

IN THE SUPREME COURT
OF THE STATE OF OREGON

FOUNTAINCOURT HOMEOWNERS'
ASSOCIATION and
FOUNTAINCOURT
CONDOMINIUM OWNERS'
ASSOCIATION,

Plaintiffs,

v.

FOUNTAINCOURT DEVELOPMENT,
LLC, et al,

Defendants.

FOUNTAINCOURT DEVELOPMENT,
LLC, et al,

Third-Party Plaintiffs,

v.

ADVANCED SURFACE
INNOVATIONS, INC., an Oregon
corporation, et al,

Third-Party Defendants.

Washington County Circuit
Court No. C075333CV

CA No. A147420

SC No. S062691

RESPONDENTS' BRIEF ON
THE MERITS

FILED: JUNE 2015

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

Fourth-Party Plaintiff,

v.

DANA CHRISTOPHER and RED HILLS
CONSTRUCTION, INC.,

Fourth-Party Defendants.

FOUNTAINCOURT HOMEOWNERS'
ASSOCIATION and FOUNTAINCOURT
CONDOMINIUM OWNERS'
ASSOCIATION,

Garnishors-Respondents,
Respondents on Review,

v.

AMERICAN FAMILY MUTUAL
INSURANCE COMPANY,

Garnishee-Appellant,
Petitioner on Review.

Designation of Parties Filing Brief: Respondents on Review
FountainCourt Homeowners' Association and FountainCourt Condominium
Owners' Association, Plaintiffs/Garnishors below.

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Court from which review is taken: This is a review of the August 6, 2014 decision of the Court of Appeals which (1) affirmed a December 14, 2010 Supplemental Judgment entered in Washington County Circuit Court (Hon. Marco A. Hernandez) in favor of Respondents and against Petitioner and (2) reversed an April 4, 2011 Supplemental Judgment for Attorney Fees, Costs and Disbursements entered in Washington County Circuit Court (Hon. D. Charles Bailey) in favor of Respondents and against Petitioner. The decision in the Court of Appeals was rendered by Armstrong, Presiding Judge; and Duncan, Judge, and Brewer, Judge pro tempore.

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I. Legal Questions Presented; Proposed Rules of Law

A. Questions Presented on Petitioner's Request for Review and Proposed Rules of Law

1. When a contractor is held liable on a single claim of negligently causing physical damage to property and the contractor's insurance policy provides that its insurer will pay the sums that the contractor becomes liable to pay as damages because of property damage, does the insurer have the right to relitigate the basis for the contractor's liability? No. When a judgment is entered against a contractor on a single claim of negligently causing physical property damage the contractor's insurer may not relitigate the basis for the contractor's liability.

2. Where an insurance policy is structured as a broad grant of coverage subject to exclusions, must the insured disprove the applicability of the exclusions in order to satisfy its *prima facie* burden? No. The insured does not have to disprove the applicability of exclusions where the policy is structured as a broad grant of coverage subject to exclusions; the insurer has the burden of proving the applicability of any exclusions.

3. Where a contractor's negligent work causes property damage that is covered by the contractor's insurance policy, can the insurer avoid liability because the contractor's work contained defects? No. Where

a contractor's negligent work causes covered property damage, the presence of defects in the contractor's work is immaterial to the coverage obligation.

4. Where a garnishment involves the interpretation of an insurance policy and there is no disputed issue of material fact, is the insurer entitled to a jury trial? No. An insurer is not entitled to a jury trial in a garnishment proceeding where there is no disputed issue of material fact.

B. Question Presented on Respondents' Contingent Request for Review and Proposed Rule of Law

Where, with leave of court for good cause shown and no prejudice to the adverse party, a party amends its pleading to allege a right to attorney fees under ORS 742.061 and the amended pleading is submitted to the court before judgment is entered awarding attorney fees, is the requirement of ORCP 68 C(2)(a) that a party plead the statute under which attorney fees are sought satisfied?

Yes. The requirement in ORCP 68 C(2)(a) that a party allege the statute that provides a basis for an award of attorney fees in a pleading filed by that party is satisfied where the party amends its pleading to allege the statute with leave of court for good cause shown prior to the entry of judgment awarding attorney fees and the failure to allege the statute in the original pleading did not affect the substantial rights of the adverse party.

II. Nature of the Action; Relief Sought in the Trial Court; Nature of the Judgments Rendered by the Trial Court

Respondents FountainCourt Homeowners' Association and FountainCourt Condominium Owners' Association (collectively "FountainCourt") were plaintiffs in the underlying construction defect case. The sole claim was negligence causing physical property damage. The jury rendered a verdict in favor of FountainCourt and against Sideco, Inc. ("Sideco"), among several other defendants. (TCF 411) The trial court entered a general judgment against Sideco in the principal amount of \$485,877.84. (TCF 455) Sideco did not appeal.

