11-23-2011

Employers Mut. Cas. Co. v. Donnelly Appellant's Reply Brief Dckt. 38623

BEFORE THE
SUPREME COURT
OF THE STATE OF IDAHO

Docket No. 38623-2011
Case No. CV-2007-885 (Bonner County, Idaho)

EMPLOYERS MUTUAL CASUALTY COMPANY,
PLAINTIFF / APPELLANT / CROSS-RESPONDENT;

vs.

DAVID and **KATHY DONNELLY,**
DEFENDANTS / RESPONDENTS / CROSS-APPELLANTS.

On appeal from the
First Judicial District of the State of Idaho,
in and for the County of Bonner

Honorable Steve Verby, District Judge, presiding

REPLY BRIEF FOR THE APPELLANT / CROSS-RESPONDENT

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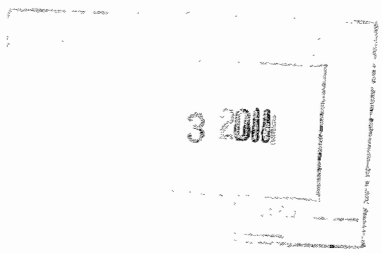

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IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF IDAHO, IN AND FOR THE COUNTY OF KOOTENAI

FEDERAL HOME LOAN MORTGAGE CORPORATION, Plaintiff, vs. ROBERT STILLMAN, and GLORIA STILLMAN, husband, and wife, and all other residents designated as John Does I-X, Defendant.	Case No. SUMMONS

NOTICE: YOU HAVE BEEN SUED BY THE ABOVE-NAMED PLAINTIFF. THE COURT MAY ENTER JUDGMENT AGAINST YOU WITHOUT FURTHER NOTICE UNLESS YOU RESPOND WITHIN 20 DAYS. READ THE INFORMATION BELOW.

TO: ROBERT & GLORIA STILLMAN and all other residents designated as John Does I-X,

YOU ARE HEREBY NOTIFIED that in order to defend this lawsuit, an appropriate written response must be filed with the above designated court within 20 days after service of this Summons on you. If you fail to so respond the Court may enter judgment against you as demanded by the plaintiff in the Complaint.

A copy of the Complaint is served with this Summons. If you wish to seek the advice or

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I. THE DISTRICT COURT ERRED IN DETERMINING THAT EMC HAD A DUTY TO PAY ATTORNEY FEES AND COURT COSTS TAXED AGAINST ITS INSURED IN LITIGATION IN WHICH EMC PROVIDED A DEFENSE, UNDER A RESERVATION OF RIGHTS, BUT WHERE THERE WAS NO COVERAGE FOR THE SUBSTANTIVE DAMAGES AWARDED TO THE POLICY CLAIMANT.

A. *The plain language of the Applicable Policy supports EMC's position that it is not contractually obligated to pay Donnelly's costs and fees.*

Regarding the payment of attorney fees awarded against an insured, the Applicable Policy with RCI provides as follows:

> **SUPPLEMENTARY PAYMENTS –COVERAGES A AND B**
> 1. We will pay, with respect to any claim we investigate or settle, or any "suit" against an insured we defend:
> a. All expenses we incur.
> . . .
> e. All costs taxed against the insured in the "suit."

R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. A, at p. 7-8, filed Nov. 12, 2009).[1] "Suit" is defined in the policy as "a civil proceeding in which damages because of 'bodily injury', 'property damage' or 'personal advertising injury' *to which this insurance applies* are alleged." Id., at p. 15 (emphasis added).

Donnelly argues that the District Court was correct in holding that this language required payment of their costs and fees in this case, because there is no language indicating that the policy language requiring fees is tied to a finding of coverage. Specifically, the District Court held that "EMC has never set forth any specific language in its policy that ties its promise to pay costs on a finding of coverage." R. Vol. 3, p. 486. This is simply not accurate. The Applicable

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[1]Relevant excerpts to the Applicable Policy are attached to the *Brief for the Appellant* at Addendum A.

Policy language tying payment of fees to coverage is the language (and placement) of the heading "Supplemental Payments." The Applicable Policy only requires payment of attorney fees awarded against the insured on covered claims, because the language "supplementary payments" indicates that payments will only be made *in addition to* payments on the underlying claim, and because of the limiting language that the supplementary payments only apply in suits where the insurance applies are alleged.

