B/13/B

IN THE SUPREME COURT OF THE STATE OF OREGON

BROWNSTONE HOMES CONDOMINIUM ASSOCIATION, an Oregon non-profit corporation,

Plaintiff-Appellant, Petitioner on Review,

v.

BROWNSTONE FOREST HEIGHTS, LLC, an Oregon limited liability company, et al.,

Defendants,

and

CAPITOL SPECIALTY INSURANCE CO.,

Garnishee-Respondent, Respondent on Review.

Supreme Court No. S061273

Court of Appeals No. A145740

Multnomah County Circuit Court No. 0606-06804

ORIGINAL

RESPONDENT CAPITOL SPECIALTY INSURANCE CO.'S RESPONSE TO APPELLANT'S BRIEF ON THE MERITS

On Review from a Decision
of the Court of Appeals
February 27, 2013
Opinion before Haselton, C.J.,
Armstrong, P.J., and Duncan, J
In an Appeal from the Judgment of the Circuit Court
for Multnomah County, Honorable Peter Chamberlain,
Judge *pro tempore*

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I. INTRODUCTION

The trial court ruled in favor of Garnishee Capitol Specialty Insurance Co. ("Capitol") because Plaintiff / Petitioner on Review, Brownstone Homes Condominium Association ("Brownstone"), had given Capitol's insured an unconditional covenant not to execute, thereby defeating any possibility of insurance coverage pursuant to the plain language of the insurance policy and this Court's decision in *Stubblefield v. St. Paul Fire and Marine Ins. Co.*, 267 Or 397, 517 P2d 262 (1973). Subsequent to the trial court's decision, Brownstone and Capitol's insured modified their settlement to eliminate the unconditional covenant upon which the trial court's decision had been based. Accordingly, and as explained in Capitol's Motion to Dismiss, this appeal should be dismissed as moot.

Should this Court reach the merits of the appeal, then it should first note what Brownstone is *not* appealing. Specifically, Brownstone argued to the Court of Appeals that Stubblefield did not apply because the covenant not to execute was ambiguous and conditional. *Brownstone Homes Condo. Assoc. v. Brownstone Forest Hts.*, 255 Or App 390, 392, 298 P3d 1228 (2013). Brownstone is not making that argument again here. Thus, it is undisputed that the covenant not to execute was unambiguous and unconditional, and undisputed that *Stubblefield* applies unless Brownstone is successful on any of

its three arguments presented to this Court. As shown below, all three arguments should be rejected.

Brownstone first argues that *Stubblefield* does not apply to garnishment actions. However, as the Court of Appeals correctly observed, Brownstone's rights "against Capitol are, at most, no greater than those of its judgment debtor, A & T, under the terms of the insurance policy." *Brownstone Homes*, 255 Or App at 397. Because *Stubblefield* applies to insureds, it also applies to garnishors, like Brownstone. Accordingly, Brownstone's first argument fails.

Next, Brownstone argues that it complied with ORS 31.825 and, therefore, *Stubblefield* does not apply. However, as the Court of Appeals observed, "ORS 31.825 refers to the judgment using the present perfect verb tense." *Brownstone Homes*, 255 Or App at 398. The legislature chose a verb tense that "necessarily connotes that the judgment must be entered *before* the assignment of rights," *id.* (emphasis added), but it is undisputed that this did not occur in this case. Accordingly, Brownstone's second argument fails.

Finally, Brownstone argues that *Stubblefield* should be overruled. However, as set forth below, the *Stubblefield* Court correctly interpreted the phrase "legally obligated to pay" when it held that an insured in possession of an unambiguous, unconditional covenant not to execute is not "legally obligated to pay" any associated judgment. *Stubblefield* is consistent with this Court's subsequent decision in *Hoffman Const. Co. of Alaska v. Fred S. James & Co. of*

Oregon, 313 Or 464, 836 P2d 703 (1992), which explained and synthesized the rules of insurance policy interpretation. The *Stubblefield* Court's interpretation of "legally obligated to pay" is also consistent with the dictionary, and with this Court's and the legislature's repeated use of the phrase "legally obligated" without any sign of confusion over its meaning. Accordingly, *Stubblefield* should not be overruled.

II. QUESTIONS PRESENTED

This appeal presents four questions, as follows:

1. Should this appeal be dismissed as moot because the unconditional covenant not to execute has been revoked?
2. Does *Stubblefield* apply to garnishment actions?
3. Does the use of the present perfect verb tense in ORS 31.825 require that a judgment be entered prior to the exchange of an assignment and covenant not to execute?
4. Was this Court correct when it held in *Stubblefield* that an insured who receives an unambiguous, unconditional covenant not to execute is not "legally obligated to pay"?

III. PROPOSED RULES

1. An appeal of a decision interpreting a party's right to insurance coverage based on a settlement agreement is rendered moot if the party subsequently amends the settlement agreement to eliminate the key language

that was the basis for the trial court's decision.

2. *Stubblefield* applies to garnishment actions under ORS 18.352 because the garnishor "steps into the shoes" of the debtor for purposes of litigating insurance coverage.

3. ORS 31.825 only applies to avoid *Stubblefield* if the judgment is entered *prior to* the assignment and associated covenant not to execute.

4. *Stubblefield* was correctly decided and should not be overruled.

IV. SUMMARY OF PROCEEDINGS

Capitol accepts the "Summary of Proceedings" as stated by Brownstone. In addition, Capitol filed a Motion to Dismiss this appeal because, subsequent to the trial court's decision, Brownstone and Capitol's insured amended their settlement agreement to eliminate the unconditional covenant not to execute that formed the basis for the trial court's ruling. Also, relying on that amended settlement, Capitol's insured filed suit (on Brownstone's behalf) against Capitol in Multnomah County Circuit Court, Case No. 1007-10652, seeking recovery of the same damages alleged in the present lawsuit. Capitol removed the matter to the federal court, District of Oregon Case No. 3:10-cv-00980. The District Court ruled for Capitol, and the insured appealed to the Ninth Circuit, Case No. 12-35180. Oral argument was held on July 10, 2013, but no decision has yet been rendered.

V. SUMMARY OF MATERIAL FACTS

Capitol accepts Brownstone's "Summary of Material Facts" with one addition: subsequent to the trial court's ruling, Brownstone and Capitol's insured amended their settlement agreement to eliminate the unconditional covenant not to execute that formed the basis for the trial court's ruling.

VI. SUMMARY OF ARGUMENT

This appeal should be dismissed because the unconditional covenant not to execute which formed the basis of the trial court's ruling, and which was necessary to invoke *Stubblefield*, has been eliminated. The questions presented by this appeal – whether *Stubblefield* applies to garnishment actions, whether ORS 31.825 can be used in this case to avoid *Stubblefield,* and whether *Stubblefield* should be overruled – are all moot. Accordingly, the appeal should be dismissed.

Should the Court reach the merits of Brownstone's appeal, then it should reject each of Brownstone's arguments. First, *Stubblefield* applies to garnishment actions because, as the Court of Appeals noted, Brownstone's rights "against Capitol are, at most, no greater than those of its judgment debtor, A & T, under the terms of the insurance policy." *Brownstone Homes*, 255 Or App at 397. Because *Stubblefield* applies to insureds, it also applies to garnishors, like Brownstone.

Second, the plain language of ORS 31.825 embodies a timing requirement that has not been satisfied in this case. The legislature's decision to employ present perfect verb tense leaves no doubt "that the judgment must be entered *before* the assignment of rights." *Brownstone Homes*, 255 Or App at 398 (emphasis added). Brownstone's contrary arguments ignore the plain language of the statute and misconstrue the legislative history.

Third, *Stubblefield* was correctly decided and should not be overruled. *Stubblefield* has been the law of the land for forty years, and its interpretation of the phrase "legally obligated to pay" is consistent with the long-standing interpretive rules synthesized in *Hoffman*. Brownstone's policy arguments for overturning *Stubblefield* should be ignored because, pursuant to *Hoffman,* policy plays no role in the interpretation of insurance policies. Overturning *Stubblefield* would create uncertainty in the field of insurance law, encourage unreasonable and excessive settlements, and possibly introduce constitutional vagueness problems into numerous statutes and prior court decisions that employ the phrase "legally obligated." Accordingly, this Court should decline Brownstone's invitation to overturn *Stubblefield.*

VII. ARGUMENT

1. This appeal is moot and should be dismissed.

As Capitol argued in its Motion to Dismiss, which is incorporated herein by reference, this appeal is moot because the underlying settlement agreement

has been amended, and the unconditional covenant not to execute that provided the basis for the trial court's judgment has been eliminated. Thus, *Stubblefield* is no longer properly at issue, and the questions presented on appeal – all of which concern *Stubblefield* – are now moot.

Brownstone contends that, despite the elimination of the unconditional covenant, there is still a controversy over whether or not Capitol must pay any portion of the underlying, stipulated judgment. Capitol agrees that a controversy remains; it is just not over *Stubblefield* or ORS 31.825. Rather, the parties' current controversy concerns Capitol's coverage obligations, if any, related to the amended settlement agreement. However, that controversy is currently being considered by the Ninth Circuit Court of Appeals, Case No. 12-35180. The questions presented by this appeal no longer concern an actual controversy between the parties and, therefore, are moot.