FountainCourt garnished two general liability insurance policies issued to Sideco by Petitioner American Family Mutual Insurance Company ("American Family"), as authorized by ORS 18.352. American Family denied responsibility for Sideco's debt. (TCF 493 ¶15) Following a show cause hearing held pursuant to ORS 18.782, the court made a determination that FountainCourt had met its *prima facie* burden of establishing coverage under the insuring agreement but American Family had not met its burden of proving the applicability of a policy exclusion. (TCF 525) The court entered a supplemental judgment against American Family for the unsatisfied portion (\$433,958.16) of the Sideco judgment (TCF 524) and a

second supplemental judgment for attorney fees of \$68,538 pursuant to ORS 742.061. (TCF 558)

American Family appealed from the supplemental judgments. The Court of Appeals affirmed the first supplemental judgment but reversed the second supplemental judgment awarding attorney fees. *FountainCourt Homeowners' Association v. FountainCourt Development, LLC*, 264 Or App 468, 334 P3d 973 (2014).

III. Facts Material to Review

FountainCourt's case against Sideco went to the jury on the sole claim of negligence causing physical property damage pursuant to *Harris v. Suniga*, 344 Or 301, 180 P3d 12 (2008). *FountainCourt*, 264 Or App at 484. The trial court instructed the jury that "Plaintiffs must allege and prove physical damage to their property." *Id.* The court further instructed the jury on the measure of damages, as follows:

"If you find that the plaintiffs are entitled to damages, you shall determine the amount of physical damage to the plaintiffs' real property, if any, that was caused by the defendant's fault or negligence. The measure of damages for the partial destruction of real property is the reasonable cost of repairing the damaged property."

Id. This instruction mirrored UCJI No. 70.12.

The jury found Sideco negligent, awarded damages of \$2,145,156 and allocated 22.65% of the fault to Sideco; the court entered judgment against Sideco. *FountainCourt*, 264 Or App at 475.

At the garnishment hearing, FountainCourt showed that Sideco's negligent work had caused damage to each of the FountainCourt buildings during the two-year American Family policy period. *Id.* at 481-82. This evidence was not disputed. Rather, American Family argued that FountainCourt could not collect under the policy because it could not show (1) what *portion* of the judgment represented the cost to repair damage to underlying building components (as opposed to damage to Sideco's own work) and (2) what *portion* or amount of damage occurred during the American Family policy period (as opposed to time periods before and after American Family's policy was in effect).

The trial court rejected American Family's argument that it was FountainCourt's burden to prove these things. It held that American Family had the burden of proving what portion of the judgment represented damage to Sideco's own work, if it wished to rely on the "Damage to Your Work" exclusion in the policy, and it had failed to meet that burden. The court further held that FountainCourt met its burden of proving coverage under the policy – i.e., that the judgment against Sideco was for "damages because of

property damage” during the policy period – and did not have to parcel damages into discrete time periods. (*See TCF 525*)

The Court of Appeals likewise rejected American Family’s argument that FountainCourt had the burden of carving out from the jury’s verdict the amount of damages, if any, that represented the cost to repair damage to Sideco’s own work, as opposed to damage to other components.

FountainCourt, 264 Or App at 483-84 (“Giving effect to every provision in the policy, . . . we reject the idea that the ‘your work’ distinction is, as American Family urges, one inherent in the definition of ‘property damage,’ rather than an exclusion under the policy.”). The Court of Appeals also rejected American Family’s argument that to obtain coverage FountainCourt had to show “which portion of the damages awarded by the jury occurred during the discrete period of time that American Family was on the risk.”

Id. at 486. Rather, it held that “FountainCourt had the *prima facie* burden to prove that the judgment awarding damages against Sideco reflected amounts that Sideco was legally obligated to pay as damages because of property damage that occurred during American Family’s policy period,” and that the trial court did not err in concluding that FountainCourt had met its burden.

Id.

American Family did not argue in the Court of Appeals that the supplemental judgment was erroneous in light of the multi-unit exclusion in the insurance policy. *See id.* at 479 (identifying American Family's three assignments of error with respect to that judgment) and Appellant's Brief at 4-7 (Summary of Arguments). Yet American Family attempts to raise that argument in this review proceeding. American Family failed to preserve this argument and it should not be considered. *State v. Burgess*, 352 Or 499, 508, 287 P3d 1093 (2012).

FountainCourt requested attorney fees pursuant to ORS 742.061 in its Pre-Hearing Memorandum (TCF 510) but did not specifically allege the statute in its original garnishment pleading or motion for order to show cause. At the close of the garnishment hearing, FountainCourt repeated its request for an award of fees. (Tr 5519-20) American Family asked the trial court to defer a decision on fees until after it ruled on the merits. The court agreed to the request. (Tr 5549-50) In its order finding for FountainCourt on the merits, the court directed FountainCourt to file an ORCP 68 motion. (TCF 525 ¶5)

American Family objected to FountainCourt's ORCP 68 motion on two grounds, arguing first that ORS 742.061 should not apply in a garnishment proceeding and second, that even if it does apply FountainCourt

did not plead an entitlement to attorney fees as required by ORCP 68 C(2).