B. The District Court's reliance upon Mutual of Enumclaw v. Harvey was misplaced and that case is distinguishable from the facts in this case.

In reaching its decision, the District Court relied upon Mutual of Enumclaw v. Harvey, 115 Idaho 1009, 772 P.2d 216 (1989). In their response brief, Donnelly argues the District Court was correct in this reliance because the language of the policies share some similarities. *Respondents/Cross-Appellants' Brief*, at 28. However, the similarities in the policies cited by Donnelly are immaterial to the issues in this case and go to the limits of insurance. Placing the language of the policies side by side, as Donnelly did in their brief, highlights the important differences. *Respondents/Cross-Appellants' Brief*, at 28.

The crucial differences between the polices is the language in the Applicable Policy of "Supplemental Payments" versus the language in the Enumclaw Policy of "Supplemental Coverages" and the **placement** of the sections in the policies themselves. The placement of the language in the Enumclaw Policy, under a heading entitled "Supplemental Coverages," was important to that court's determination that there was coverage for costs in that case. Id. at 1012 (the language that the company would pay "all costs taxed against the insured in any suit defended by Company" **as well as the placement of the language** "under a heading named

'Supplementary **Coverages**' implies that the provisions therein are separate from an in addition to the basic policy coverage."). In the Applicable Policy, the language is found not in its own coverage section, but in addition to (supplementary to) the Coverages A and B.

This difference in language and placement is significant, given the fact that the Court in Enumclaw explained that "[t]he results in the cases depend[s] 'upon the language employed by the parties in their contract. . . .'" Id. at 1012. Using a case specific approach, looking at the language and placement of language in the Applicable Policy, it is clear that the payment of costs is conditioned upon a finding of coverage for the underlying claim giving rise to the costs.

The District Court also relied upon the Mutual of Enumclaw decision's rationale that when a company has the right to control the defense and the power to refuse settlement, it should also bear the consequences of case management decisions, including the taxing of costs. Id., 115 Idaho at 1012. While this rationale is flawed and could have a chilling effect on the willingness of insurance companies to accept the defense of mixed cases, it also completely ignores the reality of this case, which is, that RCI had its own independent counsel who participated throughout the Underlying Litigation. Independent counsel for RCI was on the pleadings and could have stepped in with respect to areas where he felt the interests of RCI were not adequately protected by counsel appointed by EMC, and for purposes of trial and settlement.

Because the language, and the placement of the language, in the policies differs on the substantive issue of whether the duty to pay costs is a standalone duty, or a duty supplementing coverage only if there is underlying coverage, Mutual of Enumclaw v Harvey, *supra*, is distinguishable from the facts in this case and the District Court should not have relied upon it in reaching its decision in this case.

C. *Other persuasive authority, ignored by the District Court, supports RCI's position.*

In responding to RCI's discussion of the 2009 California case of State Farm General Ins. Co. v. Mintarsih, 175 Cal. App. 4th 274, 95 Cal.Rptr. 3d 845 (App. 2009), Donnelly attempts to distinguish Mintarsih and cite additional recent California authority on the issues. However, Donnelly misreads Mintarsih, which does fit squarely within the factual confines of this case, and cites authority from California which not only does not apply, but was superceded by a grant of rehearing and is "not citable" under the California Rules of Court. See Arrowood Indemnity v. Travelers Indemnity, 188 Cal. App. 4th 1452, 116 Cal. Rptr. 559 (2010).

First, with respect to Arrowood Indemnity v. Travelers Indemnity, *supra*, a Shepherd's check indicates that the decision was determined to be "not citable" because there was a subsequent petition for rehearing. Thus, the case should not be cited to or relied upon by this Court. However, even if it were good authority, the Arrowood case is not instructive in this case because that court was not addressing the issue of whether costs arising from non-covered claims in a "mixed" case were covered. Rather, that case involved a dispute between two carriers, which each covered the insured during different time frames, as to which was responsible for the costs taxed against the insured. Finally, nothing in the Arrowood case overturned or questioned the decision in the Mintarsih case, which is still good law, and is still persuasive authority in support of EMC's position in this case.