2. *Stubblefield* applies to garnishment actions.

Most liability insurance policies, like the policies at issue here and in *Stubblefield*, only provide coverage for amounts the insured becomes "legally obligated to pay." *Stubblefield*, 267 Or at 400, Supp. ER-8. As a matter of basic contract law, if the insured is not "legally obligated to pay," then there is no "liability" to insure. As a result, the insured's claims against its insurer fail as a matter of law. *Stubblefield*, 267 Or at 400-01.

Brownstone argues that even though the insured could not recover in

light of *Stubblefield*, the debtor can, if it proceeds as a garnishor pursuant to ORS 18.352. That statute provides:

> Whenever a judgment debtor has a policy of insurance covering liability, or indemnity for any injury or damage to person or property, which injury or damage constituted the cause of action in which the judgment was rendered, **the amount covered** by the policy of insurance shall be subject to attachment upon the execution issued upon the judgment.

ORS 18.352 (emphasis added). Thus, pursuant to the statute's plain language, only "the amount covered" is subject to garnishment. As explained above, and by this Court in *Stubblefield*, no amount is covered when the insured possesses an unambiguous, unconditional covenant not to execute.

Brownstone's argument – that a garnishor possesses greater rights than the judgment debtor – is inconsistent with this Court's decision in *State Farm Fire & Cas. Co. v. Reuter*, 299 Or 155, 700 P2d 236 (1985). In *Reuter,* this Court wrote:

> Whether Bullen would proceed against State Farm under ORS 736.320 [now 742.031] or under ORS 23.230 [now 18.352], either as garnishor or subrogee, **Bullen's rights against State Farm are no greater than those of Reuter. As garnishor she stands in the shoes of the [subrogor]**....
>
> The foregoing discussion aims to point up the derivative nature of Bullen's claim.... The point is that, although her present status is that of a claimant, her future status, insofar as any claim against State Farm is concerned, would be as a judgment creditor of Reuter (if she prevails on her claim against Reuter). Within that status, **she is subject to the claims or defenses that the insurer has against the one**

from whom she derives her claim.

299 Or at 166-67 (emphasis added). Thus, Brownstone's claim against Capitol is subject to all of the same defenses Capitol could assert in a lawsuit brought by its insured. These defenses include the argument, premised on *Stubblefield*, that no coverage is available because Capitol's insured was never "legally obligated to pay."

Brownstone attempts to avoid this outcome by proposing that we should determine the garnishor's rights under a fictional circumstance, *i.e.*, under the false assumption that the insured/debtor had paid the judgment. Brownstone relies on *Jarvis v. Indemnity Ins. Co.*, 227 Or 508, 363 P2d 740 (1961) and *Allegretto v. Or. Auto Ins. Co.*, 140 Or 538, 13 P2d 647 (1932) in support of that proposition. However, no recovery was had by the garnishor in either of those cases, and the language Brownstone relies upon is dicta. Moreover, because of the unconditional covenant not to execute, Capitol's insured was not "legally obligated to pay" the judgment. Accordingly, as a matter of basic contract law, there is no coverage *even if* we accept the fiction that Capitol's insured paid the judgment when it was not legally obligated to do so.

The case law is clear that a garnishor possesses no greater rights than the judgment debtor, *Reuter*, 299 Or at 166-67, and ORS 18.352 supports this conclusion by providing that "**the amount covered** by the policy of insurance shall be subject to attachment." (emphasis added). Nothing in the text of ORS

18.352 or in its legislative history suggests that the statute was intended to create coverage where none otherwise exists, or to give the judgment creditor greater rights than the insured. Accordingly, because Capitol's insured could not prove any entitlement to coverage under the policy language, nor can Brownstone. Brownstone's contrary arguments should be rejected, and the Court of Appeal's decision should be affirmed.

3. ORS 31.825 does not apply because Brownstone gave Capitol's insured an unconditional covenant not to execute *prior to* entry of the stipulated judgment.

Brownstone argues that *Stubblefield* does not apply in light of ORS 31.825, which provides:

> A defendant in a tort action against whom a judgment **has been rendered** may assign any cause of action that defendant has against the defendant's insurer as a result of the judgment to the plaintiff in whose favor the judgment **has been entered.** That assignment and any release or covenant given for the assignment shall not extinguish the cause of action against the insurer unless the assignment specifically so provides.

(emphasis added). Pursuant to its plain language, the protections of ORS 31.825 only apply to a settlement by a "defendant in a tort action against whom a judgment has been rendered." (emphasis added). In this case it is undisputed that Capitol's insured did not meet this description at the time of the settlement, assignment, and covenant not to execute. Rather the judgment was entered several months later. Accordingly, ORS 31.825 does not apply.

As Brownstone acknowledges, Opening Brief, p. 24, "[t]he use of a

particular verb tense in a statute can be a significant indicator of the legislature's intention." *Martin v. City of Albany,* 320 Or 175, 181, 880 P2d 926 (1994). Here, the legislature chose the present perfect tense, which tense "necessarily connotes that the judgment must be entered before the assignment of rights." *Brownstone Homes*, 255 Or App at 398 (citing to *Burdge v. Palmateer,* 338 Or 490, 498 n 5, 112 P3d 320 (2005) and *State v. Root,* 202 Or App 491, 494-96, 123 P3d 281 (2005), *rev den*, 340 Or 308, 132 P3d 28 (2006)); *accord Portland School District No. 1J v. Great American Insurance Company, et al.*, 241 Or App 161, 249 P3d 148 (2011), *review denied,* 350 Or 573, 258 P3d 1239 (agreeing that there is a timing requirement to ORS 31.825).

This Court has stated that it will "not lightly disregard the legislature's choice of verb tense, because we assume that the legislature's choice is purposeful." *Martin*, 320 Or at 181. Accordingly, Brownstone has a heavy burden to demonstrate that the legislature did not intend a timing requirement despite its contrary choice of language.

Brownstone makes two arguments to avoid the plain language of ORS 31.825. First, Brownstone contends that the legislative history of ORS 31.825 suggests that no timing requirement was intended. But if no timing requirement was intended, then ORS 31.825 abrogated *Stubblefield* entirely. The legislative history never mentions *Stubblefield*, or expresses such a broad intent.

There are numerous references in the legislative history to the case of

Oregon Mut. Ins. Co. v. Gibson, 88 Or App 574, 746 P2d 245 (1987), but this suggests that the legislature's concern was not with *Stubblefield* in general but, rather, with the *Gibson* Court's extension of the contractually-based *Stubblefield* rule into the field of tort law. *See Gibson,* 88 Or App at 578 ("... this action differs from *Stubblefield* and *Lancaster* in that it is based on a theory of negligent failure to procure insurance and is against the insurance agents rather than against the insurer..."). If the legislature had intended to abrogate *Stubblefield* entirely, then one would expect at least a mention of *Stubblefield* somewhere in the legislative record. However, it is not to be found.

Ultimately, if the legislative history supports either party's position, then it is Capitol's. *See Brownstone Homes*, 255 Or App at 398 ("That construction of ORS 31.825 [to include a timing requirement,] comports with the statute's legislative history."). For example, the following exchange took place during the Senate Committee on the Judiciary's March 27, 1989, hearing on the proposed bill (SB 519):

> COUNSEL WEBBER: SB 519 would only kick in and the assignment would only take place after the court has issued the judgment in excess of policy coverage?
>
> MR. BUEHLER: That is the reading of the bill, and as it stands now, Mr. Clark would have had the right to proceed to the bankruptcy court to get a release and have direct action against the insured after trial on his injury claim. He could have gone to trial on his injury claim, but knowing he was never going to get the assignment from the insured, he had no options.

> COUNSEL WEBBER: But a judgment under the underlying coverage is a precursor to getting the assignment.
>
> MR. BUEHLER: That is correct.

Supp ER-14. After this exchange, the statute was revised to include the "has been rendered" language which was the focus of the Court of Appeals' analysis. Brownstone's Court of Appeals Opening Brief on the Merits, p. 27. There is no indication in the legislative record that anyone specifically intended for there to be no timing requirement.

Second, Brownstone argues that the common-law backdrop of ORS 31.825 reveals there was no intention to include a timing requirement. Specifically, Brownstone relies upon *Lancaster v. Royal Ins. Co. of Am.*, 302 Or 62, 726 P2d 371 (1986), wherein this Court held that the timing of a covenant not to execute was irrelevant for purposes of applying *Stubblefield.*

However, the legislative history, discussed above, suggests the legislature wanted to limit rather than overrule *Stubblefield.* If one were to limit *Stubblefield*, one logical way to do it would be based on a timing requirement. *See, e.g., Collins v. Fitzwater*, 277 Or 401, 411, 560 P2d 1074 (1977), *disavowed, Lancaster,* 302 Or at 66-67 ("Prior to the execution of the covenants not to execute, Parker was legally liable on the outstanding judgments.... At the time of the assignment, Parker had not yet been relieved of his liability...").