See FountainCourt, 264 Or App at 491. The trial court found that American Family had “purposely wait[ed] until after the trial to object apparently so plaintiff could not move to amend its original motion.” (Ex 1 to TCF 558) It held that American Family “should not benefit from waiting in the woods to ambush” and granted *FountainCourt* leave to amend. *Id.*

On March 11, 2011, *FountainCourt* submitted to the court and served American Family with its “Amended Allegations” pleading pursuant to ORS 18.780 (TCF 557) and its Amended Motion for Order to Show Cause (TCF 556). Both specifically alleged that *FountainCourt* was entitled to “attorney fees pursuant to ORS 742.061.”¹ The court entered a supplemental judgment awarding *FountainCourt* \$68,538 in attorney fees on April 4, 2011. (TCF 558)

The Court of Appeals reversed the supplemental judgment for attorney fees, holding that *FountainCourt* did not properly plead entitlement to fees as required by ORCP 68 C. *FountainCourt*, 264 Or App at 491.

¹ The Amended Allegations was submitted to the trial court under cover of a March 11, 2011 letter from counsel and is in the record as TCF 557. The certificate of service attached thereto indicates that it was served on counsel for American Family on March 11, 2011. Although for some reason the pleading was not filed by the clerk until April 4, 2011, the filing occurred “within a reasonable time after service” as permitted by ORCP 9 C.

FountainCourt filed a Petition for Reconsideration. By Order dated September 22, 2014, the Court of Appeals denied reconsideration. In its response to American Family's Petition for Review by this Court, FountainCourt included a contingent request for review of the Court of Appeals' decision reversing the trial court's award of attorney fees, pursuant to ORAP 9.10(1).

IV. Summary of Argument

FountainCourt's responses to American Family's four arguments are summarized as follows:

1. This is not a "mixed coverage" case and American Family's attempt to characterize it as such is mistaken and misleading. The case against Sideco went to trial on a single claim – negligence causing physical property damage – and the jury was instructed that the measure of damages was the cost to repair the physical damage to FountainCourt's property. The burden of proving that a portion of the damages awarded by the jury was for the cost to repair damage to Sideco's own work, as opposed to damage to other components, rested with American Family as the party asserting that the "Damage to Your Work" policy exclusion was applicable. That American Family was unable to meet its burden does not make this a "mixed coverage" case.

2. The trial court (and the Court of Appeals) rightly held that FountainCourt met its *prima facie* burden of proving that the judgment against Sideco was for “damages because of property damage” covered by the American Family insurance policy. American Family’s suggestion that this burden was met with evidence showing “only the possibility” that the damages were within the insuring agreement is false: FountainCourt showed that Sideco was held liable for damages because of property damage that occurred during the policy period – the proof needed to meet its burden. *In addition*, FountainCourt showed that all of the damages awarded could have been for the cost to repair underlying components rather than repairing damage to Sideco’s work. This testimony, which was not controverted by American Family, was unnecessary to meeting FountainCourt’s *prima facie* burden and was offered only to rebut American Family’s contention that the “Your Work” exclusion applied and that FountainCourt (rather than American Family) had the burden of excluding any cost to repair damage to Sideco’s work. American Family’s argument is a red herring.

3. The trial court did not equate defective work with property damage. The court properly instructed the jury that if it found Sideco liable it should determine “the amount of physical damage to the plaintiffs’ real property, if any, caused by the defendant’s fault or negligence.”

(Tr 4963-64) This uniform instruction was a correct statement of the law and the jury is presumed to have followed it. *State v. Smith*, 310 Or 1, 26, 791 P2d 836 (1990). FountainCourt proved extensive damage to property caused by Sideco's work. The subsequent garnishment involved no "assumed" factual findings. Nor was it FountainCourt's burden to show what portion of the damage occurred during the American Family policy period. Proof *that* the judgment represented amounts that Sideco was required to pay as damages because of property damage that occurred during the policy period was sufficient to meet FountainCourt's *prima facie* burden. Finally, American Family's argument regarding the multi-unit exclusion was not raised in the Court of Appeals should not be considered.

4. The question before the trial court at the garnishment hearing was the interpretation of American Family's insurance policy, which was a question of law. *Hoffman Construction Co. v. Fred S. James & Co.*, 313 Or 464, 469, 836 P2d 703 (1992). American Family's attempt to controvert the existence of property damage, established in the underlying trial against Sideco, did not create an issue of fact. The fact of Sideco's liability for damages because of property damage was conclusive against American Family. *Jarvis v. Indemnity Ins. Co.*, 227 Or 508, 363 P2d 740 (1961). There was no disputed issue of material fact and no right to a jury trial.

The argument supporting FountainCourt's contingent request for review is summarized as follows:

5. ORCP 68 C(2)(a) provides that a party seeking attorney fees shall allege the statute that provides a basis for the award in "a pleading" filed by that party. In its initial pleading, FountainCourt did not allege that it was relying on ORS 742.061. That omission was cured in FountainCourt's amended pleading, which was submitted to the court weeks before the supplemental judgment awarding fees was entered. FountainCourt's failure to allege a right to attorney fees under ORS 742.061 in its original pleading was not a defect that affected the substantial rights of American Family, and American Family has never contended that it did. Its assignments of error in the Court of Appeals were limited to the issues of whether the pleading requirement of ORCP 68 C was met and whether ORS 742.061 applies in a garnishment proceeding. Because FountainCourt filed "a pleading" that alleged the right to fees under ORS 742.061, and the omission of that allegation in the original pleading did not prejudice American Family, the trial court's fee award was proper. The Court of Appeals misunderstood the relevant sequence of procedural events and its reversal of that judgment was error and should be reversed.

