No. 11-1474

IN THE
Supreme Court of the United States

FARMERS INSURANCE COMPANY OF WASHINGTON AND FARMERS INSURANCE EXCHANGE,

Petitioners,

v.

EMILY L. MORATTI, a minor, by and through her Guardian Ad Litem GERALD R. TARUTIS,

Respondent.

On Petition For Writ Of Certiorari To The Washington Court Of Appeals

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RESPONDENT'S BRIEF IN OPPOSITION

Howard M. Goodfriend
Counsel of Record
Catherine W. Smith
SMITH GOODFRIEND, P.S.
1109 First Avenue, Suite 500
Seattle, WA 98101
(206) 624-0974
howard@washingtonappeals.com
Attorneys for Respondent

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RESTATEMENT OF QUESTION PRESENTED

The question presented in the petition was not properly presented to nor passed on by the Washington courts. The petition presents the following questions:

(1) Whether due process is violated by Washington's presumption that the value of an insured tortfeasor's settlement with a claimant, as established in a proceeding in which the insurer participates, is the proper measure of damages for a bad faith claim against the insurer?

(2) Whether due process is violated by Washington's rebuttable presumption that an insurer's bad faith results in harm to the insured?

(3) Whether the federal constitutional issues raised by petitioner are properly before this Court when they were not considered by any of the courts below because petitioner first raised a due process issue in its motion for reconsideration of the state intermediate appellate court's decision?

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INTRODUCTION

Ignoring concessions and waivers that prevent the petitioner from raising the question presented at this late date, the petition seeks to turn presumptions under Washington state law into constitutional issues of national importance. Yet even had petitioner preserved its due process challenge, the presumptions of which it complains had no effect on the outcome of this case. Moreover, they are consistent with this Court's precedent and the common law tradition. The petition should be denied.

JURISDICTIONAL STATEMENT

This Court has jurisdiction to review federal questions presented by a final judgment of the highest court of a state. 28 U.S.C. § 1257(a). However, as elaborated below, the petitioner failed to timely raise any federal question, including the due process issue pressed in the question presented. The petitioner's first mention of the Due Process Clause was in its motion for reconsideration to the Washington Court of Appeals. That court exercised its discretion under state law to deny reconsideration on this newly-raised ground, and the Washington Supreme Court declined to take review.

The decisions below do not finally resolve an issue of federal law as required by Section 1257(a) because petitioner failed to timely raise any federal issue in state court. This Court has recognized

such failure to present a federal claim may be a jurisdictional defect. *Howell v. Mississippi*, 543 U.S. 440, 445-46, *reh'g denied*, 544 U.S. 944 (2005); *Yee v. City of Escondido, Cal.,* 503 U.S. 519, 533 (1992); *Stembridge v. State of Georgia,* 343 U.S. 541, 547 (1952). Whether the failure is "jurisdictional or prudential," this Court should decline review in this case, where the state court decision does not resolve a federal issue and petitioner failed to timely present any federal question to the Washington courts. *Adams v. Robertson*, 520 U.S. 83, 90 (1997).

STATEMENT OF THE CASE

I. The Washington Insurance Scheme.

Under Washington law, insurers owe their insureds a duty of good faith. RCW 48.01.030. This duty includes a responsibility to make reasonable investigations into claims against the insured. Where that investigation establishes a likelihood the insured will be liable, the insurer must make a good faith attempt to settle claims, and, at a minimum, ascertain the most favorable terms available. The insurer also has an obligation to timely communicate its investigations, evaluations, and any settlement offers, to the insured. Pet. App. 30a; Wash. Pattern Instr.-Civil 320.05, *reprinted in* 6A Wash. Practice 327 (2012); *Truck Ins. Exch. Co. v. Century Indem. Co.,* 887 P.2d 455, 459-60 (Wash. App.), *rev. denied,* 898 P.2d 308 (Wash. 1995). The duty of good faith implements the legislature's judgment that

insurers have an "enhanced" responsibility to protect the interests of the insured. S*afeco Ins. Co. of Am. v. Butler*, 823 P.2d 499, 505 (Wash. 1992).

Under Washington law insurers that breach the duty of good faith are "estopped from denying coverage." *Butler*, 823 P.2d at 505. To provide insurers a "strong disincentive" from engaging in bad faith conduct, and in particular to prevent an insurer from putting the insurer's own interests above those of an insured whose policy limits may be inadequate to pay a liability claim in full, an insurer may be held liable for the full extent of the insured's liability to the plaintiff, even if the damages exceed the policy limits, if the insurer is found to have failed to fulfill its good faith duties. *Id.* at 505-06.

