

WASHINGTON COURT OF APPEALS AFFIRMS TRIAL COURT RULING: STIPULATED JUDGMENT OF \$8.75 MILLION IS UNREASONABLE

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In *Water's Edge Homeowners Ass'n v. Water's Edge Associates, et al.*, ---P.3d ---, (September 29, 2009), the Washington Court of Appeals affirmed a ruling that a settlement consisting of a stipulated judgment of \$8.75 million against an insured developer and an insured property manager and in favor of a plaintiff condominium association was unreasonable, after the insurers of the developer and property manager intervened.

The Water's Edge Homeowners Association ("HOA") alleged that Water's Edge Associates ("Associates") and Key Property Services, Inc. ("KPS") failed to disclose the true condition of the condominium property at issue when they converted apartments into condominiums. The condominiums suffered from considerable rot in the siding, roof, and stairways.

Insurers for KPS and Associates, Farmers Insurance Exchange, Mid-Century Insurance Company, and Truck Insurance Company (collectively "the Insurers"), defended under a reservation of rights. Meanwhile, KPS and Associates, through independent coverage counsel, filed a coverage action against the Insurers alleging bad faith.

HOA agreed to settle the case against Associates and KPS by way of a stipulated judgment of \$8.75 million. The settlement contained a covenant not to execute, and the coverage and bad faith claims were assigned to HOA. The Insurers were not a part of the settlement negotiations.

HOA moved the trial court for a ruling that the stipulated judgment was reasonable. The Insurers successfully intervened at the reasonableness hearing, conducted limited discovery, and submitted a body of evidence showing that the proposed judgment was not reasonable. The trial court found that the stipulated judgment in the amount of \$8.75 million was unreasonable, and that a \$400,000 judgment would have been appropriate. HOA appealed the trial court's ruling.

Applying an abuse of discretion standard to the actions of the trial court, the Court of Appeals considered the factors for determining reasonableness, as detailed in *Chaussee v. Md. Casualty Co.*, 60 Wn. App. 504, 803 P.2d 1339 (1991), including the following: "[t]he releasing person's damages; the merits of the releasing person's liability theory; the released person's ability to pay; any evidence of bad faith, collusion, or fraud; the extent of the releasing person's investigation and preparation of the case; and the interests of the parties not being released."

The Court of Appeals noted that a trial court need not list any of the *Chaussee* factors in the judicial order -- so long as the trial court mentions that the parties addressed the *Chaussee* factors in their briefs. Additionally, the Court explained that a trial court need not specifically cite or list the evidence it relied on in determining reasonableness.

The Court of Appeals affirmed the trial court's determination that the settlement was unreasonable based on several considerations. First, the economic loss rule - prohibiting plaintiffs from recovering purely economic damages in tort - applied to HOA's assigned claims of misrepresentation and breach fiduciary duty. Second, HOA was only entitled to the lesser of the costs to repair or the diminution in value, and it was impossible to show diminution in value because every condo owner who sold their unit made a profit. Third, the interests of the Insurers were "systematically neglected, ignored, and grossly violated by the settlement" because they were not invited to the settlement meeting or other settlement negotiations. Fourth, there was substantial evidence of bad faith, collusion, or fraud in that the collaborative effort between purported adversaries was beneficial to the settling parties and prejudicial to the Insurers. Fifth, HOA's reservation of the right to recover on a malpractice claim was evidence of a joint relationship

between HOA and the property owners.

This holding recognizes an insurer's ability to challenge questionable settlements based on agreed judgments and assignments, particularly where the insured's assigned defense counsel assesses the insured's exposure in a range far below the amount of the stipulated judgment. The case stands for the proposition that courts must evaluate both the process and substance of insured negotiated settlements in determining whether they are reasonable.

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

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