Second, despite Donnelly's attempts to distinguish Mintarsih, the fact is that the Mintarsih case provides on point, persuasive authority, which supports a finding that there is not coverage for the costs taxed against RCI in this case.

In attempting to distinguish Mintarsih, Donnelly argues that the duty to pay costs is tied to the duty to defend, and that if a company has a duty to defend, determined at the onset of the case, then there is a duty to pay costs. This focus on the duty to defend is correct in part, but it ignores the rest of the Mintarsih decision, which addresses the situation where there is a duty to defend only some of the claims alleged: a "mixed case." Where a company is required under the contract (as opposed to under an implied-in-law duty) to defend a case on all claims, there may be duty to pay costs. However, where a company defends all claims in a case, even though some of the claims are clearly not contractually covered, because it is required to defend at least one of the claims, the analysis is more complex.

The first part of the Mintarsih case addresses a basic premise: where there is a *contractual* duty to defend there is a duty to pay costs and fees under a supplemental coverages provision. However, the court goes on to discuss the case where there is arguably coverage for some claims, and no coverage for others. The Mintarsih court concludes that in such "mixed cases," the duty to defend does not give rise to a duty to pay costs and fees under a supplemental coverages provision. Id. at 286.

In reaching this conclusion, the Mintarsih court distinguishes between a *contractual* duty to defend, and an *implied-in-law* duty to defend. The *contractual* duty to defend is the duty to defend a claim where facts are alleged that may give rise to coverage. Mintarsih, 175 Cal. App. 4th at 284, n. 6. In a "mixed action," the duty to defend clearly non-covered claims when there are both non-covered claims and potentially covered claims in the same case arises from an *implied-in-law* duty to defend. Id. at 286. The Mintarsih court explained that there is a *contractual* obligation to defend potentially covered claims, and an *implied-in-law* obligation to

defend clearly non-covered claims joined in the same lawsuit. The duty to pay costs and fees is tied to the **contractual** obligation to defend the lawsuit.

Where there is a *contractual* duty to defend, there is a duty to pay costs and fees of the other party under the "supplemental payments" provision. However, the *implied-in-law* duty to defend non-covered claims in a mixed action **does not** give rise to a duty to pay fees under a supplementary payments provision:

> **An insurer's implied-in-law duty to defend an entire "mixed" action, including claims that are not even potentially covered, does not give rise to an obligation under a supplemental payments provision to pay costs awarded against the insured that can be attributed solely to claims that were not potentially covered.** This is because the duty to defend claims in a "mixed" action that are not potentially covered is not a contractual duty, and the reference in the supplemental payments provision to "suits we defend" encompasses only those claims that the insurer agreed to defend under the terms of the policy.

Id. at 286 (emphasis added).

The Underlying Litigation is a "mixed action," as defined by the California court, because there were potentially covered claims and there were clearly non-covered claims. The bodily injury claims were potentially covered, and those claims led EMC to defend the entire action, including the clearly non-covered claims, under a reservation of rights.

In an attempt to distinguish Mintarsih, Donnelly appears to argue that the Mintarsih case was a "mixed action" because it involved tort claims and wage claims arising out of different conduct, and conclude that this case is not a "mixed action" because all claims arise out of the same operative facts. This is not what the term "mixed action" means. A "mixed action" is one where a defense is provided for all claims, despite the fact that there are potentially covered claims and non-covered claims in the same suit. This action is clearly a "mixed action" because

a defense was provided for all claims, even non-covered claims, because there was an allegation of potentially covered bodily injury.

The bodily injury claims in this case were defended under a *contractual* duty to defend, as explained by the Mintarsih court. The remaining claims were defended under an *implied-in-law* obligation to defend the lawsuit as a whole where there are some potentially covered claims. This *implied-in-law* duty to defend the claims upon which damages were awarded in this case (the statutory claims and the contract claims) "does not give rise to an obligation under a supplemental payments provision to pay costs awarded against the insured that can be attributed solely to claims that were not potentially covered." Mintarsih, at 286.