A timing requirement is consistent with the underlying reasoning of *Stubblefield* and with the policy language. Specifically, as a matter of contract law, there can be no coverage under a typical liability policy if the insured is never "legally obligated to pay." If, as here, the insured was given an unconditional covenant not to execute *prior* to entry of judgment, then the insured never had any obligation to pay that judgment. ORS 31.825 avoids this problem by requiring at least some period of time between the judgment and the covenant. During that period of time, the insured would be "legally obligated to pay," and the language of the insuring agreement would be satisfied.

In contrast, Brownstone's interpretation asks us to presume the legislature intended to create an unnecessary, unconstitutional conflict with policy language, *see* Or Const Art I, § 21; US Const Art I § 10, cl 1, and to include meaningless language in the statute in contravention of ORS 174.010 ("In the construction of a statute, the office of the judge is simply to ascertain and declare what is, in terms or in substance, contained therein, not to insert what has been omitted, or to omit what has been inserted..."). If the phrase "against whom a judgment has been rendered" is removed from ORS 31.825, then we reach the result for which Brownstone has been advocating: "A defendant in a tort action may assign any cause of action that defendant has against the defendant's insurer...". ORS 31.825. However, absent compelling evidence to the contrary, we must assume that the legislature meant something

by the phrase "against whom a judgment has been rendered." The most obvious explanation is that the legislature intended to impose a timing requirement. Accordingly, Brownstone's arguments fail.

Finally, even if there were a conflict between the Court of Appeals' ruling and the common law backdrop of ORS 31.825, the law is clear that "it is the current wording of the statute that controls." *King City Rehab, LLC v. Clackamas County*, 214 Or App 333, 338-39, 164 P3d 1190 (2007) (*citing State v. Couch*, 341 Or 610, 618, 147 P3d 322 (2006)).

Amicus Curiae, Oregon Trial Lawyers Association ("OTLA"), makes the creative argument that even though ORS 31.825 includes a timing requirement, Brownstone *technically* complied because "a party can only assign a right it possesses," p. 4, and, therefore, "even though A&T executed the covenant *before* the entry of the judgment, the assignment was not effective until *after* the entry of the judgment." Brief on the Merits of *Amicus Curiae* Oregon Trial Lawyers Association ("OTLA Brief"), pp. 4-5. As shown below, OTLA's argument, while creative, misses the mark.

There is no general prohibition under Oregon law for a pre-loss assignment of an insured's rights. *See, e.g., Holloway v. Republic Indem. Co. of America*, 341 Or 642, 650-52, 147 P3d 329 (2006), (discussing pre-loss and post-loss assignments). OTLA relies on *Springfield Intern. Restaurant, Inc. v. Sharley,* 44 Or App 133, 605 P2d 1188 (1980), to argue that there is such a

prohibition and, therefore, the assignment in this case did not effectively take place until after the judgment was entered. However, the assignment in *Springfield never* occurred because it was "only one part of the larger transaction" which never closed. 44 Or App at 138, 140. It is true that "[a] contract to assign a right in the future is not an assignment," OTLA Brief, p. 7 (quoting *Springfield*), but that is not what occurred here, as the settlement actually "closed" and the assignment actually occurred. Because all of this occurred *prior* to the judgment, ORS 31.825 does not apply.

OTLA's arguments are misplaced for the further reason that the focus needs to be on the covenant not to execute; not on the assignment. After all, Brownstone did not proceed via assignment, and the lynchpin for a *Stubblefield* argument is the covenant not to execute. Regardless of the timing of the assignment, the covenant not to execute was in place before the judgment. Therefore, there was not a single moment when the insured was "legally obligated to pay" the judgment. Accordingly, Capitol would prevail pursuant to *Stubblefield* regardless of the effective timing of the assignment.

4. Stubblefield was correctly decided and should not be overruled.

For the reasons discussed below, this Court should decline Brownstone's invitation to overrule *Stubblefield.*

A. *Stare Decisis.*

Brownstone argues that *Stubblefield* should be overruled pursuant to the standard set forth in *G.L. v. Kaiser Foundation Hospitals, Inc.*, 306 Or 54, 757 P2d 1347 (1988), for the reconsideration of "a nonstatutory rule or doctrine." However, *Stubblefield* applied contract language; not a "nonstatutory rule or doctrine." In *G.L.*, the plaintiff argued for an extension of "the traditional role of vicarious liability to new limits." 306 Or at 57-8. The *G.L.* Court wrote that "[t]he *particular character* of the 'policy' argument in this case calls upon us to turn again to the question of this court's analysis of policy arguments." *Id.*, at 58 (emphasis added).

Thus, the *G.L.* Court was considering a common-law rule and policy arguments of an unusual or "particular" nature. It was not considering whether to overturn its prior interpretation of specific contract language. Accordingly, *G.L.* does not provide the appropriate framework for analyzing Brownstone's arguments in this case. Rather, this Court should analyze Brownstone's arguments according to the general principles of *stare decisis*. While *Stubblefield* should not be overturned under either analytical framework, a brief discussion of *stare decisis* is appropriate to help guide the Court's analysis.

Stare decisis "is a unitary doctrine that applies generally to this court's decisions." *Farmers Ins. Co. of Oregon v. Mowry*, 350 Or 686, 693, 261 P3d 1 (2011). It applies, among other times, whenever a litigant attempts to overturn

a prior court's interpretation of contractual language. *See, e.g., Bump v. Union High Sch. Dist. No. 3*, 144 Or 390, 394, 24 P2d 330 (1933) ("It is indispensable to the administration of justice that, after a question concerning the conduct of public bodies, the law of contracts, as well as other subdivisions of the substantive law, has been decided by this court, after careful consideration, that the question should be deemed settled and closed to further argument. The doctrine of *stare decisis* so requires.").

"A decent respect for the principle of *stare decisis* dictates that this court should assume that its fully considered prior cases are correctly decided." *State v. Ciancanelli*, 339 Or 282, 290, 121 P 3d 613 (2005). "Put another way, the principle of *stare decisis* means that the party seeking to change a precedent must assume responsibility for affirmatively persuading us that we should abandon that precedent." *Id.*; *see also Milne v. City of Canby*, 195 Or App 1, 11, 96 P3d 1267 (2004) ("Under the doctrine of *stare decisis,* we adhere to our prior decisions unless error is plainly shown to exist.") (internal quotations omitted).

This Court has repeatedly "emphasized the 'undeniable importance of stability in legal rules and decisions,' an importance based on the values of predictability, fairness, and efficiency that are furthered by adherence to precedents." *Mowry, supra,* 350 Or at 693 *quoting Stranahan v. Fred Meyer, Inc.,* 331 Or 38, 53, 11 P3d 228 (2000). "Few legal principles are so central to

our tradition as the concept that courts should '[t]reat like cases alike,' H.L.A. Hart, *The Concept of Law* 155 (1st ed 1961)." *Id.*, at 698.

With respect to settlements involving covenants not to execute, Oregon courts have treated "like cases alike" for 40 years since *Stubblefield* was decided, *en banc*. This Court has applied or distinguished *Stubblefield* in two decisions,[1] and the Court of Appeals has applied or distinguished *Stubblefield* in nine decisions.[2] This Court should not suddenly change course unless given a highly persuasive, legally-based (not policy-based, as explained below) reason to do so.

B. The *Stubblefield* Court correctly interpreted the phrase "legally obligated to pay".

Because we are dealing with a question of insurance policy interpretation rather than a question of public policy (*e.g.*, whether to extend the doctrine of vicarious liability, as in *G.L.*), Brownstone's only viable argument for overturning *Stubblefield* is that it was decided prior to this Court's clarifying recitation of the steps of insurance policy interpretation in *Hoffman, supra*.

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[1] *Lancaster, supra*; *Collins*, *supra*.

[2] *Portland School Dist. No. 1J*, 241 Or App 161; *Terrain Tamers Chip Hauling, Inc. v. Insurance Marketing Corp. of Oregon,* 210 Or App 534, 152 P3d 915 (2007); *Holloway v. Republic Indem. Co. of America*, 201 Or App 376, 119 P3d 239 (2005), *reversed* 341 Or 642 (2006); *Brownstone Homes, supra; Far West Federal Bank, S.B. v. Transamerica Title Ins. Co.*, 99 Or App 340, 781 P2d 1259 (1989); *Gibson, supra; Lancaster v. Royal Ins. Co. of America*, 76 Or App 436, 709 P2d 254 (1985), *reversed* 302 Or 62 (1986); *Stumpf v. Continental Cas. Co.,* 102 Or App 302, 794 P2d 1228 (1990); and *Warren v. Farmers Inc. Co. of Oregon,* 115 Or App 319, 838 P2d 620 (1992).