V. Argument

A. Coverage Was Determined From Established Facts, Not “Assumed” Facts

It has long been the law of this state that an insurance carrier may be liable under a policy of insurance that covers the liability of its insured determined in an underlying judgment. Indeed, ORS 18.352 states that rule and any number of cases embody it. *See Jarvis*, 227 Or at 511-12 (underlying judgment is conclusive in subsequent coverage litigation “if the issue decided in the prior action was material to the judgment and is identical with the issue claimed in the later action to be res judicata, even though the insurer was not a party to the first action.”); *Heider v. Commercial Ins. Co.*, 248 Or 564, 566, 436 P2d 268, 269 (1968) (“cases may arise in which the complaint would not allege facts creating a duty to defend but that the ultimate proof in the case would show a duty to pay a judgment entered on the complaint.”); *Ledford v. Gutoski*, 319 Or 397, 403, 877 P2d 80, 84 (1994) (“Even when an insurer does not have a duty to defend based on the allegations in the initial complaint, the facts proved at trial on which liability is established may give rise to a duty to indemnify if the insured's conduct is covered.”); *Mutual of Enumclaw Ins. Co. v. Gass*, 100 Or App 424, 428, 786 P2d 749, *rev den*, 310 Or 70, 792 P2d 104 (1990)

(“The duty to pay is independent of the duty to defend and depends on whether the evidence at trial shows that the judgment was entered on a covered claim.”) (citing *Heider*).

“It is well settled that the pleadings may be introduced to show what was adjudicated, and in the absence of conflicting evidence they are, of course, conclusive. It is elementary law that the relief granted must necessarily be responsive to and in conformity with the pleadings and proof.”

Jarvis, 227 Or at 515.²

Here, the case against Sideco went to the jury on the single theory of negligence causing physical property damage. The jury was instructed that FountainCourt had to prove physical damage to its property and that if FountainCourt showed such damage the jury must determine “the amount of physical damage to plaintiffs’ real property, if any, that was caused by the defendants’ fault or negligence.” *FountainCourt*, 264 Or App at 474-75. As the Court of Appeals noted, “FountainCourt could not have prevailed on its claim without proving that Sideco negligently caused damage to FountainCourt’s property.” *Id.* at 486.

American Family’s argument that the determination of its coverage obligation was based on “assumed factual findings” is therefore meritless.

² In this case, the trial judge who presided at the garnishment hearing also presided at the underlying trial against Sideco and obviously knew “what was adjudicated” in that action. (*See Tr 5194-95*)

The trial court's determination that American Family was liable under the policy was based on an interpretation of the policy in light of facts that were actually and necessarily adjudicated in the underlying action, as determined by the pleadings, jury instructions, verdict and judgment.

American Family's argument conspicuously conflicts with its prior admission that the Sideco judgment included covered damages. According to American Family's brief below, "The issue is not *whether* the claims against Sideco triggered American Family's 'property damage' coverage. The issue is *how much* 'property damage' occurred during the American Family policy period." (Appellant's Reply Brief at 13, emphasis added.)

See also FountainCourt, 264 Or App at 485 ("American Family concedes that '[s]ome consequential water damage may have occurred while American Family was on the risk.'").

The burden of proving that some portion of the damages awarded was for the cost to repair damage to Sideco's own work, as opposed to damage to other components, rested with American Family as the party asserting the "Damage to Your Work" exclusion.³ *Stanford v. American Guaranty Life Ins. Co.*, 280 Or 525, 527, 571 P2d 909 (1977). Under *ZRZ Realty v.*

³ The "Damage to Your Work" exclusion appears at page 4 of Ex 122 and at SER 10 in Respondents' Answering Brief.

Beneficial Fire & Casualty Ins., 349 Or 117, 241 P3d 710 (2010), *adh'd to as modified on recons*, 349 Or 657, 249 P3d 111 (2011), that distinction was not “one inherent in the definition of ‘property damage[.]’” *FountainCourt*, 264 Or App at 484. Rather, as the Court held in *ZRZ Realty*, “our cases allocate the burden of production and persuasion based on whether the policy grants limited coverage or broad coverage subject to an exclusion.” 349 Or at 132.

The American Family policy contains a broad grant of coverage subject to exclusions. American Family’s argument ignores the structure of its policy and the proper allocation of burdens derived from that structure. Notably, American Family has never suggested that it met its burden of proving the applicability of the “Your Work” exclusion. Rather, its entire effort has been spent trying to convince the courts that it should be relieved of that burden and that *FountainCourt* should have to carve out any damages potentially subject to a policy exclusion. That is not the law.

American Family relies on *Ferguson v. Birmingham Fire Ins. Co.*, 254 Or 496, 460 P2d 342 (1969), for the rule that an insurer can contest coverage following a liability trial against its insured. In this case, American Family did contest coverage; it was not denied that opportunity. But it could not retry the underlying liability case in the guise of contesting coverage.