Donnelly also goes into a discussion about when the duty to defend is triggered and concludes that if there was a duty to defend in this case at the onset, then there was coverage for the costs and fees under the Supplemental Payments provision. *Respondents/Cross-Appellants' Brief*, at 33-34. Again, this might be the case if there were only potentially covered claims in this case. However, this is a "mixed action," and at the onset of this case, there was one potentially covered claim and the rest of the claims were not covered.[2] In such a "mixed action" where a defense is provided based upon a potentially covered claim, the insurer is not liable for payment of costs and fees taxed on claims that were not covered from the outset of the litigation. Thus,

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[2]It should be noted that EMC defended this case under a reservation of rights, and then filed a Declaratory Judgment action to determine its rights and responsibilities regarding coverage while defending the underlying action. *See EMC v. Rimar Constr. Inc. and David and Kathy Donnelly*, Bonner County Case No. CV 2007-00885. This procedure is the proper way to protect the interests of the insured and still receive a determination of contractual rights in a case such as this. Thus, EMC is puzzled by Donnellys comments questioning why EMC would defend the action, made in Note 6 of *Respondents/Cross-Appellants' Brief*. EMC clearly would defend its insured until such time as it had a ruling in the Declaratory Judgment action.

Donnelly's discussion of when the duty to defend arises really has no applicability in this case. No one disputes that EMC undertook to defend its insured.

The fact that the District Court dismissed the bodily injury claims which gave rise to the coverage in the first place, immediately prior to the trial in this matter, and the fact that the trial proceeded only on what later proved to be non-covered claims, is notable to highlight the unfairness of requiring EMC, which went above and beyond in defending its insured at trial, even after the claims it believed may have been covered were dismissed, to pay costs and fees awarded based solely on non-covered claims.[3] As noted by the court in Mintarsih, holding that EMC is required to pay costs and fees attributable to the non-covered claim would have a chilling effect on companies continuing to defend their insureds even in questionable cases, or when the contractual duty to defend is extinguished and all that remains is a potential implied-in-law duty to defend. The better public policy is to encourage companies to do what EMC did and provide a defense in "mixed cases"or to continue to provide a defense after claims giving rise to coverage are extinguished.

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[3]EMC had tried to get the issue of coverage resolved prior to trial by filing a declaratory judgment action. However, the Donnellys moved to stay the declaratory judgment action until after the trial of the underlying matter. Thus, the Donnellys themselves prevented resolution of the coverage issues prior to trial, leaving EMC in the position to continue to defend the action through trial, or risk an adverse decision in the declaratory judgment action. See Bonner Co. Case No. CV-2007- 00885.

II. THE DISTRICT COURT PROPERLY DETERMINED THAT EMC HAD NO DUTY TO INDEMNIFY THE CONTRACT-BASED DAMAGES AWARDED TO DONNELLY DUE TO EXCLUSIONS IN THE INSURANCE POLICY.

A. The only claims advanced by Donnelly in the Underlying Litigation upon which they obtained relief were for breach of the implied warranty of workmanship and for violation of the Idaho Consumer Protection Act.

Donnelly urges the Court to determine that insurance coverage may exist because tort-based damages might have been awarded on Donnelly's claim in the Underlying Litigation for breach of contract. Apparently, Donnelly concedes that contract-based damages are not subject to coverage and for coverage to apply the Court must be able to characterize the damages award, in part, as deriving from a tort-based claim. In support of the argument that damages may have been tort-based, Donnelly directs the Court to the *Amended Verified Complaint* filed in the Underlying Litigation, arguing that a negligence claim for property damages was asserted. *Cross-Appellants/Respondents' Brief*, at 4-5. A close review of the proceedings in the Underlying Litigation reveals otherwise.

The *Amended Verified Complaint* filed in the Underlying Litigation includes claims for breach of contract, misrepresentation/fraud/nondisclosure, professional malpractice/negligence, breach of warranties, violation of the Idaho Consumer Protection Act, and quiet title/declaratory relief. R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. B, filed Nov. 12, 2009). As to the breach of contract claim, while it includes a vague reference that property damage may have resulted from negligent conduct of RCI, the claimed relief as a result thereof is clearly alleged to lie in contract because Donnelly alleged that "[a]s a direct and proximate result of Defendant RCI's **material breaches of contract**, Plaintiffs have suffered substantial damages." Id., at Ex. B, pg. 10-11. See also *Cross-Appellants/Respondents' Brief*, at 4-5.

