BULLIVANTHOUSER

Matthew J. Sekits
Seattle,
Shareholder-in-Charge

Direct Dial: 206.521.6452
Fax: 206.386.5130
Email Attorney

Liability insurers are bound by findings in judicially approved settlements

By Matthew J. Sekits

The Washington Supreme Court, in *Mutual of Enumclaw v. T&G Construction,* __ P.3d __, 2008 WL 4670256 (Wash., Oct. 23, 2008), held that, if a coverage question turns upon the same facts at issue in the underlying action, the liability insurer will be bound by the results of a settlement judicially approved as reasonable, absent collusion or fraud.

In this case, Mutual of Enumclaw (MOE) provided liability insurance to T&G, a siding subcontractor on a condominium project. After the project was complete, the condominium owners association (Association) sued the general contractor for poorly installed siding, which caused rot and mold to the surfaces underneath the siding. The general contractor, in turn, sued T&G.

T&G tendered to MOE, and MOE defended under a reservation of rights. T&G eventually settled all claims against it, without participation by MOE, and assigned its claims against MOE to the Association. The Association and T&G then presented the settlement to the trial court at a reasonableness hearing. MOE also appeared and objected on several grounds.

MOE argued the amount of the settlement was too high, because the statute of limitations applied to bar all claims against T&G. In addition, MOE argued that "spot" or "surgical" repairs, and not the complete removal and replacement of the siding on all buildings, was a sufficient remedy. The trial court rejected both arguments and found the settlement reasonable. In its ruling, the trial court noted, in particular, that the trier of fact was "likely to find that the statute of limitations did not apply."

In the subsequent coverage action, MOE argued that it was entitled to litigate to finality whether the statute of limitations had run and that the "impaired property" and "your work" exclusions defeated coverage. Contrary to MOE's first argument, the Supreme Court said it would be inequitable to allow MOE to relitigate questions that had already been resolved. Thus, if a coverage question turns on the same facts that are in dispute in the underlying action, the insurer will be bound by the factual findings of a good faith settlement, which is judicially approved as reasonable, unless the insurer can show the settlement was the product of collusion or fraud.

Turning to MOE's second argument concerning the applicability of the business risk exclusions, the Supreme Court remanded to the trial court for further proceedings. In so doing, the Supreme Court noted that the cost to replace the siding— the insured's work— was not excluded by the "impaired property" or "your work" exclusions when that cost is a consequential damage of the effort to repair property damage (i.e., to repair the rot and mold to the surfaces underneath the siding installed by T&G).

The *T&G Construction* opinion raises many issues, a few of which are identified below:

- Previously, Washington law provided that, when an insurer is defending under a reservation of rights, it is not bound by a judicial determination of the insured's liability.

See Wear v. Farmers Ins. Co., 49 Wn. App. 655, 745 P.2d 526 (1987). In *Wear*, the plaintiff proved a negligence case against the insured defendant, but the insurer, which provided a defense under a reservation of rights, was permitted to prove in a subsequent coverage action that the insured had, in fact, intentionally harmed the plaintiff, thereby precluding coverage. Does *Wear* survive *T&G Construction* and, if so, how?

- The court's ruling does not apply to coverage questions that turn upon facts not at issue in the liability action. For example, if the insurer has a coverage question based upon whether the defendant is an insured (e.g., whether he was a "resident relative" of the named insured), such a question should not be resolved in the reasonableness hearing, and the insurer should not be bound by the result if such a question was addressed in the hearing.
- The absence of collusion or fraud is one of the criteria for determining the reasonableness of the settlement. If the issue of collusion or fraud is addressed in the reasonableness hearing, is the insurer precluded from raising the issue again in a coverage action (in which the insurer will be able to conduct some discovery on the issue)?
- The reasonableness hearing establishes the ***insureds'*** liability and, by extension, determines the ***insurers'*** liability. Is the insurer entitled to a jury trial on the disputed issues of fact?