Therefore, "when an insurer refuses, in bad faith, to settle a tort claim asserted by an injured party, the insured c[an] settle the tort claim against him," in excess of "his liability coverage." *Besel v. Viking Ins. Co. of Wisconsin*, 49 P.3d 887, 890 (Wash. 2002) (quoting *Murray v. Aetna Cas. & Surety Co.*, 379 P.2d 731, 732 (Wash. 1963)) (internal quotation marks omitted). So long as that settlement amount is judged to be "reasonable," the insured can "recover from the insurer the amount paid in settlement in excess of the limits of the policy." *Id.* (internal quotation marks omitted).

Analogously, an insured can agree to have a judgment entered against him and assign the plaintiff his right to pursue a bad faith action against the insurer in exchange for a "covenant not to execute"—an agreement to attempt to recover the judgment against the insured only through the bad faith action. *Besel*, 49 P.3d at 890-91; *Butler,* 823 P.2d at 507. Just as with a settlement in which the insured pays the plaintiff and then pursues a bad faith action on his own, so long as the settlement is judged to be reasonable, an insurer is liable for the full amount of the judgment against the insured – if, in the assigned action, the plaintiff can prove that the insurer acted in bad faith. *Besel*, 49 P.3d at 891.

The Washington courts have explained that the covenant not to execute "does not release [the insured] from liability." *Besel*, 49 P.3d at 891. Instead, the covenant is "an agreement [that the plaintiff will] seek recovery only from a specific asset [of the insured]—the proceeds of the insurance policy and the rights owed by the insurer to the insured.'" *Id.* (quoting *Butler*, 823 P.2d at 508) (internal quotation marks omitted). Through agreeing to a settlement with a covenant not to execute, the insured protects certain assets, while forfeiting others. *Besel,* 49 P.3d at 891. The insurer—if later found to have acted in bad faith—"is in no position to argue that the steps the insured took to protect himself should inure to the insurer's benefit" by reducing the insurer's liability

from what it would have been had the insured paid the settlement out of pocket. *Id.* (alteration omitted) (quoting *Greer v. Northwestern Nat'l Ins. Co.*, 743 P.2d 1244, 1251 (Wash. 1987) (internal quotation marks omitted)).

The reasonableness of the settlement amount is established at a hearing that evaluates the value of the plaintiff's claim against the insured. The reviewing court must examine, *inter alia*, "[t]he [plaintiff's] damages; the merits of the [plaintiff's] liability theory; the merits of the [insured's] defense theory; . . . [and] any evidence of bad faith, collusion, or fraud" in reaching the settled on value. *Besel,* 49 P.3d at 891 (internal quotation marks and citation omitted).

Moreover, the hearing only serves to establish the measure of damages in a subsequent bad faith action if the insurer is provided notice of the hearing and an opportunity to intervene and participate. *Mut. Of Enumclaw Ins. Co. v. T&G Constr., Inc.*, 199 P.3d 376, 380-81 (Wash. 2008); *Fisher v. Allstate Ins. Co.*, 961 P.2d 350, 353 (Wash. 1998); *Green v. City of Wenatchee,* 199 P.3d 1029, 1035 (Wash. App. 2009). The insurer must be provided an "opportunity to argue against the settlement's reasonableness," including the ability to present defenses the insured could have established had he litigated against the plaintiff and any evidence suggesting that the settlement was the product of collusion between the plaintiff and the insured. *Besel,* 49 P.3d at 892.

To recover from the insurer, an insured, or a plaintiff prosecuting an assigned bad faith claim, must separately proceed against the insurer, and establish duty, breach, causation, and harm. Pet. App. 9a; *Smith v. Safeco Ins. Co.,* 78 P.3d 1274, 1277 (Wash. 2003); *see also Murray v. Mossman*, 355 P.2d 985, 987 (Wash. 1960). "[W]hether an insurer acted in bad faith is a question of fact." Pet. App. 8a (citing *Smith*, 78 P.3d 1274). After duty and breach have been established, Washington law recognizes as permissible a "rebuttable presumption of harm." *Butler*, 823 P.2d at 504.