Moreover, however, the characterization of damages relative to the breach of contract claim is not relevant because the jury awarded no damages based on that claim. R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. E, filed Nov. 12, 2009). Likewise, the jury found no liability, and awarded no damages, as to the tort claims based on fraud, misrepresentation, nondisclosure, professional malpractice and negligence.[4] Id. It is noteworthy that the general negligence claim only related to alleged negligence of RCI and Rimar based upon the allegation that they were acting as an engineer or architect. Id. The jury found that RCI and Rimar acted neither as an architect or engineer. Id.

The jury only awarded damages based upon breach of the implied warranty of workmanship, and based upon the statutory claims. Id. Argument as to the potential nature of damages based on the breach of contract claim is a red herring. The only claims that deserve analysis for a determination of insurance coverage are those upon which liability was found and damages were awarded - the warranty claim and the consumer protection act claim.

B. Donnelly does not challenge the District Court's determination that there is no coverage for statutory-based damages.

On appeal, Donnelly does not challenge the determination by the District Court that the statutory damages of $2,000 awarded by the jury in the Underlying Litigation is not subject to coverage under the Applicable Policy. *Cross-Appellants/Respondents' Brief*, at 3. As such, this

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[4]During the course of the Underlying Litigation Donnelly did claim bodily injury from potential carbon monoxide poisoning - a potential tort-based claim in negligence - but the District Court did not permit any evidence in that regard to be presented to the jury. R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. C, filed Nov. 12, 2009). The exclusion of that evidence occurred less than one month before trial - after EMC began providing a defense to RCI; after the declaratory judgment action had been filed; and after the declaratory judgment action had been stayed.

Court need only investigate the warranty claim to determine whether the jury award of $126,611.55 in the Underlying Litigation is subject to coverage under the Applicable Policy.

C. *The damages awarded for breach of the implied warranty of workmanship are, under the circumstances of the Underlying Litigation, based in contract and not in tort.*

1. EMC's reservation of rights letter is not instructive.

Donnelly argues that the mere fact that EMC provided a defense to RCI, under a reservation of rights, is instructive that tort-based property damages were claimed by Donnelly and subject to coverage. *Cross-Appellants/Respondents' Brief*, at 5-6. This argument misinterprets the contents of EMC's reservation of rights letter. EMC never indicated to its insured that there would be coverage for any alleged property damage. Instead, EMC clearly and unequivocally stated to its insured that -

> EMC will be providing a defense for Rimar Construction in this litigation because there is a potential for coverage of bodily injury. However, you should be aware that there is no coverage for defective work or breach of contract - neither of which are property damage. In addition, Exclusions a. and m. are secondary bars to coverage.

R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. I, pg. 2, filed Nov. 12, 2009).[5] EMC went on its letter to detail the alleged facts, potential bases for coverage, and the reasons for non-coverage or exclusion. Id. EMC clearly advised its insured that no part of Donnelly's claim was subject to coverage, except the claim for bodily injury, which as noted above was never presented to the jury. Id. As such, EMC's reservation of rights letter is not an admission that coverage may exist for certain property damage. It indicates completely to the

[5]Said reservation of rights letter also advised RCI to obtain its own independent counsel for representation during the Underlying Litigation, and RCI in fact availed itself of this right.

contrary. Moreover, the position of EMC in its reservation of rights letter was not a basis for the actual damage award for the breach of warranty claim, and therefore really offers nothing as to the nature and character of the damages actually awarded by the jury in the Underlying Litigation.

2. The jury verdict in the Underlying Litigation allocated damages.

Donnelly contends that the jury's verdict in the Underlying Litigation is an unallocated general verdict. This is simply incorrect. The jury returned a special verdict, from which the District Court then applied the applicable law to the involved claims to enter an appropriate judgment. Further, both the special verdict and judgment are allocative of both liability and damages. Based upon the allocation of liability and damages in the Underlying Litigation, there is no coverage.