However, as discussed below, a *Hoffman* analysis of the key policy language reaches the same result that the *Stubblefield* Court obtained: an insured which receives an unambiguous, unconditional covenant not to execute is not "legally obligated to pay". The fact that *Stubblefield* was decided prior to *Hoffman* counts for little on its own. This Court explained in the context of an analogous dispute over statutory interpretation:

> More recently and directly, this court has rejected the proposition that cases predating *PGE* should be discounted or disregarded on that basis.... We now reaffirm that rejection. In *PGE,* this court did not fashion new rules for determining the meaning of statutes; nor did the court disavow old or settled rules for doing so. Rather, the court synthesized existing interpretative principles—some codified in Oregon statutes since nearly the beginning of statehood, others reflected in settled case law for many years—into a logical methodology. *PGE,* 317 Or. at 610–12, 859 P.2d 1143. Thus, *PGE* did not change the substantive principles that apply to statutory interpretation so much as it provided a coherent and predictable order in which to invoke those principles. The absence of a *PGE*-style examination of legislative intent does not deprive a prior statutory interpretation of its ordinary effect as a precedent. Consequently, a decision of this court interpreting a statute can be neither discounted nor disregarded merely because it predates *PGE.*

Mastriano v. Bd. of Parole & Post-Prison Supervision, 342 Or 684, 691-92, 159 P3d 1151 (2007). The same should generally be true of pre-*Hoffman* decisions that interpreted insurance policy language, as *Hoffman* did not change the law of insurance policy interpretation but, rather, just clarified and synthesized that

law. *See Hoffman*, 313 Or at 469-70 (citing prior cases that support its interpretive framework).

Regardless, and as shown immediately below, if we subject the disputed, "legally obligated to pay" phrase to a strict *Hoffman* analysis, we reach the same result that the *Stubblefield* Court reached forty years ago: there is no legal obligation to pay if the insured obtained an unambiguous, unconditional covenant not to execute.

1. "Legally obligated to pay" has a plain meaning: it refers to a payment obligation that is legally enforceable.

The first step in a *Hoffman* analysis is to determine whether the disputed word or phrase has a "plain meaning." *Hoffman,* 313 Or at 469. If it does, then the Court must "apply that meaning and conduct no further analysis." *Holloway*, 341 Or at 650. That is exactly what the *Stubblefield* Court did. It explained its decision simply and conclusively:

> [T]he result of the separate 'Covenant Not to Execute' was that the amount which the insured in this case was 'legally obligated' to pay to plaintiff as damages for such personal injuries was the sum of $5,000. The insured agreed, however, to pay that amount to plaintiff himself and that amount was expressly excluded from the assignment and was reserved to the insured. It follows that by the terms of the assignment in this case plaintiff acquired no rights which are enforceable by it against defendant.

Stubblefield, 267 Or at 400-01 (emphasis added). Thus, the *Stubblefield* Court gave "legal obligation" its ordinary meaning: an obligation that can be enforced by legal process.

In *Lancaster,* this Court addressed a covenant where it appeared that the payment obligation was at least partially enforceable because the insured's assets were not protected. *Lancaster,* 302 Or at 67 ("plaintiff 'hereby agrees not to enforce said judgment against Mr. Martin [the insured] by execution or any other manner against Mr. Martin *personally* * * *,'") (emphasis supplied by court). This created a question of fact as to whether or not the insured was "legally obligated to pay," leading the Court to rule for the insured. *Id.* The issue concerned application of the facts to the "legally obligated to pay" language; there was no suggestion that "legally obligated to pay" was unclear or ambiguous.

As shown below, the *Stubblefield* and *Lancaster* Courts' plain meaning interpretation of "legally obligated to pay" is supported by the dictionary, and is consistent with other, non-insurance decisions of this Court evaluating "legal obligation" in situations where the defendant possessed a complete defense. The fact that "legally obligated" has a plain and well-understood meaning is further shown by the Oregon's courts' and legislature's repeated use of the phrase without any sign of confusion over its meaning. Accordingly,

Stubblefield's plain meaning interpretation of "legally obligated to pay" was correct and should not be overturned.

a. The dictionary, and the distinction between "legal" and "moral" obligations.

If a policy term is not defined, then it is proper to consult a dictionary. *Dewsnup v. Farmers Ins. Co. of Oregon*, 349 Or 33, 40, 239 P3d 493 (2010). According to the dictionary, the word "obligate" means: "—*v.t.* 1. to oblige or bind morally or legally: *to obligate oneself by contract to purchase a building.* 2. to pledge, commit, or bind (funds, property, etc.) to meet an obligation. –*adj.* 3. morally or legally bound; constrained. 4. necessary; essential." *Webster's Encyclopedic Unabridged Dictionary of the English Language,* p. 994 (1989 ed.). Thus, there are two types of "obligations": those that are "legal" and those that are "moral." The phrase "legally obligated" is specific and unambiguous because it clarifies that we are speaking only of "legal," and not also "moral," obligations. *See Holloway,* 341 Or at 651 ("Contrary to the Court of Appeals' assertion, the policy makes perfectly clear which 'rights or duties' may not be assigned. The anti-assignment clause specifically states that '*[y]our* rights or duties' may not be assigned.") (emphasis added by *Holloway* court).

The distinction between "legal" and "moral" obligations has been discussed by this Court on several occasions. In *Walsh Construction Co. v. Smith*, 272 Or 398, 401, 537 P2d 542 (1975), this Court, sitting *en banc,* considered whether a "'moral make-up' clause" found in ORS 456.720 legally

obligated the legislature to appropriate sufficient money to replenish deficiencies in a "debt service" account. Originally, the statute provided that such funds "[s]hall be appropriated," but later, the word "shall" was replaced with "may." *Walsh Construction Co.*, 272 Or at 401-04. The Court concluded that there was no "legal obligation," reasoning:

> Intervenors regard the presence of a make-up provision as a pledge of the state credit because a bond dealer or vendor of certificates would point to the statute as an assurance to potential buyers of the certificates of indebtedness, that if the source of payment of the certificates should prove insufficient, a future legislature would come to the rescue with an appropriation of state funds to prevent or overcome a default. Certainly the purchasers of the bonds cannot predicate such an expectation upon any **legal obligation** of the state because the bonds themselves are required to contain a statement to the contrary. If there is a pledge, then, it is at most based upon a moral obligation which the members of future legislatures might feel to meet the deficiency.

Id., at 404 (emphasis added). Numerous other cases have drawn this same distinction. *See, e.g., Nine v. Starr*, 8 Or 49, 50 (1879) ("We think that whatever the moral obligation of a putative father may be to support such a child, no **legal obligation** attaches to him in that behalf. . . .") (emphasis added); *Moses v. Meier*, 148 Or 185, 189, 35 P2d 981 (1934) ("Whether there would be a moral obligation to redeem such certificates of indebtedness is a matter with which this court is not concerned. Suffice it to say there is no **legal obligation** to do so in the event the special fund is exhausted.") (emphasis

added); *State ex rel. Bayer v. Funk*, 105 Or 134, 154, 209 P 113 (1922) (discussing an "obligation which was moral in its nature, and was not a **legal obligation**.") (emphasis added).

Brownstone argues that "legally obligated to pay" does not have a plain meaning but could refer to a number of different things:

> The phrase could mean obligated to pay pursuant to a judgment for money damages. Or it could mean obligated to pay pursuant to a settlement agreement. Or it could mean obligated to pay pursuant to a licensing agency rule...

Opening Brief, p. 40. It is true that an "obligation" can arise from a variety of sources, including a judgment, settlement or rule[3]. However, that is not the question presented here. The question presented is whether, regardless of the obligation's source, the insured was "legally obligated to pay." As shown immediately below, if an obligation to pay is not enforceable, then the insured is not "legally obligated to pay." Accordingly, *Stubblefield* was properly decided.

b. A person is not "legally obligated" if they possess an absolute defense to any legal effort to enforce the alleged obligation.

In *Beck v. David*, 128 Or 542, 546, 274 P 914 (1929), the defendant testified that "plaintiff verbally agreed to buy the lot and convey it to her for

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[3] See page 29, footnote 6 for an explanation of why neither ORS 701.098(4)(a)(E) nor any rule promulgated thereunder creates any obligation to pay the judgment at issue in this case.

[$1,200]." However, because the agreement was not in writing, defendant was not "legally obligated." *Beck*, 128 Or at 546. The Court explained: "it being a contract for the sale of land, and not being in writing, **it was not enforceable, and therefore a violation of its terms could not be the basis of a valid counterclaim**." *Id.* (emphasis added). The defendants were "**not legally obligated** to take the lot off plaintiff's hands," and the agreement was not "enforceable for any purpose by either of the contracting parties." *Id.* (emphasis added).

Brownstone argues that Capitol's insured was "legally obligated to pay" the judgment but would have had a breach of contract counterclaim if Brownstone sought to enforce that obligation. However, the unconditional covenant not to execute (while it still existed) would have provided an absolute *defense*, not just a basis for a counterclaim. Like the defendants in *Beck,* Capitol's insured was never "legally obligated" because the judgment was unenforceable in light of the unconditional covenant not to execute.

In *State ex rel. Bayer*, this Court, sitting *en banc,* considered a situation where it "appear[ed] from the allegations" that a city believed it was "under a moral, but not under any legal, obligation to pay." 105 Or at 150. The city "offered to pay ... $36,702.84 as a moral, but not as a legal, obligation, on condition that the relator. . . should obtain, a judicial determination that the city council had authority to pay said sum of money to the relator as a moral

obligation, and **not as one which was enforceable in an action at law**." *Id.* (emphasis added). The Court ruled that the city lacked authority to pay a moral obligation, writing:

> The council of the city of Portland, under its charter provisions, has no power or authority to pay out the public moneys of the city in payment of any obligations except the legal obligations of the city. The payment of obligations not founded upon a sufficient consideration, and **not enforceable in an action at law**, are not within the express or implied powers of a municipality in this state.