II. The Dispute Below.

This dispute arose under this state law regime governing insurance bad faith in Washington state. The restatement of facts in this response is taken largely from the Washington Court of Appeals opinion reinstating the jury's verdict.[1] It rebuts the factual premise of Farmers' arguments, which were rejected by a jury after a four-week trial, and corrects the procedural history presented by Farmers in its petition.

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[1] Additional citations are to the transcribed report of proceedings ("RP"), and to the trial court pleadings (clerk's papers or "CP") compiled for the Washington Court of Appeals.

Landlord William Lipscomb rented an apartment to Emily Moratti's mother and grandfather. He failed to provide smoke detectors required by law. Pet. App. 2a. Indeed, it was later discovered that the entire apartment contained only one nonoperational smoke detector, far from Emily's bedroom. Pet. App. 3a. After a fire broke out at the apartment, Emily, who was then 16 months old, sustained severe burns, requiring extensive medical treatment. Pet. App. 2a.

Lipscomb's liability policy was issued by petitioner Farmers. Moratti's guardian contacted Farmers in an effort to settle her claims against Lipscomb. In what Farmers acknowledged below was an "incorrect" liability determination (Farmers' Resp. Br. at 1), acting on a company policy to close claims within thirty days, and without visiting the scene, taking statements, or consulting with the fire department, Farmers responded that Lipscomb had no potential liability and that it was closing its investigation into the incident. Pet. App. 2a; Exs. 6, 7; 7/29 [pm] RP 58-60, 7/30 [am] RP 97-98, 148-49, 7/30 [pm] RP 29-30.

Over the next nearly-six months, Farmers continued to rebuff Moratti's efforts to settle her claims. Contrary to Farmers' contention that it was never offered the opportunity to settle, Pet. 5, Farmers refused to even review a proffered settlement from Moratti's lawyers even though they were willing to release Lipscomb in return for

Farmers' policy limits plus Lipscomb's personal contribution of $100,000. Pet. App. 13a; Ex. 16; 7/30 [am] RP 125, 8/5 [am] RP 16, 8/6 [pm] RP 62-64.

Overwhelming evidence supports the jury's finding that Farmers acted in bad faith in refusing to attempt to settle the claim. Pet. App. 13a. Farmers shut the door to any settlement discussions even though its investigator determined that there were no working smoke detectors in the rental unit at the time of the fire, Pet. App. 3a; Farmers' own claims adjuster admitted to Moratti's attorney that Lipscomb violated state law, *id.*; and Moratti's attorney had informed Farmers that her medical bills exceeded Lipscomb's policy limit by almost $700,000. Pet. App. 2a. At the same time, Farmers falsely informed Lipscomb that the Seattle Fire Department had cleared him of any liability, and did not disclose to him that Moratti's attorneys were still pursuing her claim. Pet. App. 3a; Ex. 6. Farmers' assertion that it was never given the opportunity to settle Moratti's claims is patently false.

Two years after the fire, eighteen months after Moratti's first attempt to settle, and after Moratti had filed suit against its insured, Farmers finally offered Moratti $100,000 to settle her lawsuit. That offer was declined. Pet. App. 4a. As the Washington Court of Appeals recognized, Farmers' reliance on this belated tender of policy limits to absolve it of any liability for its failure to protect its

insured's interests "ignores the principle that the duty to settle is intricately and intimately bound up with the duty to defend and to indemnify. Those duties are continuing duties that do not stop merely because the insurer offers the policy limits two years after it left the insured with the belief that there was no liability." Pet. App. 8a.

Farmers also makes much of its supposed "full and unconditional defense to Moratti's lawsuit." Pet. 5. However, Farmers ignores that its defense – which was accompanied by its warning to Lipscomb that he should hire independent counsel, because his liability would likely exceed policy limits – came only after Farmers' own refusal to investigate, attempt to settle, and communicate with its insured caused Moratti to sue Lipscomb. Pet. App. 13a.

Equally false is Farmers' assertion that Lipscomb would not have contributed to a settlement before Moratti filed suit – particularly in light of the agreement he eventually did reach with Moratti after Farmers' bad faith refusal to negotiate forced Moratti's lawyers to file a lawsuit. As the trial approached, Lipscomb independently settled with Moratti by agreeing to pay $600,000 of his own funds and to entry of a $17 million judgment against him, coupled with Moratti's covenant not to execute that judgment except from the assets Lipscomb assigned to Moratti – Lipscomb's claims against Farmers for bad faith and violations of Washington's Consumer

Protection Act. Pet. App. 43a-45a, 47a-48a. The settlement was conditioned on the Washington courts holding it reasonable, Pet. App. 4a, 45a-46a, and provided that if the settlement was approved Moratti would seek to litigate or settle all of the assigned claims. Pet. App. 47a-48a.