An unallocated general verdict was not entered by the jury in the Underlying Litigation. Rather, the jury returned a special verdict, from which the district court applied the law toward entry of a judgment. Simply put, a "verdict" is "a jury's finding or decision on the factual issues of a case." BLACK'S LAW DICTIONARY, at 1696 (9th ed. 2009). A verdict can be general or special in nature, and where the verdict is special in nature it is more likely representative of an allocated finding of liability and award of damages.

A "general verdict" is one in which "the jury finds in favor of one party or the other, as opposed to resolving specific fact questions." BLACK'S LAW DICTIONARY, at 1696 (9th ed. 2009). That is, where the jury enters a verdict finding generally for one party, without specifying the reasons therefore among varying claims, then the verdict is general in nature. Statler v. United States, 157 U.S. 277, 279 (1895). The Supreme Court confirms that "[a] general verdict is

defined to be one 'by which the jury pronounces generally upon all or any of the issues.'" Glenn v. Sumner, 132 U.S. 152, 156 (1889). "[G]eneral verdicts do not involve factual findings but rather ultimate legal conclusions." Zhang v. Am. Gem Seafoods, Inc., 339 F.3d 1020, 1031 (9th Cir. 2003). "If the jury announces only its ultimate conclusions, it returns an ordinary general verdict." Id.

On the other hand, a "special verdict" is one in which "the jury makes findings only on factual issues submitted to them by the judge, who then decides the legal effect of the verdict." BLACK'S LAW DICTIONARY, at 1697 (9th ed. 2009). This meaning is confirmed by the Supreme Court, which has stated that a "special verdict is . . . [w]here the jury states the naked facts as they find them to be proved, and pray the advice of the court thereon." Statler, 157 U.S. at 279. "[A] special verdict is 'in the form of a special written finding upon each issue of fact,'" and is permissible by Federal and State Rule 49(a). Zhang, 339 F.3d at 1031. If the jury "returns only factual findings, leaving the court to determine the ultimate legal result, it returns a special verdict." Id.

It is clear that the verdict rendered by the jury in the Underlying Litigation is a special verdict. The verdict does not contain any generalized findings in favor of one party or the other followed by a general award of damages. Rather, the verdict contains the jury's response to a number of factual questions posed to it concerning whether certain facts were proven. For instance, the jury answers "yes" to a question of whether there was a contract between Donnelly and RCI. R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. E, Quest. 1, filed Nov. 12, 2009). The jury also answers "yes" to a question as to whether RCI materially breached the contract with Donnelly. Id., at Quest. 3. The jury goes on to answer 39 questions

posed to them requiring them to make factual determinations. Id. From this, it is clear the role of the jury was to make factual determinations to assist the District Court in its entry of an appropriate judgment based on application of law to the facts determined by the jury. As such, the jury returned an allocated "special verdict" and not an unallocated "general verdict." The special verdict was allocative in that it made an actual determination of the facts that were a prerequisite to the claims of the parties, and on those claims which formed a basis for relief, it allocated the proper award of damages.

After entry of a special verdict by the jury in the Underlying Litigation, the District Court applied the jury's findings to the claims and entered an appropriate judgment. The judgment represents the "court's final determination of the rights and obligations of the parties in a case." BLACK'S LAW DICTIONARY, at 918 (9th ed. 2009). The judgment allocated liability among the various claims involved in the Underlying Litigation. The judgment actually goes through each claim for relief asserted by the parties in the Underlying Litigation and makes a determination of liability. For instance, the judgment recites that Donnelly prevailed on its breach of contract claim against RCI, as well as on its breach of the implied warranty of workmanship. R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. F, at ¶1, 3, filed Nov. 12, 2009). However, it recites that RCI prevailed on Donnelly's claim of breach of express warranty. Id., at ¶ 2.

In addition, the judgment entered in the Underlying Litigation also allocated damages among the claims upon which relief was found to be appropriate. For instance, damages were only awarded on three distinct and separate claims. The judgment awarded $126,611.55 for breach of the implied warranty of workmanship, and $1,000.00 each on two separate claims for

violation of consumer protection statutes. Id., at ¶ 3, 4, 5. Such finite and discreet recitals, findings and conclusions represent an allocated verdict - it is known with precision and exactness the claims upon which relief was granted and the damages awarded upon each claim. Without question this represents an allocated special verdict and judgment.

