emphasis in original). Under this court's precedents, however, Oregon Auto does not have to defend unless the complaint *rules in* that possibility. In other words, the complaint has to allege that some damage occurred before L & T finished the job.[12]

Ledford is on point again. In that case, this court said: "If the facts alleged in the complaint against the insured do not fall *within* the coverage of the policy, the insurer should *not* have the obligation to defend." 319 Or at 400 (quoting *Isenhart*, 233 Or at 54 (emphasis added). The Court of Appeals seems to have stood that rule on its head. It held that if the facts alleged in the complaint do not fall *outside* the coverage of the policy, then the insurer *should* have the obligation to defend.

This is not just semantics. The complaint against West Hills might not have ruled out the possibility of property damage during L & T's ongoing operations,

---

[12] As noted earlier, West Hills disagrees with Oregon Auto's interpretation of the "ongoing operations" requirement in the endorsement. *See* note 3 *supra*. It contends that its liability arises out of L & T's ongoing operations no matter when the damage occurs, so long as the damage is causally related to the construction. The Court of Appeals declined to decide which interpretation is correct. 273 Or App at 166. It assumed, instead, that "ongoing" means what Oregon Auto says, but still concluded that Oregon Auto still owed a duty to defend based on the court's "rule in" theory of the duty to defend. If this court concludes, as it should, that that theory is mistaken, it should remand the case to the Court of Appeals to determine, in the first instance, the meaning of the "ongoing operations" requirement.

but, likewise, the complaint didn't rule that in. It alleged that some property damage had already occurred by the time the homeowners bought their units: "When the [homeowners] 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." 273 Or App at 155. The complaint, however, didn't allege that the homeowners bought their units *while* L & T was still working on them, which seems improbable. In fact, the complaint referred to the homeowners as "foreseeable future plaintiffs," ER 45, ¶ 40, and ER 46, ¶ 42, and described some of them as "secondary purchasers" and "subsequent owners," ER 36, ¶ 4(b), suggesting that they acquired their homes after they were built. Accordingly, the 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. In other words, it didn't *deny* that any damage occurred during L & T's operations. It's possible, then, that some did. But it's equally possible that none did. That doesn't make the complaint "ambiguous," as the Court of Appeals suggested, 273 Or App at 168, just vague. It would be ambiguous if it alleged *both* things: that *some* damage occurred during L & T's ongoing operations and that *no* damage occurred then. In any event, the mere possibility that some damage occurred while L & T was still on the job is not enough to bring a claim within coverage. The complaint has to

actually allege a covered event, not just fail to negate one, in order trigger a duty to defend.

The Court of Appeals *itself* said exactly that in an earlier case that it didn't mention in its opinion here, let alone distinguish. The issue in *Martin v. State Farm Fire and Casualty Co.*, 146 Or App 270, 932 P2d 1207, *rev den* 325 Or 491 (1997), was whether Martin's umbrella insurer owed a duty to defend him against claims for the cost of cleaning up environmental contamination of his property caused by leaky underground oil tanks. The policy covered claims for damage to property not owned by Martin himself and, therefore, covered claims for damage to the groundwater beneath his property, which was owned by the state. 146 Or App at 277. The claims at issue, however, "did not allege any damage, or threat of damage, to groundwater," only to the soil. *Id.* The court acknowledged that "those allegations do not exclude the possibility that part of the purpose for the plaintiffs' remedial actions was to prevent groundwater contamination." *Id.* The court concluded, however, that they were not enough to impose a duty to defend, because "*failing to exclude a possibility of an event is not the same as affirmatively alleging that the event has occurred*." *Id.* (emphasis added).

That reasoning is persuasive, and this court should follow it here. The homeowners' failure to allege that property damage did *not* occur during L&T's

ongoing operations for West Hills is not the same as affirmatively alleging that property damage *did* occur then.

The Court of Appeals's holding to the contrary could dramatically change traditional insurance practice. Consider: Most CGL policies cover liability for property damage that occurs during the policy period (subject, of course, to various terms, conditions, and exclusions).[13] *See* ER 18 (para. 1.b.(2)). The occurrence of property damage during that period is the trigger of coverage. If the complaint against an insured doesn't allege when the property damage occurred, if it omits that date, then it's theoretically possible that it occurred *at any point in time*. That would mean, under the Court of Appeals decision in this case, that every liability

---

[13] Most policies use forms drafted by the Insurance Services Office, or ISO, an insurance industry trade group. The standard ISO form – like the one in Oregon Auto's policy with L & T – provides that the insurer "will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." *See* Pugh Decl., Ex. A, p. 1, and Ex. B, p. 1. The form then describes the bodily injury and property damage "to which this insurance applies":

> "**b.** This insurance applies to 'bodily injury' and 'property damage' *only if*:
>
> "* * * * *
>
> "**(2)** The 'bodily injury' or 'property damage' *occurs during the policy period*[.]"