In *Ferguson*, the complaint against the insured alleged willful trespass and sought treble damages; but the statute also permitted plaintiff to recover double damages for non-willful trespass, without amending the complaint. *Id.* at 507. The Court ruled that the insurer had a duty to defend because the complaint raised the potential for liability based on covered (i.e., non-willful) conduct but that the insured could not require the insurer to waive its right to deny indemnity coverage for liability based on intentional conduct as a condition of defending. *Id.* at 511. Critically, the Court reversed the trial court's interpretation of an exclusion for damage to property over which the insured was exercising control, and remanded for a new determination of coverage in light of its interpretation, stating: "We hold, therefore, that if on remand the question of coverage is resolved in favor of plaintiff, defendant will be liable for the amount of the judgment" in the underlying liability action. *Id.* at 512. The case thus reaffirms the principle that the judgment in the liability action can establish coverage where the insurer fails to prove the applicability of an exclusion.

American Family's reliance on *Ohio Casualty Ins. Co. v. Ferrell Developments, LLC*, 2011 WL 5358620 (D Or 2011), and *State Farm Fire & Cas. Co. v. Paget*, 123 Or App 558, 860 P2d 864 (1993), *rev den*, 319 Or 36 (1994), is likewise misplaced. *Ferrell* involved an award of damages against

the insured for, among other things, increased permit costs, financing costs and other sums that the court found were not “property damage.” At *6. The court granted summary judgment for the insurer when the insured did not prove how much of the award was covered. At *8. FountainCourt respectfully submits that the court in *Ferrell* incorrectly analyzed the issues and erroneously placed the burden on the insured to eliminate excluded damages. In any event, there is nothing to eliminate in the present case. The Sideco judgment awarded damages for one thing only: physical damage to property.

In *Paget*, a divided Court of Appeals held that a judgment in the underlying action that the insured was liable for negligent assault did not preclude the insurer from asserting that there was no coverage because the question whether the insured had acted intentionally was not litigated in the underlying case. The majority found that the insurer’s duty of loyalty to the insured precluded it from trying to show intentional conduct.⁴ The court relied on the *Restatement (Second) of Judgments* §§ 58(1)(b) and 58(2)

⁴ Judge Rossman dissented, noting that the evidence in the underlying case showed conclusively that the judgment against Paget was based on covered conduct: “State Farm is obligated to pay the judgment in *Colvin v. Paget*, because, according to the uncontested evidence in this proceeding, it is precisely the obligation that State Farm has agreed to pay under the terms of the policy.” *Paget*, 123 Or App at 564.

(1980) which state that an indemnitor is precluded from relitigating issues determined against the indemnitee “as to which there was no conflict of interest” between them and that a conflict of interest for these purposes exists when the claim against the indemnitee “is such that it could be sustained on different grounds, one of which is within the indemnitor’s obligation to indemnify and another of which is not.” *Paget*, 123 Or App at 563.

Here, in clear contrast, the claim against Sideco could not be sustained on “different grounds.” The only ground on which the claim could be sustained was upon proof of negligence causing physical property damage. *FountainCourt*, 264 Or App at 486. Sideco had every reason to oppose a finding of property damage in an effort to avoid liability for negligence and its counsel did so vigorously. The interests of Sideco and American Family were perfectly aligned in this respect and American Family’s suggestion of a conflict with its insured is contrived. Sideco’s liability because of property damage was actually litigated and essential to the judgment, and American Family is bound by it. *Paget* is inapplicable.

American Family’s demand for a holding that, whenever an insurer defends under a reservation of rights, the judgment in the underlying liability action has no effect other than to cap the insurer’s liability, finds no support

in any authority cited to this Court and would rewrite more than 50 years of settled law.

B. Coverage Was Based on Proof, not “Possibility”

The trial court (and the Court of Appeals) held that FountainCourt met its *prima facie* burden of proving that the judgment against Sideco reflected “damages because of property damage” covered by the American Family insurance policy. American Family argues that this burden was met with evidence showing “only the possibility” that the damages were within the insuring agreement. This argument is demonstrably false.

FountainCourt showed that the judgment against Sideco was for damages because of property damage that occurred during the policy period. This satisfied FountainCourt’s *prima facie* burden. But FountainCourt went beyond that and showed that all of the damages awarded could have been for the cost to repair underlying components rather than repairing damage to Sideco’s work. *FountainCourt*, 264 Or App at 485. This testimony from its expert, not controverted by American Family, was unnecessary to meeting FountainCourt’s *prima facie* burden. Rather, it was offered to rebut American Family’s contention that the “Damage to Your Work” exclusion applied and that plaintiffs had the burden of excluding the cost to repair damage to Sideco’s own work.

FountainCourt has never asserted that it can obtain coverage merely by showing the “possibility” that the judgment against Sideco was for covered property damage. American Family’s statement that FountainCourt so argued (Petitioner’s Brief at 18) lacks citation to the record and is utterly without support. Rather, FountainCourt showed conclusively that the judgment against Sideco was for damages because of property damage that occurred during the policy period. Even though it has admitted as much, American Family refuses to pay on its obligation, instead urging the Court to erect new impediments to obtaining policy benefits.