Since it is specifically known upon which claims in the Underlying Litigation relief was granted, and the precise amount of damages awarded on each claim, it is not difficult to apply the required facts and law on those matters to the Applicable Policy to determine whether coverage applies. Based on such reasoning, the District Court properly determined that there was no coverage for the claims in the Underlying Litigation upon which Donnelly received relief. This is because those claims are excepted from coverage under the Applicable Policy as contract based damages.

3. The jury finding of liability, and award of damages, on the breach of implied warranty of workmanship claim was a contract-based award subject to an exclusion from coverage.

The District Court properly determined that all of the damages awarded for the breach of the implied warranty of workmanship claim in the Underlying Litigation were based on contract liability. Whether the damages assessed by the jury related to work performed by Donnelly or consequential damage to other property not worked on by Donnelly is irrelevant since the entirety of the damage award was based on the existence of a contract. The contract liability exclusion in the Applicable Policy clearly applies to the warranty of workmanship claim, at least under the circumstances presented by the Underlying Litigation.

The proceedings of the Underlying Litigation unequivocally demonstrate that the District Court presented the warranty of workmanship claim to the jury as a contract-based claim. The

jury instructions provided in the Underlying Litigation made it clear that liability on the warranty of workmanship claim was dependent on the existence of a contract between Donnelly and RCI (EMC's insured). R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. D, filed Nov. 12, 2009). Two jury instructions clearly illustrate this irrefutable fact -

- "With regard to the claim of the implied warranty of workmanship, the Donnellys have the burden of proving . . . [a] contract existed between [RCI] and the Donnellys" - the fact that the existence of a contract is a necessary element of the claim demonstrates that it sounds in contract;[6] and
- In assessing damages for breach of the implied warranty of workmanship the jury was to award damages for "those losses and expenses which may reasonably have been in contemplation of both parties as a probable result of such breach when the contract was made" - the District Court's use, yet again, of the word "contract" indicates that the damages to be awarded are in the nature of contract.[7]

The jury's award of damages was entirely dependent on the existence of a contract, so the contract liability exclusion is applicable. The District Court correctly so determined.

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[6]R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. D, instr. 51, filed Nov. 12, 2009).

[7]R Vol. 3, Clerk's Exhibits (*Plaintiff's Motion for Summary Judgment*, Ex. D, instr. 90, filed Nov. 12, 2009).

III. THE DISTRICT COURT PROPERLY DETERMINED THAT ATTORNEY FEES COULD NOT BE AWARDED, PURSUANT TO IDAHO CODE § 41-1839, TO DONNELLY BECAUSE DONNELLY HAD NO INSURANCE RELATIONSHIP WITH EMC AND HAD NOT SUBMITTED A PROOF OF LOSS.

A. *Donnelly made no proof of loss upon EMC, Donnelly was not an insured of EMC, and EMC did not waive the requirement of a proof of loss.*

Donnelly argues that attorney fees and court costs should have been assessed against EMC in favor of Donnelly under IDAHO CODE § 41-1839. For the reasons set forth in EMC's *Brief for the Appellant* (filed Sept. 21, 2011), at pp. 33-36, EMC asserts the District Court correctly determined a fee award was not proper. *First*, Donnelly made no proof of loss upon EMC, asserted no claim for money damages against EMC, and provided no evidence of making any demand upon EMC for a sum certain before initiating a counterclaim against EMC. *Second*, Donnelly was not an insured of EMC, and therefore had no rights under IDAHO CODE § 41-1839. *Third*, contrary to Donnelly's argument, EMC never waived the requirement that a proof of loss first be provided.[8]

B. *Even if Idaho Code §41-1839 is applicable, the District Court's refusal to award fees to Donnelly is harmless error.*

Even if Donnelly is correct in its interpretation of IDAHO CODE § 41-1839, it would not result in reversal of the District Court's determination. Rather, the District Court's determination would merely be harmless error because Donnelly was not a prevailing party and not entitled to an award of attorney fees in any instance. The rule of law is clear that where a ruling of the court