Id., at 162 (emphasis added). Because the obligations were "not enforceable in an action at law," they were not "legal obligations" and could not be paid by the City. Here, the judgment was not enforceable against Capitol's insured because it possessed an unambiguous, unconditional covenant not to execute. As a result, Capitol's insured was never "legally obligated to pay."

Brownstone argues that "[t]he covenant does not preclude Brownstone from executing on the judgment." Opening Brief, p. 39. However, the covenant very clearly did preclude Brownstone from executing on the judgment. It provided: "[Brownstone] agrees that **in no event** will it execute upon or permit the execution of the stipulated judgment against A&T or its assets...". ER-32. No court would allow execution on the judgment under those circumstances. *See Beck* and *Bayer, supra.*

Brownstone argues that it could have avoided the unconditional covenant not to execute "by showing that the object of the agreement (Brownstone's right

to collect the proceeds of Capitol's policy) was frustrated." Opening Brief, p. 39. Brownstone relies on *Tindula v. Bauman,* 271 Or 383, 385, 532 P2d 785 (1975), a case which rejected a "frustration of purpose" argument.

"Frustration of purpose" provides a basis to rescind a contract. *See Chang v. Pacificorp*, 212 Or App 14, 22, 157 P3d 243 (2007) ("The frustration of purpose doctrine allows rescission of a contract if one party's mutually understood 'principal purpose' in entering into the contract is 'frustrated * * * by the occurrence of an event the non-occurrence of which was a basic assumption' of the parties. *Restatement (Second) of Contracts* § 265 (1981)"). Accordingly, if Brownstone's "frustration of purpose" argument was successful, then the Settlement Agreement would be rescinded, and Brownstone would not be permitted to keep the judgment that resulted from the settlement. *See, e.g., Johnston v. Gilbert*, 234 Or 350, 353 n 3, 382 P2d 87 (1963) ("It is a firmly established general rule that restoration of the status quo is an essential element of rescission...").

No court would have permitted Brownstone to retain the benefit of the judgment while simultaneously jettisoning the unconditional covenant not to execute. Otherwise, the purpose of the contract would have been frustrated from the standpoint of Capitol's insured. Brownstone and Capitol's insured did modify the settlement agreement in an effort to convert the unconditional covenant into a conditional one, but that modified settlement agreement is the

subject of a second lawsuit, and is the reason the present appeal should be dismissed. *See* Section VII.1, *supra* and Capitol's Motion to Dismiss.

If the "principal purpose" of the settlement agreement has truly been frustrated[4], then it is possible the entire agreement could have been rescinded, but not just the part of the agreement that Brownstone wants to avoid. *Johnston, supra.* Accordingly, Brownstone's argument that it could have avoided the unconditional covenant (which no longer exists anyhow) via a frustration of purpose argument is misplaced.

This Court has consistently held that a "legal obligation" is distinct from any other "obligation" – perceived or actual – that cannot be enforced in a court of law. *See, e.g., State ex rel. Kane v. Goldschmidt*, 308 Or 573, 580-83, 783 P2d 988 (1989) (*en banc*) (reviewing prior case law). To this point, the *Kane* Court specifically rejected an argument – much like Brownstone's argument based on the hypothetical[5] risk of consequences with the Construction Contractors Board, Opening Brief, p. 40 – that an obligation should be deemed

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[4] It has not: Brownstone received payment of $900,000, and the insured received a release from liability. ER- 30-31.

[5] ORS 701.098(4)(a)(E) does not mention "outstanding judgment[s]" as Brownstone implies in footnote 20 of its Opening Brief, but, rather, provides that the administrator of the board "may" suspend or refuse to renew a license for "[f]ailure to pay a construction debt." The stipulated judgment does not constitute a "construction debt" because Capitol's insured received an unconditional covenant not to execute on the judgment.

"legal" if failure to perform can result in negative consequences outside of a court. This Court explained:

> Nor does the fact that the legislature may feel compelled to make payments in a future biennium out of the fiscal concern to protect its credit rating convert the state's 'obligation' into a legal one subject to Article XI. The economic and fiscal consequences of either continuing the agreements or allowing them to terminate by failing to appropriate money merely becomes a factor in the public policy calculus...

Id., at 586-87. The insured in *Stubblefield,* (like Capitol's insured) may or may not have felt obligated for any number of reasons to pay the judgment. However, in light of the unconditional covenant not to execute, he was not "legally obligated" to do so. Accordingly, *Stubblefield* was correctly decided, and the Court of Appeals' decision should be affirmed.

c. Oregon's courts and legislature have repeatedly used the phrase "legally obligated" without any sign of confusion over its meaning.

As the following, non-exhaustive lists demonstrate, Oregon's courts and legislature have repeatedly employed the phrase "legally obligated" without any definition and without any sign of confusion over its meaning. The extensive use of this phrase indicates that it has a well-understood, plain meaning, and refers to an obligation enforceable in a court of law.

Most recently, this Court, sitting *en banc*, explained a driver's statutorily-derived legal obligation to consent to sobriety tests, and made a distinction

between the legal obligation on one hand and the driver's physical – but not legal – ability to refuse the test on the other hand:

> The driver may choose to physically refuse, and the state will not force the driver to do what he or she is **legally obligated** to do. However, because **the driver has only the physical ability, *but not the legal right*, to refuse**, the legal validity of the driver's refusal does not depend on whether his or her decision to physically refuse is fully informed or voluntary.

State v. Cabanilla, 351 Or 622, 633, 273 P3d 125 (2012) (emphasis added). There was no need to define "legally obligated" because that phrase has a well-understood, plain meaning.

Here are some additional examples of cases that have used the phrase "legally obligated":

* *Lopez v. Dep't of Revenue*, TC-MD 120843C, 2013 WL 4267610 (Or. T.C. Aug. 13, 2013) ("Without a detailed construction contract, the court cannot even determine whether the contractor was **legally obligated** to put in the concrete basement floor and patio.") (emphasis added).

* *State v. Glushko*, 351 Or 297, 316, 266 P3d 50 (2011) ("In this case, there is no question but that both defendants caused the delays in bringing their cases to trial by their failures to appear. Both had notice that they were **legally obligated** to appear.") (emphasis added).

* *Norgaard v. Port of Portland*, 223 Or App 543, 553 n 4, 196 P3d 67 (2008), *quoting Beentjes v. Placer Cnty. Air Pollution Control Dist.*, 397

F3d 775, 781 (9th Cir 2005) ("...in the absence of a showing that money used to pay a judgment will necessarily be replaced with state funds, we adhere to our basic proposition that the fact that the state may ultimately *volunteer* to pay the judgment * * * is immaterial; the question is whether the state treasury is **legally obligated** to do so.") (bold added).

* *Douglas Med. Ctr., LLC v. Mercy Med. Ctr.*, 203 Or App 619, 635, 125 P3d 1281 (2006) ("...although Mercy had been seeking additional payment for services for which SureCare had already paid, there was no evidence that SureCare was, in fact, **legally obligated** to pay the disputed additional amount.") (emphasis added).

* *Jole v. Bredbenner*, 95 Or App 193, 197, 768 P2d 433 (1989) ("A promise to do what a promissor is already **legally obligated** to do is not consideration. *Meyer v. Livesley,* 56 Or 383, 389, 108 P. 121 (1910).") (emphasis added).

* *West v. French*, 51 Or App 143, 153, 625 P2d 144 (1981) (holding, in light of statue stating that any fee award "shall be remitted promptly to" the legal aid organization, "the client is **legally obligated** to pay over to legal aid the amount of the fee awarded when it is paid") (emphasis added).

* *Buena Dairy Associates v. Dep't of Agric.*, 38 Or App 35, 47, 590 P2d 240 (1979) ("The respondent's principal contention is that under the PAMCO lease a separate document would have been required to 'consign' the

herd to petitioners, whereas the final lease form constituted a unitary transaction under which the herd was leased, and in the same instrument consigned back to the lessor. The former complied with the regulations because, it is contended, PAMCO could have changed its mind, but the latter did not comply because the lessee could not change its mind. Such an attempted distinction is not well-founded[.] PAMCO was **legally obligated** to 'consign' the herd to the lessor for 'sale' to Cloverleaf.") (emphasis added).

* *Peck v. Sec. Bank of Oregon*, 276 Or 61, 68, 554 P2d 505 (1976) ("We think the above rule is not applicable to this case because the plaintiff was not obliged to borrow the $600,000 from the bank, but could have, if given reasonable notice by the bank, paid the purchase price from other sources. If the plaintiff had been **legally obligated** to finance the purchase only by borrowing the $600,000 from the bank, the rule quoted above may have been applicable.") (emphasis added).

* *Porter v. Riverdale Sch. Dist. No. 51 JT*, 21 Or App 773, 783, 536 P2d 1265 (1975) (Schwab, C.J., concurring) ("In other words, although not **legally obligated** to do so, the school district has retained authority in individual cases to send high school age students to schools other than Lake Oswego.") (emphasis added).