C. Sideco’s Liability Was Because Of Property Damage, not Defective Work, Caused by an Occurrence During the Policy Period

FountainCourt presented proof that Sideco’s negligent installation of siding materials allowed water intrusion and resulting physical damage to underlying components installed by others. This evidence is summarized in Trial Exhibit 112 and testimony from plaintiffs’ expert at Tr 5278. In other words, FountainCourt proved that Sideco’s work damaged other property.

The jury was instructed in accordance with UCJI No. 70.12 that the measure of damages for partial destruction of real property is the reasonable costs of repairing the damaged property. FountainCourt presented evidence regarding the reasonable cost to repair the damaged property. (*Eg*, Ex 109)

The jury did not accept FountainCourt's figure and awarded a lower amount. *FountainCourt*, 264 Or App at 474, 475. Sideco was found 22.65 percent at fault. *Id.*

American Family argues that because the FountainCourt cost estimate included amounts to repair damage to Sideco's work as well as damage to other work, the judgment against Sideco is not limited to damages because of "property damage." This argument flies in the face of the plain language of the policy grant, which provides that American Family will pay amounts that the insured is legally obligated to pay in damages "because of" property damage. The grant does not say that American Family will only pay *for* property damage, much less that it will only pay for property damage to property other than the insured's work.

American Family's position also ignores the rule of *ZRZ Realty*, 349 Or at 132. The policy here contains a broad grant of coverage, subject to certain exclusions. The exclusion for property damage to "your work" is not part of the insuring grant. To the extent American Family contends that some portion of the damages awarded by the jury was for repairing damage to Sideco's own work, it was incumbent upon American Family to prove it. American Family failed to do so and instead tried to shift that burden to FountainCourt.

This is the persistent fallacy in American Family's position. It argues that defective workmanship is not covered (Petitioner's Brief at 22), but this is a materially incomplete and inaccurate statement. A correct statement would be that a showing that the insured's work is defective, *without more*, does not establish coverage under the CGL policy. That is the import of the cases cited by American Family. *See Milgard Manufacturing, Inc. v. Continental Ins. Co.*, 92 Or App 609, 759 P2d 1111 (1988) (claim for cost of design alterations and diminution in value); *California Ins. Co. v. Stimson Lumber Co.*, 325 Fed Appx 496 (9th Cir 2009) (amounts paid by insured in class action settlement for replacement of defective siding product); *cf. Oak Crest Construction Co. v. Austin Mutual Ins. Co.*, 329 Or 620, 998 P2d 1254 (2000) (damages to redo paint that failed to cure); *Schneider Equipment, Inc. v. Travelers Indemnity Co.*, 2006 WL 2850465 (D Or 2006) (insurer met burden of proving applicability of exclusion for damage to the well on which the insured was working); *Naumes, Inc. v. Chubb Custom Ins. Co.*, 2007 WL 54782 (D Or 2007) (suit involving nonconforming ingredients added to diet drink, which required destruction of drink, stated claim for property damage).

None of these cases holds that the presence of defective work defeats coverage where there is resulting damage. Nor do the cases hold that repairs

to damaged property cannot include repairs of the conditions that caused the damage. In *Farmers Ins. Co. v. Trutanich*, 123 Or App 6, 11, 858 P2d 1332 (1993), a homeowner made a claim under his policy after discovering strong odors in the house caused by a tenant that had operated a methamphetamine lab. The insurer argued that there was no property damage, citing *Wyoming Sawmills, Inc. v. Transportation Ins. Co.*, 282 Or 401, 578 P2d 1253 (1978). The court held otherwise, stating:

“There is evidence that the house was physically damaged by the odor that persisted in it. The cost of removing that odor was a direct rectification of the problem. *Wyoming Sawmills* thus is not directly applicable here. To the extent that it has any relevance, it supports the conclusion that the removal cost is a direct physical loss.”

123 Or App at 10-11. See also *Mutual of Enumclaw Ins. Co. v. T&G Construction, Inc.*, 165 Wash2d 255, 270, 199 P3d 376, 384 (2008) (“Removing and repairing the siding is simply part of the cost of repairing the damage to the interior walls and was properly treated as property damage by the trial court.”). American Family’s reliance on *Wyoming Sawmills* is misplaced. See *FountainCourt*, 264 Or App at 484 n 10.

American Family also cites the unpublished decision in *MW Builders, Inc. v. Safeco Ins. Co.*, 267 Fed Appx 552 (9th Cir 2008), for the proposition that, “For a claim of faulty workmanship to give rise to ‘property damage,’ a claimant must demonstrate that there is damage to property separate from

the defective property itself.” (Petitioner’s Brief at 24) FountainCourt amply demonstrated such damage in the trial against Sideco. (*Eg*, Ex 112 and Tr 5278) Cases dealing with defective work standing alone are inapposite.⁵

American Family promised to pay “those sums that the insured becomes legally obligated to pay as damages because of . . . ‘property damage.’” (Ex 122, page 1 (SER 9)) Sideco became liable to pay damages because of property damage caused by its negligence. But for the finding of property damage, Sideco would not have been liable. *Harris v. Suniga*, 344 Or at 310-11. All of Sideco’s liability, therefore, was “because of” property damage. Under the coverage grant, it does not matter which property is damaged. If there is liability because of property damage the grant is satisfied and the burden shifts to the insurer to prove the applicability of exclusions. Having promised to pay those sums for which Sideco became liable “because of property damage,” up to the policy limit, American

⁵ *MW Builders* fails to recognize that, if there is liability because of property damage – any property damage – the coverage grant is satisfied. *MW Builders* was decided more than two years before this Court, in *ZRZ Realty*, clarified that burden-of-proof allocation is a function of how the coverage grant is structured. See *ZRZ Realty*, 349 Or at 132 (“our cases allocate the burden of production and persuasion based on whether the policy grants limited coverage or broad coverage subject to an exclusion”).