See ER 18.

insurer the insured has ever had, no matter how long ago, would owe a duty to defend. None of them could refute the "possibility" that the alleged damage occurred while it was the insurer on the risk.[14] Likewise, in an auto case, if the complaint omits the date of the accident, every insurer the defendant has ever had in his life would have to defend, because of the "possibility" that the accident occurred while its policy was in force. That can't be right.[15]

It would be different if the timing of the property damage were not the trigger of coverage, but rather the trigger of an *exclusion*. That's because the insurer has the burden to prove that a claim is excluded after the insured first proves that the claim falls within the general grant of coverage. *See* note 10 above. If the policy excluded coverage for property damage that occurs at a particular point in time – for example, after L & T's "completed operations" – Oregon Auto

---

[14] This is not idle speculation. Date-less complaints are becoming commonplace. In construction-defect cases, they are now the norm. Those complaints no longer allege when the construction started, when it was completed, when the building started to leak, when it stopped, *etc.* This is, no doubt, by design. The pleaders are trying to avoid any dates that might take the claim out of the coverage of any of the defendants' insurers over the years, and also trying to impose a duty to defend on as many of those insurers as possible.

[15] To further illustrate the problem with the Court of Appeals "rule out" theory of coverage, consider what would happen if the complaint omitted not just the date of the accident, but also the fact that the injury was caused by the insured's use of a motor vehicle. In that event, the insured would also be entitled to a defense from every homeowner's insurer he has ever had, because none of those insurers could deny coverage based on the standard exclusion for motor-vehicle injuries. None of them could rule out the possibility that the injury was not auto-related.

could not rely on the complaint's silence to invoke the exclusion and deny a defense. In that situation, it would be "possible" that the property damage occurred after the completed operations – indeed, it would be just as probable that it occurred then as that it occurred earlier. However, as this court explained in *Bresee Homes*, the insurer can't rely on the mere possibility that the damage occurred after completed operations – a possibility created by the absence of an allegation of when the damage occurred – to invoke the completed-operations exclusion and deny a defense.

The same logic should apply to West Hills's tender of defense under the additional-insured endorsement. West Hills can't rely on the mere possibility that the damage occurred *before* L & T's completed operations – a possibility created, again, by the absence of an allegation of when the damage occurred – to establish that it is an insured and thus entitled to a defense.

VII. CONCLUSION

The Court of Appeals erred in relying on extrinsic evidence to decide the duty to defend issue, and in concluding that Oregon Auto must defend any complaint that does not rule out the possibility of coverage. The decision of that court should be reversed, and so should the trial court's judgment.

Respectfully submitted,

s/ Thomas M. Christ

Thomas M. Christ, OSB 834064

For Oregon Automobile Insurance Company

Certificate of Compliance with ORAP 5.05(2)

Brief length

I certify that this brief complies with the 14,000 word-count limitation in ORAP 5.05(2)(b)(i) (A) and that the word count of this brief, as described in ORAP 5.05(2)(a), is 11,109 words.

Type size

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

s/ Thomas M. Christ

Thomas M. Christ

Certificate of Filing and Service

I certify that I electronically filed the attached Brief on the Merits with the State Court Administrator, using the Oregon Appellate eFiling system, on June 2, 2016.

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

Michael E. Farnell
Parsons Farnell & Grein, LLP
1030 S.W. Morrison St.
Portland, OR 97205

Peter J. Viteznik
Kilmer Voorhees & Laurick, PC
732 N.W. 19th Ave.
Portland, OR 97209

I further certify that on the same date, I conventionally served the attached Brief on the Merits by causing a copy thereof to be mailed by first-class mail, addressed as follows:

Emily Sarah Miller
Parsons Farnell & Grein, LLP
1030 S.W. Morrison St.
Portland, OR 97205

For Petitioner on Review

s/ Thomas M. Christ

Thomas M. Christ