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# WASHINGTON SUPREME COURT HOLDS INSURERS BOUND BY SETTLEMENT APPROVED AT REASONABLENESS HEARING WHERE COVERAGE TURNS UPON SAME FACTS OR LAW AT ISSUE IN UNDERLYING DISPUTE

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In *Mutual of Enumclaw Ins. Co. v. T & G Constr., et al.*, --- P.3d ----, (October 23, 2008), the Washington Supreme Court held that if a coverage question turns upon the same facts or law at issue in the underlying dispute between the claimant and the insured, the insurer will be bound by the results of a trial or settlement judicially approved as reasonable, absent a showing of collusion or fraud.

The Villas at Harbour Pointe Owners Association sued the condominium developer and the general contractor, Construction Associations, Inc. (CAI), for alleged construction defects. CAI sued a number of subcontractors including T & G Construction, Inc., the subcontractor responsible for installing the exterior siding. T & G's insurer, Mutual of Enumclaw (MoE), defended T & G under a reservation of rights.

The Association settled with all parties except T & G. As part of the settlement, CAI assigned its claims against T & G to the Association. Thereafter, T & G and the Association entered into a settlement agreement. T & G agreed to entry of a $3.3 million stipulated judgment and to assign its coverage and bad faith claims against MoE to the Association. In exchange, the Association agreed to not execute on the judgment and to dismiss the claims against T & G. A reasonableness hearing followed. MoE intervened and challenged the reasonableness of the settlement agreement. One of the issues was the impact on liability of T & G's administrative dissolution and the running of the statute of limitations. At the conclusion of the hearing, the trial court determined the settlement agreement was reasonable and entered a stipulated judgment for $3 million against T & G. In a separate action, MoE sought a judicial determination that it had no obligation to indemnify T & G. One of the issues in the coverage litigation related to T & G's administrative dissolution and its statute of limitation defense.

The trial court concluded that MoE was bound by the findings and conclusions from the reasonableness hearing.

The Court of Appeals reversed, explaining that a reasonableness hearing is not an adjudication on the merits, and that absent bad faith, the court's determination that a stipulated covenant judgment agreement between an insured and the claimant is reasonable does not prevent an insurer in a declaratory judgment action from contesting coverage.

The Supreme Court reversed the Court of Appeals. In concluding that an insurer will be bound by a settlement judicially approved as reasonable, the Court looked to the factors trial courts consider in assessing whether a settlement agreement is reasonable: (1) the releasing party's damages; (2) the merits of the releasing party's liability theory; (3) the merits of the released party's defense theory; (4) the released party's relative fault; (5) the risks and expenses of continued litigation; (6) the released party's ability to pay; (7) any evidence of bad faith, collusion, or fraud; (8) the extent of the releasing party's investigation and preparation; and (9) the interests of the parties not being released. *Besel v. Viking Ins. Co.*, 146 Wn.2d 730, 738, 49 P.3d 887 (2002). The Court continued:

> The merits of the homeowners' liability case and the merits of T&G's defense theories were, of course, central to any settlement because whether to settle, and under what terms, turned in large part on the risk of an adverse judgment. Those same issues must be carefully considered in any judicial proceeding to determine the reasonableness of the settlement. Like any issue touching on the liability of a releasing party, T&G's statute of limitation defense had to have been considered by the parties during settlement discussions and was carefully evaluated by the judge both at summary judgment and at the reasonableness hearing.

*T & G Constr.*, --- P.3d ----, (October 23, 2008), Slip Op. at 7-8 (citations omitted).

On this basis, the Court held that "[w]hen the insurer had an opportunity to be involved in a settlement fixing its insured's liability, and that settlement is judged reasonable by a judge, then it is appropriate to use the fact of the settlement to establish liability and the amount of the settlement as the presumptive damage award for purposes of coverage."

The Court did make it clear, however, that simply because presumptive damages are approved in a reasonableness hearing, that does not mean the damages are covered under the insurance policy:

> For example, a comprehensive general liability policy . . . might exclude work performed by the insured and its subcontractors but provide coverage for the insured's failure to properly inspect work it consulted upon. An insurer may properly litigate these questions in a coverage case.

*T & G Constr.*, --- P.3d ----, (October 23, 2008), Slip Op. at 12 (citations omitted). The Court then remanded to the trial court for determination of remaining coverage issues.

The Court's decision stands for the principle that once a liability defense issue is determined in the tort case, it cannot be relitigated in a coverage action. However, the Court seemed to expand its holding further by stating that "if a coverage question turns upon the same facts or law at issue in the underlying dispute between the claimant and the insured, the insurer will be bound by the results of a trial or settlement judicially approved as reasonable, absent a showing of collusion or fraud." Slip Op. at 2. This suggests that the insurer would be bound by the liability court's findings on *both* liability and coverage issues, even in the absence of bad faith. If so, the decision is directly contrary to Washington precedent that holds otherwise. *Wear v. Farmers Ins. Co.*, 49 Wn.App. 655, 745 P.2d 526 (1987) (insurer that defended under reservation of rights not collaterally estopped from litigating coverage issue in subsequent declaratory action). The Supreme Court in *T & G* neither cited to nor discussed the Wear decision.

*To discuss any questions you may have regarding the decision discussed in this Alert, or how it may apply to your particular circumstances, please contact Bill Knowles (wknowles@cozen.com, 206-224-1289) or Matt Taylor (mtaylor@cozen.com, 206-373-7208).*