Family is liable for the judgment against Sideco, as the trial court and the Court of Appeals correctly held.

Nor was it FountainCourt's burden to establish the portion of the damages awarded by the jury that occurred during the American Family policy period. Proof *that* the judgment represented amounts that Sideco was required to pay as damages because of property damage that occurred during the policy period was sufficient to meet FountainCourt's *prima facie* burden. *FountainCourt*, 264 Or App at 486-87 ("FountainCourt has established that the judgment was 'based upon evidence which identified it as one within the coverage of the insurer's obligation,' *Jarvis v. Indemnity Ins. Co.*, 227 Or 508, 512, 363 P2d 740 (1961), thus satisfying its *prima facie* burden.").

The American Family policy defined "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." See *FountainCourt*, 264 Or App at 473 (quoting policy). In rejecting American Family's timing-of-damage argument, the Court of Appeals referenced the continuing nature of the water damage experienced at FountainCourt, stating:

"In the case of continuing and progressive water damage, the award of damages is not tied to discrete instances of property damage along a time continuum; instead the liability for property damage may be the same in every triggered policy period."

Id. at 487.

This reasoning follows *St. Paul Fire & Marine Ins. Co. v. McCormick & Baxter Creosoting Co.*, 324 Or 184, 923 P2d 1200 (1996). In that case, construing the “during the policy period” language in a general liability policy comparable to American Family’s, the Court held that “if an insurable event – i.e., an accident – occurs at some point during the course of the policy period, then that event is covered.” 324 Or at 201. “If *property* is injured during the policy period, there has been an ‘occurrence,’ and coverage under the policy is triggered.” *Id.* (emphasis in original).

Accordingly, it was not FountainCourt’s burden to prove the amount of damage that occurred during the American Family policy period. When continuing physical injury to tangible property occurs in successive policy periods, and the property damage results in the insured’s liability, each policy is triggered up to its limits of insurance. *See Cascade Corp. v. American Home Assurance Corp.*, 206 Or App 1, 8-9, 12, 135 P3d 450 (2006) (existence of other insurance does not permit one insurer to pay less than the limits of an applicable policy).

The final argument in Section V(C) of American Family’s brief involves a policy exclusion for property damage arising out of the insured’s work on certain defined multi-unit buildings, American Family contending

that “only 3” of the FountainCourt buildings were covered under its policy. (Petitioner’s Brief at 29-30) American Family made no assignment of error in the Court of Appeals regarding the trial court’s ruling that American Family had failed to meet its burden of proving that the multi-unit exclusion was applicable. Nor did it make any argument on the issue.

“It has long been the rule in this court that we will not address arguments that were not raised in the Court of Appeals.” *State v. Burgess*, 352 Or 499, 508, 287 P3d 1093 (2012); *see also Tarwater v. Cupp*, 304 Or 639, 644 n 5, 748 P2d 125 (1988) (petitioner on review “cannot shift or change his position and argue or raise an issue that was not before the Court of Appeals”); ORAP 5.45(1). American Family’s argument regarding the multi-unit exclusion and the damages assessed against Sideco that it now contends were covered by the exclusion was not preserved and should not be considered.

D. American Family Was Not Entitled to a Jury Trial

The garnishment proceeding was properly tried by the court as upon an issue of law, pursuant to ORS 18.782.⁶ American Family's attempt to controvert facts necessarily determined in the *underlying* action – i.e., that Sideco's work caused physical damage to FountainCourt's property – was unavailing to create a material issue of fact. The jury's determination in the underlying case that Sideco's negligence caused \$485,877.84 in physical property damage was conclusive and not subject to retrial. *Jarvis*, 227 Or at 515. In the garnishment proceeding, American Family attempted to avoid this outcome by suggesting that “physical damage” as defined in the jury instruction and “physical injury” under the policy definition of property damage were different. The argument was disingenuous at best and did not raise a factual issue requiring resolution. *See Straube v. Larson*, 287 Or 357, 361 n 1, 600 P2d 371 (1979).

To decide the garnishment issue, the trial court received evidence on whether property damage for which Sideco had been held liable occurred

⁶ ORS 18.782 provides that “[t]he proceedings against a garnishee shall be tried by the court as upon the trial of an issue of law between a plaintiff and defendant.” This statutory language replaced ORS 29.350 which, prior to its repeal in 1981, provided that garnishment issues would be tried “as upon the trial of an issue of fact.” Or Laws 1981, ch 883, §§ 1, 24.

during the policy periods. FountainCourt's expert so testified. (Tr 5283) That testimony was not disputed: American Family's expert agreed that all of the damage presented to the jury could have occurred during the policy periods. (Tr 5440)

There was no dispute over facts material to the garnishment and American Family was not entitled to a jury trial.

