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Hemingway, the Oregon Supreme Court, and What Is Right until It Is Wrong

By Jacqueline Mitchson

Ernest Hemingway wrote, "Remember everything is right until it's wrong. You'll know when it's wrong." On November 19, 2015, the Oregon Supreme Court held that everything you knew about covenants not to execute was right, until it was wrong.

In *Brownstone Homes Condominium Association v. Brownstone Forest Heights, LLC*, 358 Or 223 (2015), the Oregon Supreme Court overruled *Stubblefield v. St. Paul Fire & Marine Ins. Co.*, 267 Or 397 (1973) and opened 40-plus years of Oregon law on covenants not to execute. The rule in *Stubblefield* has always been understood to mean that when a plaintiff and insured defendant enter into a stipulated judgment and the defendant assigns plaintiff any cause of action it may have against the defendant's insurer, coupled with plaintiff's covenant not to execute the judgment against defendant, an insurer does not owe indemnity for the judgment. This is because the insured's legal liability to plaintiff is extinguished by the covenant not to execute, which also extinguishes the insurer's liability under the policy.

Brownstone Homes was a construction defect case in which a homeowners association sued a contractor for negligence. The contractor's insurer refused to defend the contractor against the action. Thereafter, the contractor and the homeowners association entered into a settlement that included a stipulated judgment against the contractor, a covenant by the homeowners association not to execute the judgment, and an assignment of the contractor's claims against its insurer to the homeowners association. The homeowners association initiated a garnishment action against the insurer. The trial court dismissed the action on the ground that under *Stubblefield*, the covenant not to execute released the contractor from obligation to pay the homeowners association and thereby released insurer as well. The homeowners association appealed and the Court of Appeals affirmed.

The Oregon Supreme Court concluded that, although *Stubblefield* is not distinguished and had not been superseded by statute, it was wrongly decided. In so deciding, the court noted that the *Stubblefield* court had sparse reasoning, failed to reference the court's usual approach to interpreting policies of insurance, and did not cite to any authority. The court also noted that the phrase "legally obligated to pay" – at least as commonly used in liability insurance policies is ambiguous, thus triggering the rule that such ambiguities are to be constructed against the insurer. As a result, the case was remanded back to the trial court for further proceedings based on its overruling of *Stubblefield*.