Moratti provided Farmers notice of the reasonableness hearing, and Farmers intervened in that proceeding. Pet. App. 4a; CP 76-78, 81-82. At the reasonableness hearing, Lipscomb's personal counsel testified:

> The likely prospect of an unfavorable verdict significantly in excess of his insurance policy limit and the impact of that on him and his family were taking a clear and obvious toll on his health. . . . I have no doubt that the likely verdict would physically, financial, and permanently ravage him while simultaneously wrecking havoc in this family.

CP 855. Knowing that under Washington law this settlement could establish the measure of its liability if it were found to have acted in bad faith, Farmers did not challenge any aspect of the reasonableness hearing. Nor did it assert, as it had the right to under Washington law, that the settlement was a product of fraud or collusion. Pet. App. 4a. Instead, Farmers signed a written stipulation agreeing that "it does not now, and will not in this matter or any future litigation, challenge the reasonableness of the settlement."

CP 798. After a hearing at which the court considered extensive testimony, the court concluded that the settlement was reasonable. Pet. 4a; CP 80-84.

Moratti then pursued Lipscomb's bad faith claim against Farmers. At the summary judgment stage, the trial court held that if Farmers were found to have acted in bad faith, the measure of damages would be the amount of the judgment entered against Lipscomb. CP 3485. Farmers did not raise any constitutional objections to this ruling, either before the trial court or on appeal. Pet. 7.

At the close of a four-week trial, the court instructed the jury, using pattern instructions approved by the Washington Supreme Court, Pet. App. 15a, that in order to find for Moratti it must find as a matter of fact that: (1) Farmers breached its duty of good faith; and (2) that Farmers' breach "was a proximate cause of Mr. Lipscomb's damage." Pet. App. 28a-29a. The jury was instructed that the plaintiff had the burden to affirmatively prove that "Farmer[s'] failure to act in good faith proximately caused any damage to" Lipscomb. Pet. App. 31a. Proximate causation, the court's instructions told the jury, required Moratti to show by a preponderance of the evidence that "a direct sequence produce[d] the damage complained of and without which such damage would not have happened." Pet. App. 28a.

The jury returned a special verdict finding both that plaintiff had proven that Farmers had acted in

bad faith, and that Farmers' bad faith proximately caused Lipscomb damage. Pet. App. 32a. The court then entered a judgment against Farmers in the amount of the judgment entered against Lipscomb, his personal contribution to the settlement, and pre-judgment interest. Pet. App. 35a-37a.

Farmers moved for a judgment notwithstanding the verdict or in the alternative for a new trial. Pet. App. 4a. Farmers did not raise any due process challenge to the jury's verdict or to the judgment. Instead, it alleged that the action was barred by the statute of limitations, that the evidence was insufficient to support the verdict and instructions, and that the trial court had erroneously excluded some of Farmers' evidence. CP 4373-84, 4453-64. The trial court found the evidence "sufficient to present a jury question as to whether acts or omissions by Farmers constitute a failure to act in good faith and whether such failure, if found, proximately caused any damage" to Lipscomb, CP 4901, but agreed with Farmers' other arguments, vacating the judgment as time barred and ruling that in the alternative it would have granted a new trial. Pet. App. 4a-5a.

Moratti appealed. Farmers' briefs on appeal did not mention once the words "due process," or allege any constitutional infirmity with the proceedings below. In a unanimous opinion, the Washington Court of Appeals reinstated the bad faith judgment against Farmers. The court held that the claim was not barred by the statute of limitations, Pet. App.

6a, and that the evidence supported both the trial court's instruction and the jury's finding that Farmers acted in bad faith. Pet. App. 13a-16a. The court further held that the discretionary evidentiary ruling challenged in Farmers' post-trial motion was not error. Pet. App. 16a.

Farmers suggested for the first time that the manner in which Washington law allows plaintiffs to establish that the insurer's bad faith caused the insured harm violates due process in a single sentence and footnote to its 20-page motion for reconsideration of the Washington Court of Appeals decision. Even then, Farmers did not suggest any due process impediment to how Washington measures the damages caused by an insurer's bad faith. Motion for Reconsideration 2 n.4. Consistent with Washington's appellate rules limiting parties from raising new issues on reconsideration, Washington Rules of Appellate Procedure (RAP) 12.4(c), and without addressing the footnote, the Washington Court of Appeals denied reconsideration. Pet. App. 22a. The Washington Supreme Court denied Farmers' petition for discretionary review without further comment. Pet. App. 38a-39a.

