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JULY 11, 2008

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WASHINGTON STATE COURT OF APPEALS HOLDS REASONABLENESS HEARING IN CONTRACT ACTION NOT SUBJECT TO SAME FACTORS AS REASONABLENESS HEARING IN TORT ACTION

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The Washington State Court of Appeals has rejected an intervening insurer's appeal from a reasonableness hearing, holding that such a hearing in a contract action is not subject to the same factors as a hearing in a tort action.

In *The Heights at Issaquah Ridge Owners Ass'n v. Derus Wakefield I, LLC,* 2008 WL 2636552 (July 7, 2008), a condominium owners' association ("HOA") filed suit against the declarant, Derus Wakefield I, LLC ("Derus"). Derus filed a third party claim against Sacotte Construction, Inc., the general contractor ("Sacotte"). The contract between Derus and Sacotte required Sacotte to indemnify Derus for damages relating to construction defect claims. Derus had purchased two commercial general liability insurance policies from Steadfast Insurance Company ("Steadfast"). Steadfast acknowledged coverage under one of the policies, but disputed coverage under the other.

After extensive litigation, the parties engaged in settlement negotiations and reached a settlement and stipulated judgment, agreeing that the scope and cost of repair totaled $7,894,993, a reduction of 17.5% from the amount the HOA planned to present as damages at trial. The parties further agreed to $300,000 in attorney fees and $150,000 in costs, for a total of $8,344,993.

Derus agreed to pay the HOA $3,025,000, which included $75,000 from Derus, $1,950,000 from its umbrella insurer, and $1,000,000 from Steadfast. In exchange for the remaining settlement amount, Derus assigned to the HOA its rights to the claims against both Sacotte and Steadfast. The HOA agreed to a covenant not to execute on the balance of the stipulated judgment, except in pursuit of the assigned claims. The settlement agreement included similar provisions with Sacotte, which agreed to settle the dispute for the same sum of $8,344,993. Sacotte agreed to pay $1,334,807, including $1,284,307 from its insurer.[1] Sacotte, as an assignee of Derus, further agreed to assign the HOA several claims against subcontractors and their insurers.

The HOA and Derus moved to determine the reasonableness of their settlement. Steadfast moved for, and was granted, leave to intervene. Steadfast argued the agreement was not reasonable, and the trial court disagreed. Steadfast appealed this determination of reasonableness.[2]

On appeal, Steadfast argued the settlement agreement was not reasonable because Derus and Sacotte could not both agree to fully settle the claims where they had equal culpability. In other words, Steadfast claimed the HOA negotiated a double recovery from Derus and Sacotte, as opposed to apportioning damages by fault. According to Steadfast, this violated one of the *Glover* factors, which required the trial court in assessing reasonableness to consider the relative fault of the settling parties. The *Glover* factors were announced in a case involving the reasonableness of a medical malpractice settlement. *See Glover v. Tacoma General Hospital,* 98 Wn.2d 708, 711, 658 P.2d 1230 (1983). The Court of Appeals in *Issaquah Ridge* refused to apply the *Glover* factors, holding that the factors do not apply in assessing the reasonableness of settlement of a contract claim:

> Because construction defect settlements may become the presumptive measure of damages for a bad faith claim against an insurer, a reasonableness hearing is

1. Steadfast also insured Sacotte.
2. The HOA and Sacotte also moved for a determination of reasonableness. The trial court found that settlement was reasonable. Steadfast did not appeal from that determination. After both reasonableness hearings, the HOA filed suit against Steadfast alleging breach of contract and bad faith.

> appropriate. But, the nature of construction defect cases requires a different approach to determining reasonableness. Construction defect cases, like the case at hand, implicate contractual liability, rather than tort liability. Here, the defendants involved are not joint tortfeasors. Instead, they face liability due to statutory warranty or contractual obligations. The cases that establish and extend the use of the reasonableness factors – *Glover, Chaussee, and Besel* – originate in tort law and construe the reasonableness requirement of RCW 4.22.060, which concerns tort settlement agreements. As a result, the *Glover* factors reflect the tort concept of comparative fault.
>
> But, comparative fault has no role in construction defect cases which involve contractual obligations to indemnify. In these cases, protecting the insurer from excessive judgments that are the product of collusion or fraud between the claimant and insured, is the main concern. Therefore, in a contract action where the insurer is intervening to protect its interests in a separate bad faith claim, the insurer's interest relate[s] only to the existence of bad faith, collusion, and fraud in the settlement agreement. The remaining *Glover* factors, otherwise applicable in a tort case, are relevant here only to the extent they inform the questions of bad faith, collusion, and fraud.

Applying this analysis, the Court concluded there was nothing improper about the settlement agreement:

> [A]s noted above, the liability in this case stems from statutory warranty and contractually incurred indemnity, not tort. Derus and Sacotte are not equal tortfeasors. Derus, as declarant, was solely liable to the HOA for breaches of the Condominium Act. The settlement agreement with Derus reflects the damages stemming from this liability. The HOA had no claim against Sacotte. Derus, alone, had a claim against Sacotte for indemnification based on their contract. The HOA settled with Sacotte as Derus' assignee. The settlement between the HOA and Sacotte represents Sacotte's indemnification of Derus for the construction defect liability. That the settlement amount for Derus and Sacotte is the same is no coincidence – Sacotte was contractually required to indemnify Derus for the full amount of the damages. The equal financial arrangements result from the indemnity, not equal liability among joint tortfeasors. The settlement agreement accurately represents the liability of the parties, not double recovery from joint tortfeasors.

Steadfast also argued that the trial court failed to consider its interests as a party not being released by the settlement agreement. The Court rejected this argument as well. The Court noted that as a non-party, "the only interest of Steadfast to be considered was that of bad faith, collusion, or fraud by the settling parties[,]" and that the settlement agreement showed no signs of collusion or fraud.

Finally, the Court rejected the HOA's requests for fees on appeal under the following provision of Condominium Act:

> If a declarant or any other person subject to this chapter fails to comply with any provision hereof or any provision of the declaration or bylaws, any person or class or persons adversely affected by the failure to comply has a claim for appropriate relief. The court, in an appropriate case, may award reasonable attorney's fees to the prevailing party.

RCW 64.34.455. The Court held that "the declarant [Derus] supported the settlement, so Steadfast intervened to protect its own interests, not those of the declarant[,]" and as such, Steadfast did not replace Derus for the purposes of the Condominium Act fees provision. Likewise, the Court rejected the HOA's request for fees under the *Olympic Steamship* case, because "the question in this appeal is not related to insurance coverage . . . [t]he case merely concerns the reasonableness of the settlement agreement in the construction defect case."

The Court of Appeals thus affirmed the trial court. Steadfast has the right to seek review by the Washington Supreme Court.

If you have further questions about this case, please contact William Knowles (206.224.1289; wknowles@cozen.com) or Matthew D. Taylor (206.373.7208; mtaylor@cozen.com), of the firm's Seattle office.