* *Fleming v. Wineberg*, 253 Or 472, 481, 455 P2d 600 (1969) ("... the plaintiffs had to prove either that the defendant had assumed and agreed to

pay the contract balance, which he obviously had not, or that the defendant became **legally obligated** to pay something for the cattle because his conduct amounted to the equivalent of an agreement or undertaking to pay.") (emphasis added).

* *Enco, Inc. v. F.C. Russell Co.*, 210 Or 324, 338, 311 P2d 737 (1957) ("The general rule is that a promise to do that which one is already under **legal obligation** to do will not furnish sufficient consideration for a contract.") (emphasis added).

* *Norby v. Section Line Drainage Dist.*, 159 Or 80, 84, 76 P2d 966 (1938) ("Although not signed or sealed by the defendant, yet, by its acceptance of the deed and of the estate thereby conveyed, these covenants became binding on the defendant and created a **legal obligation** upon its part to perform, and thereafter it was the defendant's deed as well as that of the plaintiffs and each was estopped to deny any obligation imposed by it upon either thereof.") (emphasis added).

* *Woodford v. Olcott*, 104 Or 437, 444, 208 P 1113 (1922) ("The law intended that the loan should be made upon adequate security, and that the borrower should be **legally obligated** to repay the borrowed money.") (emphasis added).

* *Hoskins v. Powder Land & Irrigation Co.*, 90 Or 217, 223, 176 P 124 (1918), *quoting* 13 C.J. 351 ("... as a general rule, the performance of, or

promise to perform, an existing **legal obligation** is not a valid consideration.") (emphasis added).

* *Fisk v. Henarie*, 13 Or 156, 171, 9 P 322 (1886) ("If the letter from Henarie to the appellant of December 7, 1880, amounted to a request to the latter to procure a purchaser of the lands, and Henarie was authorized to act for the other owners, and the appellant acted upon it, and did procure a purchaser satisfactory to the owners, and they concluded a sale of the lands to such purchaser, the owners were **legally obligated** to pay the commission.") (emphasis added).

Here are some examples of statutes that use the phrase "legally obligated":

* ORS 105.470(1) ("The first sale of a dwelling never occupied, provided that the seller provides the buyer with the following statement on or before the date the buyer is **legally obligated** to purchase the subject real property: ...") (emphasis added).

* ORS 353.370 ("By enacting this provision, the Legislative Assembly acknowledges its current intention to provide, from funds other than those appropriated or otherwise made available to the Oregon University System, funds to pay such amount. However, except as may be required by the Oregon Constitution or ORS 291.445, neither the Legislative Assembly nor the

Emergency Board shall have any **legal obligation** to provide funds under this section.") (emphasis added).

* ORS 419B.408(2) ("No property of the child or ward's parents, or either of them, or other person **legally obligated** to support the child or ward is exempt from levy and sale or other process to enforce collection of the amounts ordered by the court to be paid toward the support of the child or ward.") (emphasis added).

* ORS 419C.303 ("The summons shall also include a notice that the parent or other person **legally obligated** to support the youth may be required to pay, at some future date, for all or a portion of the support of the youth, including the cost of out-of-home placement, depending upon the ability of the parent to pay support.") (emphasis added).

* ORS 477.745(2) ("The **legal obligation** of the parent or parents of an unemancipated minor child to pay damages under this section shall be limited to not more than $5,000 payable to the forester for one or more acts.") (emphasis added).

* ORS 480.158(2) ("**The legal obligation** of the parent or parents of an unemancipated minor child to pay damages under this section shall be limited to not more than $5,000 payable to the same claimant, for one or more acts.") (emphasis added).

* ORS 735.245(4) ("Surcharge funds shall be subject to the control of the board of directors and may be used to satisfy the **legal obligations** of the joint underwriting association.") (emphasis added).

* ORS 742.390(1) ("A reimbursement insurance policy insuring service contracts issued, sold or offered for sale in this state shall conspicuously state that, upon failure of the obligor to perform under the contract, the insurer that issued the policy shall pay on behalf of the obligor any sums the obligor is **legally obligated to pay** or shall provide the service that the obligor is legally obligated to perform according to the obligor's contractual obligations under the service contracts issued by the obligor.") (emphasis added).

* ORS 743A.090(6)(b) ("'Placement for adoption' means the assumption and retention by a person of a **legal obligation** for total or partial support of a child in anticipation of the adoption of the child. The child's placement with a person terminates upon the termination of such **legal obligations**.") (emphasis added).

* ORS 752.035(2) ("A professional liability fund established under this section shall pay, on behalf of qualified members of the profession, all sums as may be provided under the fund which any such member shall become **legally obligated to pay** as money damages because of any claim made against such member as a result of any act or omission of such member in rendering or failing to render professional services for others in the member's professional

capacity or caused by any other person for whose acts or omissions the member is legally responsible.") (emphasis added).

* ORS 757.607(3) ("The commission shall allow recovery, through a transition charge, of any otherwise unrecoverable costs arising from or related to an electric company's contractual or other **legal obligations** to the Bonneville Power Administration under ORS 757.663, or arising from or related to a failure of the Bonneville Power Administration to meet its contractual or other **legal obligations** to the electric company...") (emphasis added).

* Oregon Laws 2013, Chapter 350, Section 6 ("On payments that an insured has made and that the insurer is **legally obligated to pay** as costs of defense or indemnity, provided that interest begins to accrue only on the 31st day after the claim for payment or reimbursement is presented or payment is made by the insured, whichever is later.") (emphasis added).

The fact that the courts and legislature, bodies that typically pay close attention to the language they utilize, frequently use the phrase "legally obligated" without any sign of confusion, supports the conclusion that "legally obligated" is unambiguous and possesses a plain meaning. Moreover, this Court should be mindful that if it declares "legally obligated" to be ambiguous, then it would inadvertently subject all such prior cases and statutes to potential challenges for vagueness. *See, e.g., Ashton v. Kentucky*, 384 US 195, 200, 86 S Ct 1407, 16 L Ed 2d 469 (1966) ("Vague laws in any area suffer a

constitutional infirmity."); *City of Portland v. James*, 251 Or 8, 15, 444 P2d 554 (1968) (striking down an ordinance as "void for vagueness.")

2. The context of "legally obligated to pay" confirms its plain meaning.

If a disputed phrase has more than one plain meaning, then *Hoffman* requires the Court to analyze context. *See Holloway,* 341 Or at 650 (explaining *Hoffman* framework). Here, the relevant context is that the phrase "legally obligated to pay" appears in the insuring agreement of a "commercial general liability" policy, under the heading, "Coverage A Bodily Injury and Property Damage Liability." This context indicates that the subject of the policy is "liability."

In *Columbia River Rentals, LLC v. Phillips*, CV-08-395-HU, 2009 WL 632933, *2 (D Or Jan 14, 2009) *report and recommendation adopted*, CV 08-395-HU, 2009 WL 598014 (D Or Mar 6, 2009), Oregon's district court considered the meaning of the word "liable" in the context of a policy provision that provided additional insured coverage, but "only to the extent [the named insured is] held liable." The court explained that "liable" is not ambiguous but is equivalent to "legally obligated":

> As indicated above, undefined policy terms are given their plain, ordinary, and popular meaning. As seen from the two dictionary definitions quoted above, the primary meaning of 'liable' is to mean a **legal obligation**. While 'responsible' is another definition, it is not the primary one and thus, not the ordinary or popular meaning.

> Additionally, when considered in the context of an insurance policy, it is clear that the term 'held liable' used in the 'extent of the insured's liability' provision, refers to a legal obligation. **The point of purchasing an insurance policy is to protect the insured from having to pay money to someone else.** The payment of a sum of money in satisfaction of a claim for damages is created by a legal obligation to do so. **It is the *legal obligation* to pay money that the insurance policy protects against. Thus, the plain, ordinary, and popular meaning of 'liable' in this provision is a legal obligation.** Plaintiff is an insured only to the extent that Phillips has a legal obligation to pay someone damages as a result of his use of the leased equipment. Because Phillips cannot be legally obligated to pay himself damages, plaintiff is not an insured under the endorsement.

Id., at *7. Thus, the context – the insuring agreement of a "liability" policy – demonstrates that "legally obligated to pay" refers to a legally enforceable obligation to pay money.

Similarly, Oregon's Court of Appeals has explained:

> Neither the term 'liability insurance' nor the phrase 'insured against liability' is defined for purposes of OEC 411. However, both are relatively common phrases that are susceptible to straightforward definition. 'Liability insurance' is 'insurance against loss resulting from liability for injury or damage to the persons or property of others,' *Webster's Third New Int'l Dictionary* 1302 (unabridged ed. 2002).... Finally, 'liability,' in common usage, means '[t]he quality or state of being legally obligated or accountable[.]' *Id.* at 932.

Goddard v. Farmers Ins. Co. of Oregon, 202 Or App 79, 101-02, 120 P3d 1260 (2005), *opinion adhered to as modified on reconsideration,* 203 Or App 744,

126 P3d 682 (2006) *aff'd as modified,* 344 Or 232, 179 P3d 645 (2008). In other words, a "liability" is a "legal obligation." As the purpose of the policy is to protect the insured against "liability," the only reasonable way to construe the phrase "legally obligated to pay" in the insuring agreement is to mean an obligation that the insured can be compelled to pay via legal process.