REASONS FOR DENYING THE WRIT

I. The Question Presented Was Neither Presented Nor Passed On Below.

This Court's rules require that a petition for certiorari demonstrate "that the federal question was timely and properly raised and that this Court has jurisdiction to review the judgment." U.S. Sup. Ct. Rule 14.1(g)(i). Under Washington law, constitutional challenges must be presented in the parties' briefs to the intermediate appellate court at the latest. *State v. Johnson*, 829 P.2d 1082, 1084 (Wash. 1992) (citing RAP 2.5(a)(3)). A motion for reconsideration of a Washington Court of Appeals decision is not a proper vehicle for raising a new issue, but a means of arguing that the court has "overlooked or misapprehended" "the points of law or facts" already presented to the court when passing on the claims raised in the substantive briefing. RAP 12.4(c); *see Nostrand v. Little,* 361 P.2d 551, 556 (Wash. 1961).

This Court should deny the petition because the question presented in it was not properly raised in the state court proceedings. Farmers did not raise a due process issue in its briefing to the trial court or to the court of appeals. Rather, as Farmers concedes, Farmers first mentioned due process in its motion for reconsideration of the Washington Court of Appeals decision. Pet. 9-10. Even then, Farmers only suggested that the state-law presumption that an insured is harmed by an insurer's bad faith – a presumption that was not

even implicated in this case, where the jury was instructed that plaintiff had the burden of proving that the insured's harm was proximately caused by the insurer's bad faith – might violate due process. Motion for Reconsideration 2 n.4.

This Court has consistently declined to address issues where the petitioning party has failed "to meet his burden of showing th[e] issue was properly presented" to the state courts. *Campbell v. Louisiana*, 523 U.S. 392, 403 (1998). Indeed, this Court has suggested that there may be a jurisdictional bar to reviewing a state court decision where the federal issue had neither been "addressed [n]or properly presented in state court." *Adams v. Robertson*, 520 U.S. 83, 86, 90 (1997); *Howell v. Mississippi,* 543 U.S. 440, 445 (2005) (citing "the long line of cases clearly stating that the presentation requirement is jurisdictional"). This Court need not resolve this jurisdictional question to deny the petition for the prudential reason that the state courts did not pass on the constitutional question pressed in the petition, which was not properly presented to the courts below.

II. The Challenged Presumptions Are Immaterial To The Outcome Below.

Because of the concessions, facts, and findings below, neither of the presumptions challenged in the petition altered the outcome of this case. Accordingly, it is a poor vehicle by which to

examine the constitutionality of Washington's insurance bad faith scheme.

When Farmers intervened in the reasonableness hearing, it stipulated that it would not, as part of that hearing, or in "*any future litigation*, challenge the reasonableness of the settlement." CP 798 (emphasis added). When it made this stipulation, Farmers knew the purpose of the hearing was to obtain a judgment that the settlement was reasonable, and thereby establish the damages for a future bad faith claim. *See Besel v. Viking Ins. Co. of Wisconsin,* 49 P.3d 887, 891-92 (Wash. 2002); Pet. App. 45a-46a (conditioning the settlement on it being judged reasonable in a proceeding in which the insurer has had the opportunity to participate). Thus, Farmers' stipulation was a clear acknowledgment that it understood and accepted that the settlement would be the measure of damages in a future bad faith action against it.

Washington has long recognized that a stipulation "made for the express purpose of dispensing with the formal proof of some fact" is binding on the party. *State v. Wheeler*, 161 P. 373, 374 (Wash. 1916); *Ross v. State Farm Mutual Auto. Ins. Co.*, 940 P.2d 252, 257 (Wash. 1997); Washington Civil Rule 2A; RCW 2.44.010(1). Therefore, regardless of Washington's rule that a reasonable settlement establishes the damages for a bad faith action, there is an independent state-law basis to hold Farmers liable for the amount agreed to and found to be reasonable at the hearing.