E. The Trial Court's Award of Attorney Fees Was Proper and Should be Reinstated

The trial court had discretion to disregard the defect in FountainCourt's original pleading and allow amendment pursuant to ORCP 12 B. As noted in *Lumbermen's v. Dakota Ventures*, 157 Or App 370, 375, 971 P2d 430 (1998):

“Although on its face ORCP 68 C is stringent, its mandate is tempered by ORCP 12 B, which directs the court to ‘disregard any error or defect in the pleadings or proceedings which does not affect the substantial rights of the adverse party.’ * * * Thus, we look to whether plaintiff was fairly alerted to the fact that attorney fees would be sought and whether the defect in the pleading prejudiced plaintiff.”

Id. (citations omitted).

The failure by FountainCourt to specifically allege a right to attorney fees under ORS 742.061 in its original Allegations pleading was not a defect that affected the substantial rights of American Family. FountainCourt

requested an award of fees under ORS 742.061 in its Pre-Hearing Memorandum (TCF 512). *FountainCourt*, 264 Or App at 493. The court's order allowing FountainCourt to amend did not prejudice American Family's ability to defend against the fee application on the merits, and American Family has at no time argued that it was prejudiced. American Family based its fourth assignment of error below on two technical points only, contending first that the allegation requirement of ORCP 68 C was not met and second that ORS 742.061 does not apply in a garnishment proceeding. *FountainCourt*, 264 Or App at 491. It has never asserted prejudice.

In reversing the fee award, the Court of Appeals relied on *Mulier v. Johnson*, 332 Or 344, 350, 29 P3d 1104 (2011), in which the right to fees was alleged in a summary judgment memorandum but not in the motion itself as required by ORCP 68 C(2)(b). In that case the failure to comply with the rule was never cured. Here, with leave of court granted for good cause, FountainCourt amended its pleading to specifically allege a right to attorney fees under ORS 742.061, thus satisfying ORCP 68 C(2)(a). The amended pleading was submitted to the court weeks before the supplemental judgment was entered. *Mulier* is not applicable.

ORS 742.061 is an important statute that protects the right of an insured (or its creditor) to recover an attorney fee if the insurer fails to settle a claim within six months of tender and the plaintiff's recovery exceeds the amount offered by the insurer. *See Chalmers v. Oregon Auto. Ins. Co.*, 263 Or 449, 452, 502 P2d 1378 (1972) (ORS 742.061(1) was intended "to encourage the settlement of [insurance] claims without litigation and to reimburse successful plaintiffs reasonably for moneys expended for attorney fees in suits to enforce insurance contracts"). ORS 742.061(1) provides in pertinent part as follows:

"Except as otherwise provided in subsections (2) and (3) of this section, if settlement is not made within six months from the date proof of loss is filed with an insurer and an action is brought in any court of this state upon any policy of insurance of any kind or nature, and the plaintiff's recovery exceeds the amount of any tender made by the defendant in such action, a reasonable amount to be fixed by the court as attorney fees shall be taxed as part of the costs of the action and any appeal thereon."

American Family offered nothing to settle Sideco's liability to FountainCourt (*see TCF* 491 at 4:22-5:10) despite the fact that Sideco's liability squarely triggered coverage under the policy. Moreover, American Family knew that Sideco was effectively insolvent and would not be able to renew its state contractor's license unless the judgment was satisfied. (Tr 5386-87, 5399-5400) Its policy provided that "insolvency of the insured or

the insured's estate will not relieve us of our obligations." (Ex 122 at 8 (SER 11)) Yet it tendered nothing and instead chose a course of protracted litigation in an attempt to avoid its policy obligations to Sideco and make it harder for other insured contractors to recover in like circumstances. This is therefore a case in which the rationale underlying a fee award pursuant to ORS 742.061 is especially compelling. FountainCourt should be reimbursed for the attorney fees it has incurred to secure coverage under the policy.

VI. Conclusion

The Court of Appeals' decision affirming the December 14, 2010 Supplemental Judgment was correct and should be affirmed. The Court of Appeals' decision reversing the April 4, 2011 Supplemental Judgment for Attorney Fees, Costs and Disbursements was in error and should be reversed and the Supplemental Judgment reinstated.

RESPECTFULLY SUBMITTED on June 18, 2015.

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**CERTIFICATE OF COMPLIANCE
WITH BRIEF LENGTH AND TYPE
SIZE REQUIREMENTS**

I certify that the word count of this brief (as described in ORAP 5.05(2)(b)(B)) is 7,244 words, which is within the authorized limit of ORAP 9.17(3)(c). In calculating the number of words, I relied on the word count function of my word processing software.

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

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CERTIFICATE OF SERVICE AND FILING

I certify that on June 18, 2015 I served two copies of **Respondents'** **Brief on the Merits** by mailing one copy via first class U.S. Mail, postage prepaid, addressed to each of the following counsel for Petitioner:

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I further certify that on June 18, 2015 I filed the original of this **Respondents' Brief on the Merits** by electronic filing with the court, addressed as follows: appellaterecords@ojd.state.or.us.

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