Further, the insuring agreement provides, immediately after the disputed sentence, that "We will have the right and duty to defend the insured against any 'suit' seeking those damages." Supp ER-8. A "suit" is defined to mean a "civil proceeding" in which the plaintiff alleges damages "to which this insurance applies." Declaration of Brian Hickman in Support of the Motion for Summary Judgment, TCF-Event No. 157. Again, then, the purpose of the insurance is protect the insured against efforts to legally force it to pay damages. This context informs the meaning of "legally obligated" and confirms that the disputed phrase refers to a payment obligation enforceable in a court of law.

C. There has not been any change in the surrounding statutory law that "altered some essential legal element assumed in *Stubblefield.*"

In the alternative to its argument that *Stubblefield* was wrongly decided, Brownstone argues that *Stubblefield* should be overruled because "surrounding statutory law has altered some essential legal element assumed in *Stubblefield.*"

Opening Brief, p. 50. To support this argument, Brownstone relies exclusively on the legislature's enactment of ORS 31.825 and ORS 701.073.

With respect to ORS 31.825, the enactment of that statute did not alter some "essential legal element assumed in Stubblefield," but, rather, represented the legislature's carefully considered solution to the conflict between the "legally obligated to pay" requirement and the desire to encourage amicable settlements that do not inadvertently eliminate potential insurance coverage. If anything, the legislature's enactment of ORS 31.825 weighs against overruling *Stubblefield* because it reveals that the legislature already considered the concerns Brownstone raises here and chose to address those concerns in a way that only partially abrogated *Stubblefield*. The legislature left intact *Stubblefield's* fundamental premise that the insured must be "legally obligated," at least for some period of time, in order to trigger insurance coverage.

With respect to ORS 701.073 [formerly ORS 701.105], it appears that statute had been enacted *prior to* the *Stubblefield* decision, as Section 12 of Oregon Laws 1971, Chapter 740. Thus, the statute's enactment did not alter any legal element assumed in *Stubblefield*. Rather, the statute was part of the background against which *Stubblefield* was decided. Moreover, as discussed above, a statute obliging contractors to obtain insurance has no bearing under *Hoffman* as to how insurance policy language should be interpreted.

D. Brownstone's out-of-state authorities are not persuasive.

Brownstone cites to numerous out-of-state court decisions which have rejected *Stubblefield*. However, other court decisions are simply not relevant to the *Hoffman* analysis and the question of whether the *Stubblefield* Court correctly interpreted "legally obligated to pay." *See, e.g., Hoffman,* 313 Or at 475 ("We recognize that plaintiffs' contrary argument, that the term 'amount recoverable' is ambiguous and should therefore be construed against the insurer, has been adopted by other courts.... We are not, however, persuaded by the five decisions on which plaintiffs specifically rely."); *Holloway*, 341 Or at 642, 653, ("Although those [out-of-state] authorities may support Holloway's argument, the courts [in those cases] did not follow this court's analytical approach to insurance contract construction..."); *Interstate Fire & Cas. Co. v. Archdiocese of Portland,* 318 Or 110, 117, 864 P2d 346 (1993) ("Under Oregon law, a proper assessment of Interstate's argument regarding the number of covered 'occurrences' in this case does not begin where the district court appears to have begun, *i.e.,* with case law. Rather, it begins with an examination of the words of the applicable provisions in the insurance policy...").

On one prior occasion, this Court acknowledged that other states disagree with *Stubblefield* but decided stand-by that decision nevertheless. Specifically, in the process of rejecting a *Stubblefield* argument because the covenant not to

execute was limited to "personal" assets, this Court in *Lancaster*, wrote: "Other jurisdictions have concluded that even if the insured discharges all liability, a covenant not to execute coupled with an assignment and settlement agreement is *not* a release relieving the insurer of its obligation." 302 Or at 67 n 1. (emphasis in original). Nevertheless, the *Lancaster* Court declined to overrule *Stubblefield* but applied that case in the matter before it.

This Brief will not address every one of Brownstone's numerous out-of-state authorities but summarizes below some of the reasons these authorities are distinguishable and not relevant to a *Hoffman* analysis of "legally obligated to pay":

* Many of Brownstone's cases rely on "public policy" reasons for finding coverage, *see, e.g., Dowse v. Southern Guar. Ins. Co.,* 263 Ga App 435, 552, 588 SE 2d 234 (2003), *aff'd* 278 Ga 674, 605 SE 2d 27 (2004) (relying on "the strong public policy favoring the availability ... of the liability insurance"), *Quan Xing Hee v. Government of Guam,* 2009 WL 5218028, *10 (Supreme Court of the Territory of Guam 2009) (discussing "policy of protecting the rights of injured parties and the general public"), but "public policy" is not relevant to any stage of a *Hoffman* analysis.

* Several of Brownstone's cases rely on the fact that the insured received a covenant not to execute, but not a release from liability. *See, e.g., Guillen ex rel. Guillen v. Potomac Ins. Co. of Illinois,* 203 Ill 2d 141, 160, 785

NE 2d 1 (2003) ("... a covenant not to execute is a contract and not a release."); *Red Giant Oil Co. v. Lawlor*, 528 NW 2d 524 (Iowa 1995) ("[T]he original covenant not to execute was merely an agreement by Red Giant and was not a release."). However, as discussed above, the unconditional covenant not to execute is sufficient by itself to block any attempted collection action. Moreover, the insured in this case also received a complete release. ER-30 (original settlement agreement provided: "... each of the Settling Parties hereby agrees to release each and every other Settling Party and the paying insurers from all past present and future claims.... [T]he Settling Parties intend this agreement to be a full, final and complete settlement, adjustment and compromise of any and all Claims..."). The release included an exception for claims "by or between HOA and Capitol," *id.*, but there is no exception or reservation as to Capitol's insured, which received a complete release. Accordingly, Brownstone's cases are inapposite.

* Many of Brownstone's out-of-state cases apply estoppel to provide coverage. *See, e.g., Metcalf v. Hartford Accident & Indemnity Co.,* 176 Neb 468, 475, 126 NW 2d 471 (1964) ("...it having declined to defend the action when called upon to do so, [Hartford] is in no position to attack the judgment in the absence of fraud, collusion or bad faith."); *Guillen ex rel. Guillen*, 203 Ill 2d at 161 ("Once the insurer has breached its duty to defend, it is in no position to demand that the insured be held to a strict accounting under the policy

language."). Here, however, there has not been any finding that Capitol breached its duty to defend. Opening Brief, p. 4, n 1 (noting that Capitol had also filed a motion for summary judgment concerning its coverage defenses). Even more importantly, Oregon courts have specifically rejected the concept of "coverage by estoppel." *See, e.g., ABCD . . . Vision, Inc. v. Fireman's Fund Ins. Companies*, 304 Or 301, 306, 744 P2d 998 (1987) ("Estoppel cannot be invoked to expand insurance coverage or the scope of an insurance contract."); *Nw. Pump & Equip. Co. v. Am. States Ins. Co.*, 144 Or App 222, 226, 925 P2d 1241 (1996) ("Oregon is among the jurisdictions that have rejected the rule that insurers that wrongfully fail to defend are estopped from contesting coverage as to settlement costs."). Unless Brownstone is also requesting that this Court overturn *ABCD . . . Vision*, then Brownstone's out-of-state "coverage by estoppel" cases should be disregarded.

Brownstone relies on *Lamb-Weston, Inc. v. Oregon Auto. Ins. Co.*, 219 Or 110, 116, 341 P2d 110 (1959), for the proposition that "before *Stubblefield*, [the coverage by estoppel] rationale had been recognized by this court in the related context of consent-to-settle provisions...". Opening Brief, p. 49 n 23. However, as this Court previously explained, while sitting *en banc,* "estoppel is not available ... to negate an express exclusion in the written contract but is available ...to avoid a condition of forfeiture of coverage." *DeJonge v. Mut. of Enumclaw*, 315 Or 237, 241, 843 P2d 914 (1992). A consent to settle provision

is a condition of forfeiture because failure to comply with the condition negates coverage that otherwise would exist. *Id.* Here, the disputed "legally obligated to pay" language appears in the coverage grant, not in some condition of forfeiture. Accordingly, *Lamb-Weston* does not aid Brownstone.

E. Brownstone's other arguments for overturning *Stubblefield* should be rejected because they are not relevant under a *Hoffman* analysis.

Brownstone makes a variety of other arguments for why *Stubblefield* should be overturned, but none of the arguments are relevant under a *Hoffman* analysis. Brownstone argues that:

1. "The purpose of insurance is not just to protect the insured; it is also to protect the public." Opening Brief, p. 33.
2. "A court's task in construing a settlement agreement is to give effect to the intent of the parties by considering their agreement as a whole." *Id.*, at 42.
3. "*Stubblefield* failed to consider the court's policy of favoring settlements and their implementation." *Id.*, at 44.
4. "An insurer that has abandoned its insured is in no position to challenge an insured's decision to settle in a way that protects the insured, particularly when the challenge, if successful, results in a windfall for the insurer." *Id.*, at 46.