Similarly, the rebuttable presumption that its insured was harmed by the insurer's bad faith was not necessary to the outcome below. The factual record demonstrates that, but for Farmers' unwillingness to consider Moratti's proffered settlement offer – a breach of its duty of good faith – it could have initially settled Moratti's claim for its policy limit plus a $100,000 contribution from Lipscomb. Instead, on the eve of trial, and only following Farmers' efforts to mislead its insured regarding his potential liability, Lipscomb was forced to settle Moratti's claims for a personal contribution of $600,000, the entry of a $17 million judgment against him, and the assignment of his bad faith and Consumer Protection Act claims to Moratti. Therefore, Farmers' bad faith unquestionably harmed Lipscomb – a fact recognized by the jury and affirmed by a unanimous Court of Appeals. Pet. App. 9a.

Moreover, the trial court expressly required Moratti to prove that Farmers caused Lipscomb harm. In an instruction derived from pattern instructions approved by the Washington Supreme Court, and entirely separate from the court's statements regarding the rebuttable presumption, the trial court informed the jury that Moratti had the burden of proving as a matter of fact that Farmers "direct[ly] . . . produce[d] the damage complained of and without which such damage would not have happened." Pet. App. 28a.

Through a special verdict, the jury specifically found in the affirmative. Pet. App. 32a.

Consistent with the principles of constitutional avoidance, this Court has suggested that where "it is not clear that our resolution of the constitutional question will make any difference," the Court should not pass on the constitutional questions presented. *Ticor Title Ins. Co. v. Brown*, 511 U.S. 117, 122 (1994). Because, independent of any presumptions in Washington law, Farmers would have been (and was) found to have acted in bad faith, causing Lipscomb damage and resulting in an award equal to the value of the settlement, the due process question presented in the petition would not affect the outcome below. For this reason as well, the Court should decline review.

III. Washington Law Is Consistent With Due Process.

Contrary to Farmers' arguments, the presumption that the settlement between a plaintiff and insured that is held to be reasonable in a proceeding in which the insurer may participate establishes the damages for a successful bad faith action is consistent with *Vlandis v. Kline*, 412 U.S. 441 (1973), and the presumption that an insured is harmed by an insurer's bad faith is consistent with *Western & A.R.R. v. Henderson*, 279 U.S. 639 (1929).

Vlandis concerned a Connecticut statute that established a "conclusive and unchangeable presumption of nonresident status" for students seeking admission to the state's universities, based on the students' residence preceding or at the time of application. 412 U.S. at 443. The Court declared that because the presumption that a student who was once not a resident did not become a resident at a later date was not "necessarily or universally true," due process required that students be provided an "opportunity to present evidence" that they have since become "bona fide resident[s] entitled to the in-state [tuition] rates." *Id.* at 452.

Unlike in *Vlandis*, the settled-on value of the plaintiff's claim is neither a conclusive nor unchangeable measure of the insurer's liability for a bad faith claim. That value only becomes the measure of damages for an insurer's bad faith following a reasonableness hearing that involves all interested parties, including the insurer, providing the insurer a full and fair opportunity to present evidence whether the settlement accurately reflects the insured's liability for the tort plaintiff's injury and whether the settlement is the result of fraud or collusion between the insured and the plaintiff. *Besel v. Viking Ins. Co. of Wisconsin*, 49 P.3d 887, 891-92 (Wash. 2002); *see also Fisher v. Allstate Ins. Co.*, 961 P.2d 350, 353 (Wash. 1998).

The Washington scheme thus treats the reasonableness hearing like other proceedings that may have preclusive effect, estopping a party from

re-litigating an issue it has *already* had the opportunity to contest. *See*, *e.g.*, *Allen v. McCurry,* 449 U.S. 90, 94 (1980) ("Under collateral estoppel, once a court has decided an issue of fact or law necessary to its judgment, that decision may preclude relitigation of the issue in a suit on a different cause of action involving a party to the first case."); *Christensen v. Grant County Hosp. Dist. No. 1*, 96 P.3d 957, 960-61 (Wash. 2004). Indeed, in its petition, Farmers states that it hopes to "relitigate issues that were resolved during the reasonableness hearing," Pet. 22 – a hearing in which it waived its opportunity to contest the settlement, CP 82, knowing full well the potential consequence of its stipulations that the settlement was reasonable and that it was the result of neither fraud nor collusion.

Moreover, *Vlandis* concerns presumptions used to establish facts. 412 U.S. at 446-47; *see also* Pet. 15 (explaining that the irrebutable presumptions that this Court has found are inconsistent with due process are presumptions of "fact"). In contrast, at issue here is Washington's statutory and jurisprudential policy determination that a settlement amount judged to be reasonable is the proper measure of damages for an insurer's bad faith. This policy is neither remarkable nor irrational, as the amount set at the reasonableness hearing is a rational measure of damages for the bad-faith claim.

Washington has made the policy decision to hold an insurer responsible for the full judgment against its insured once a factual determination has been made that the insurer has both acted in bad faith and that its bad faith proximately caused damage to its insured. Under Washington law, the settlement, even if it contains a covenant by the plaintiff that he will attempt to recover only through the assigned rights, does not act as a release of the insured's liability. *Besel*, 49 P.3d at 890. Instead, it acts as judgment against the insured that the plaintiff has agreed to satisfy in a specific way. *Id*; *see also Evans v. Cont'l Cas. Co.*, 245 P.2d 470, 480 (Wash. 1952) ("[A] reasonable settlement made in good faith has many of the attributes of a judgment." (citing *St. Louis Dressed Beef & Prov. Co. v. Maryland Cas. Co*., 201 U.S. 173, 182 (1906)). Washington's policy decision encourages settlement of the injured party's claim in light of these consequences. The alternative, advanced by Farmers, would require the injured party to litigate a claim to judgment, thereby subjecting the insured to destructive financial and emotional consequences that are difficult to quantify and prove.

Further, under Farmers' alternative, insurers, whose financial resources dwarf those of their policyholders, would have no incentive to comply with their duty of good faith if their liability for breach of the duty to defend and settle were limited to an insured's policy limits. *See Truck Ins. Exch.*

of Farmers Ins. Group v. Vanport Homes, Inc., 58 P.3d 276, 284 (Wash. 2002) ("To limit an insurer's liability [for bad faith] to its indemnity limits would only reward the insurer for failing to act in good faith toward its insured.") Far from being "notorious" or "irrational," Pet. 2, Washington's law of insurance bad faith reflects policy decisions that implicate no constitutional principles.

The rebuttable presumption that an insured is harmed by its insurer's breach of the duty of good faith similarly presents no issue of constitutional dimension, particularly under the facts of this case. Farmers argues that this presumption is in tension with *Henderson* because insurers do not have "a fair opportunity to repel" the presumption. Pet. 23 (quoting *Henderson*, 279 U.S. at 642) (internal quotation marks omitted). As Farmers acknowledges, *Henderson* requires only a "rational connection" between the fact that is proven and the resulting rebuttable presumption. Pet. 15 ("The Court explained that a presumption is valid only 'if there is a rational connection between what is proved and what is to be inferred.'" (quoting *Henderson*, 279 U.S. at 642.)). Farmers ignores that the jury in this case was instructed that Moratti bore the burden of proving "that Farmers' failure to act in good faith was a proximate cause of Mr. Lipscomb's damage." Pet. App. 28a-29a. The jury found as a matter of fact that Moratti satisfied the burden of proving that Lipscomb was harmed by Farmers' bad faith. Pet. App. 32a.

Washington as a matter of policy, and implicating no due process concerns, has elevated the relationship between an insurer and the insured to have aspects of a fiduciary relationship. *See* S*afeco Ins. Co. of Am. v. Butler*, 823 P.2d 499, 503-04 (Wash. 1992); RCW 48.01.030. The common law has long recognized that harm logically flows from an agent's breach of fiduciary obligations, allowing principals to recover for such breaches without establishing loss. *Restatement (Third) of Agency* § 8.01 cmt. d(2) (2006) ("The requirement that a principal establish damage is inconsistent with a basic premise of remedies available for breach of fiduciary duty, which is that a principal need not establish harm resulting from an agent's breach to require the agent to account."); *accord Johns v. Arizona Fire Ins. Co.,* 136 P. 120, 125 (Wash. 1913) (stating that once a principal establishes his agent breached the obligations of good faith and loyalty, the burden shifts to the agent to demonstrate the breach did not cause any harm).

The Washington courts have followed these established common law principles in recognizing the "almost impossible burden" of proving damages when the insurer's bad faith makes it difficult to know how the underlying case would have been resolved had the insurer not placed its own interests above those of its insured. Pet. App. 14a (quoting *Mutual of Enumclaw Ins. Co. v. Dan Paulson Constr., Inc.,* 169 P.3d 1, 13 (Wash. 2007)).