5. "*Stubblefield* is inconsistent with *Groce" v. Fid. Gen. Ins. Co.*, 252 Or 296, 302, 448 P2d 554 (1968), a case which did not discuss or interpret the phrase "legally obligated to pay." *Id.*, at 50.

None of the above arguments are relevant under a *Hoffman* analysis. Thus, unless Brownstone is also asking this court to overturn *Hoffman*, these arguments should be disregarded.

Moreover, each of Brownstone's arguments fails for additional reasons. With respect to the first argument, Brownstone relies on ORS 701.073 for the notion that the insurance policy should be construed to protect the public. However, as Brownstone acknowledges, Opening Brief, p. 34, ORS 701.073 requires contractors to obtain "liability" insurance. The word "liability," "in common usage, means '[t]he quality or state of being legally obligated or accountable[.]'" *Goddard*, 202 Or App at 102 (quoting *Black's Law Dictionary* 932 (8th ed. 2004). As discussed above, due to the unconditional covenant not to execute, Capitol's insured was not "legally obligated" to pay anything; it was not "liable." Accordingly, there is no conflict with ORS 701.073.

With respect to the second argument, Capitol was not a party to the settlement agreement and, therefore, is not bound by the settling parties' intent. Capitol's rights *vis-à-vis* its insured are determined by the plain language of the

insurance contract; not by what its insured and some third-party intended to accomplish by way of settlement.

With respect to the third argument – that *Stubblefield* failed to consider the policy of favoring settlements – *Stubblefield* did not discourage settlements but, rather, enforced plain policy language and, thereby, encouraged parties to be mindful of insurance coverage issues when they structure their settlements. Moreover, by requiring an actual "legal obligation" to pay, *Stubblefield* encourages reasonable settlements. As discussed above, in Section VII.3, the requirement that the insured actually be obligated on the judgment, even if for just a short period of time, appears to have been one of the legislature's concerns in imposing a timing requirement within ORS 31.825. After all, if the insured is never obligated on the debt, what incentive does it have to negotiate a reasonable settlement amount?

Unlike some other states that have rejected *Stubblefield,* Oregon does not have any legal mechanism in place to ensure that settlements obtained in exchange for a covenant not to execute are indeed reasonable. *See, e.g., Water's Edge Homeowners Ass'n v. Water's Edge Associates*, 152 Wash App 572, 582, 216 P3d 1110 (2009) ("Following the stipulated settlement, the parties jointly moved the trial court for a reasonableness hearing under RCW 4.22.060."). Absent such a mechanism to ensure reasonableness, overruling

Stubblefield would not encourage reasonable settlements but would actually encourage the opposite.

When Oregon's legislature enacted ORS 31.825, it could have thrown out *Stubblefield* entirely and enacted some other mechanism to ensure that stipulated settlements are unreasonable. Instead – and consistent with Oregon law which recognizes that insurance policies are contracts – the legislature chose to provide a route around *Stubblefield* that still honored and retained the "legally obligated to pay" requirement. In this manner, the insured retains an incentive to negotiate a reasonable settlement.

Simply overturning *Stubblefield*, without making any other changes to Oregon law, would encourage insureds and underlying plaintiffs to enter excessive settlements. It would also create confusion as to Oregon insurance law in general, especially if *Stubblefield* is overturned for policy concerns or any other reason inconsistent with a *Hoffman* analysis. In the context of a different effort to overturn existing law, this Court commented:

> Finally, and assuming that it is able to convince us of the incorrectness of the challenged rule, the state must persuade us that, when the passage of time and the precedential use of the challenged rule is factored in, overturning the rule will not unduly cloud or complicate the law.

Ciancanelli, 339 Or at 291. As explained above, overruling *Stubblefield,* would "unduly cloud or complicate the law." Accordingly, this Court should decline

Brownstone's invitation to overrule *Stubblefield*. Brownstone's arguments are more appropriately addressed to the legislature.

Brownstone's fourth argument is inconsistent with Oregon law providing that "[e]stoppel cannot be invoked to expand insurance coverage or the scope of an insurance contract." *ABCD . . . Vision, Inc.*, 304 Or at 306. As discussed more thoroughly above, in Section VII.3.D., Oregon law does not recognize "coverage by estoppel."

Similarly, Brownstone's reference to an alleged "windfall" in this fourth argument is also misplaced. At no point in the *Hoffman* analysis does the court consider the equities involved. Rather, interpretation of an insurance policy is a pure question of law. *Holloway,* 341 Or at 649. In *Holloway*, for example, this Court considered a strikingly similar settlement arrangement. The insured "stipulated to the entry of a $50,000 judgment," and "Holloway entered into a covenant not to execute on the judgment against the insured for more than $6,000." *Id.*, at 646. When Holloway attempted to collect the judgment balance, this Court rejected that attempt, finding that it was barred by an anti-assignment clause in the policy. *Id.,* at 649. This Court never reached the "merits"[6] of the insurance claim, explaining:

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[6] It should be noted that *Holloway* concerned an anti-assignment clause, while this case concerns the policy's insuring agreement. Whether or not the insured is "legally obligated to pay" is the first step in analyzing the merits of

> On review, the issues before us are whether Holloway alleged facts in her complaint against the insured sufficient to trigger Republic's duty to defend or duty to indemnify and whether the purported assignment from the insured to Holloway was valid. However, our analysis begins, and ends, with our decision respecting whether the purported assignment from the insured to Holloway was valid. Because we hold that it was not, we need not decide the issue respecting the allegations in Holloway's complaint.

Id., at 649. Thus, a "windfall"[7] was acceptable in *Holloway*. Unless Brownstone is asking this Court to also overturn *Holloway,* its "windfall" argument should be ignored.

With respect to the fifth argument, *Stubblefield* does not conflict with *Groce*. Most importantly, the insured in *Groce* did not receive an *unconditional* covenant not to execute, as was received by the insured in *Stubblefield*. *Groce*, 252 Or at 302 ("The consideration given for the assignments was the agreement of the plaintiffs to satisfy their judgments against Stayton *if* any recovery was had upon the actions against the insurer.") (emphasis added). Further, *Groce* concerned a tort claim, not a breach of contract action that would be governed by the "legally obligated to pay" language. *Id.*, at 302 ("...the plaintiffs

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an insurance claim, so the "merits" have been reached in this case even though they were not reached in *Holloway*.

[7] Capitol disputes the "windfall" characterization. It did not receive any money or other affirmative benefit as a result of the lower courts' decisions. All Capitol received was confirmation that it could enforce its insurance contract as written. The only potential "windfall" here would be a recovery by Brownstone even where the insured was not "legally obligated to pay" and, therefore, not entitled to any insurance benefits.

obtained written assignments from Stayton of his cause of action against the defendant for wrongful failure to settle."). Thus, it is no surprise this Court reached a different conclusion in *Groce* than it did in *Stubblefield.*

F. Should this Court overrule *Stubblefield,* it should do so only prospectively.

Finally, should this Court decide to overrule *Stubblefield* despite the arguments presented above, Capitol respectfully requests that the Court apply that ruling only prospectively. Because Capitol relied on the soundness of the *Stubblefield* decision in preparing its litigation strategy, and the trial court relied on the soundness of *Stubblefield* in declining to address Capitol's alternative motion, it would be unfair to suddenly deem that reliance improper and to send this matter back for trial. After all, Capitol possesses several other coverage defenses, *see* Opening Brief, p. 4 n 1 (acknowledging that Capitol also moved for summary judgment with respect to coverage defenses), and it would have relied on those instead of *Stubblefield* had it been aware that this Court was going to overrule a decision that has been the law of the land for forty years. *See Peterson v. Temple*, 323 Or 322, 324, 918 P2d 413 (1996) ("... because that holding is contrary to two prior decisions of this court and a prior decision of the Court of Appeals, and because plaintiff reasonably relied on those decisions in pursuing separate actions here, we apply our holding prospectively.").

VIII. CONCLUSION

For the reasons explained above, Brownstone's appeal should be dismissed as moot. Alternatively, Brownstone's arguments respecting the merits of the appeal should be rejected, and the Court of Appeals should be affirmed.

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Of Attorneys for Respondent

CERTIFICATION OF COMPLIANCE WITH BRIEF LENGTH AND TYPE SIZE REQUIREMENTS

Brief length

I certify that (1) this brief complies with the word-count limitation in ORAP 5.05(2)(b) and (2) the word count of this brief (as described in ORAP 5.05(2)(a) is 12,754 words.

Type size

I 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).

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CERTIFICATE OF SERVICE AND FILING

I hereby certify that on this date I served the foregoing RESPONDENT CAPITOL SPECIALTY INSURANCE CO.'S RESPONSE TO APPELLANT'S BRIEF ON THE MERITS on:

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CERTIFICATE OF FILING

I hereby certify that on October 31, 2013, I filed this RESPONDENT CAPITOL SPECIALTY INSURANCE CO.'S RESPONSE TO APPELLANT'S BRIEF ON THE MERITS on the:

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DATED: October 31st, 2013

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