Farmers' criticism of this shift of the burden of proof fails to acknowledge, as the Washington courts have, that where the insurer's bad faith hampered the insured's ability to defend against or settle the plaintiff's claim, neither party can know for sure what would have been the insured's liability absent the bad faith – and that in that circumstance, the burden of proof is properly placed on the insurer. *Dan Paulson*, 169 P.3d at 13.

Moreover, the harm caused to the insured by the insurer's bad faith is quantified in an adversary hearing, in which the insurer has the opportunity to participate. Farmers participated in the reasonableness hearing in this case, and waived its rights to challenge either the reasonableness of the settlement or that it was not the result of fraud or collusion. Accordingly, any presumption of harm (which was not in any event the basis for the decision in this case) is a far cry from a "legislative fiat" taking "the place of fact in the judicial determination of issues" that *Henderson* held impermissible. 279 U.S. at 642; *see also Int'l Broth. Of Teamsters v. United States*, 431 U.S. 324, 359 n. 45 (1977) ("Presumptions shifting the burden of proof are often created to reflect judicial evaluations of probabilities[.]").

The claimed tension between this Court's precedent and Washington's legal scheme is nonexistent in this case, and presents no basis for review.

IV. This Case Does Not Present An Issue of National Importance.

The petition singularly focuses on Washington's legal scheme, but does not suggest that any court, including those in Washington itself, has ever disagreed with, or even considered, the constitutionality of Washington's regime. Indeed, in seeking to manufacture a split on the question presented, petitioner's amici demonstrate that Washington's presumptions are distinct from those that have been challenged in other states, and that Washington's presumptions in fact avoid the criticisms leveled by those courts.

Amicus recounts that the California courts have concluded that settlements for which "'[n]o evidentiary hearing was held to determine [the policyholder's] liability'" and which were not reviewed in "adversarial proceeding[s]" in which the insurer could participate, cannot be used to establish the damages for an insurer's bad faith. DRI Br. 8-9 (alteration in original) (quoting *Hamilton v. Maryland Cas. Co.*, 27 Cal. 4th 718 (2002)). Similarly, DRI continues, the Texas courts have suggested a settlement between a plaintiff and insured cannot establish the insurer's liability because the settlement is possibly the product of collusion. DRI Br. 11-12 (citing *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996)).

The Washington scheme avoids each of these concerns, by requiring that settlements used to establish damages for bad faith actions must first

be subject to reasonableness hearings in which the insurer is allowed to participate, and that requires the court determine that the settlement was not the product of fraud or collusion. *Besel v. Viking Ins. Co. of Wisconsin*, 49 P.3d 887, 891-92 (Wash. 2002); *see also Fisher v. Allstate Ins. Co.*, 961 P.2d 350, 353 (Wash. 1998). Accordingly, even if Farmers had preserved a due process issue, the Washington state law on which the petition turns presents no issue that has divided lower courts.

Notwithstanding that Washington's statutorily-prescribed reasonableness hearings police fraud and collusion, Farmers argues that this Court should be concerned with Washington's legal scheme because it allows for collusion. Pet. 25-26. However, not only does Farmers not allege that fraud or collusion was present in this case, when it was provided the opportunity at the reasonableness hearing to introduce evidence demonstrating fraud or collusion, it conceded that it had none. And in support of its argument Farmers cites a Washington Court of Appeals decision affirming a finding of collusion – demonstrating that the Washington courts are alert to and able to identify and prevent such conduct within the state's insurance bad faith scheme. Pet. 25 (citing *Water's Edge Homeowners Ass'n v. Water's Edge Assocs.*, 216 P.3d 1110, 1123 (Wash. App. 2009), *rev. denied*, 228 P.3d 17 (Wash. 2010)). *See also Werlinger v. Warner,* 109 P.3d 22 (Wash. App.), *rev. denied*, 126 P.3d 820 (Wash. 2005); *Chaussee v. Maryland Cas.*

Co., 803 P.2d 1339 (Wash. App.), *rev. denied*, 818 P.2d 1099 (Wash. 1991). Farmers' newfound contention that Washington's rebuttable presumption of harm encourages fraud and collusion raises no due process issue, particularly given Farmers' concessions below that it had no such concerns in this case.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

HOWARD M. GOODFRIEND
Counsel of Record
CATHERINE W. SMITH
SMITH GOODFRIEND, P.S.
500 Watermark Tower
1109 First Avenue
Seattle, WA 98101
(206) 624-0974
howard@washingtonappeals.com

Attorneys for Respondent

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