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[8]Donnelly cites Bonner County v. Panhandle Rodeo Assoc., 101 Idaho 772 (1980) for the proposition that EMC waived the proof of loss requirement in this action. Bonner County is inapplicable and distinguishable from the facts of this case because the waiver in Bonner County was based upon the insurers rejection of the tender of defense on a covered claim. Id. at 777. Here, EMC provided a defense and therefore never waived the proof of loss requirement.

can be sustained on grounds other than those stated, the error is harmless and reversal is not warranted. See Banning v. Minidoka Irrigation Dist., 89 Idaho 506, 510 (1965). Here, Donnelly did not prevail and would not have been entitled to an award of fees even if IDAHO CODE § 41-1839 is applicable.

It is well settled that for any party to receive an award of attorney fees based upon IDAHO CODE § 41-1839 the party must have prevailed in the action as a whole. As early as 1965, this Court, in addressing the propriety of an award of fees under IDAHO CODE § 41-1839, held that -

> **The material issue is "Who prevails?"** If the insured prevails, then that party is entitled to reasonable attorney fees.

Halliday v. Farmers Insurance Exchange, 89 Idaho 293, 301 (1965) (emphasis added). Then, in 1984, the Idaho Court of Appeals explained that an award of attorney fees under IDAHO CODE § 41-1839 is reserved for those that "**successfully** litigate[] an insurance claim." Manduca Datsun, Inc. v. Universal Underwriters Insurance Co., 106 Idaho 163, 168 (Ct. App. 1984) (emphasis added). The Manduca court further stated that "[i]n order to receive an award under [IDAHO CODE § 41-1839], an insured must **prevail** in the litigation." Id. at 169 (emphasis added). More recently, in 2006, this Court addressed the issue again and explained that a party was not entitled to attorney fees under IDAHO CODE § 41-1839 where it did not prevail in the action. Point of Rocks Ranch, LLC v. Sun Valley Title Insurance Co., 143 Idaho 411, 415 (2006).

The foregoing line of authority firmly establishes that under Idaho law a party is not entitled to an award of attorney fees under IDAHO CODE § 41-1839 unless that party actually prevails in the action. EMC submits that Donnelly did not prevail in the action as a whole, which determination is a condition precedent to any award of costs or attorney fees. EMC submits that

no party to this action prevailed overall before the District Court, and that therefore no party is entitled to an award of costs or attorney fees.

In Idaho, the determination of the prevailing party requires a three step inquiry by the Court as to (1) the result obtained in relation to the relief sought; (2) whether there were multiple claims or issues; and (3) the extent to which either party prevailed on each issue or claim. Jerry J. Joseph C.L.U. Ins. Assoc. v. Vaught, 117 Idaho 555 (Ct. App. 1990). Here, Donnelly sought a judicial declaration that there was insurance coverage for approximately $426,000 in damages it had sustained, as well as judicial voidance of a settlement agreement between RCI and EMC. The only result Donnelly obtained was a judicial declaration of coverage for approximately $297,000 in damages (roughly 70% of the amount sought). Donnelly failed in regard to its claim for fraudulent conveyance and in regard to the issue of insurance coverage for the actual damages it was awarded in the Underlying Litigation. Rather, EMC prevailed on the issue of insurance coverage of the actual damages, and Donnelly voluntarily relinquished its claim for fraudulent conveyance. Under these circumstances, EMC submits that the results of this action have been a draw - no party has prevailed in the action as a whole to date.

Where a party does not prevail entirely, it is not entitled to an award of fees. International Engineering Co. v. Daum Indus., Inc., 102 Idaho 363 (1981). More specifically, where each party is partly successful in its claims against the other, there is no overall prevailing party and each side ought to bear its own costs and fees. See id. In Daum, the plaintiffs were awarded $13,698 and the Defendant was awarded ownership of a note. Id., at 158. The note was a ten-year note with a face value of $20,000. Id., at 156. Based upon these awards, the trial court determined the case was a draw and no party prevailed. Id., at 158-59. This decision was upheld

on appeal. Id. The ratio of damages in that case was 60/40, not too far from the 70/30 ratio at issue in the present case. Such reasoning has extended to many cases in our jurisdiction. See, e.g., Ryder v. Idaho PUC, 141 Idaho 918 (2005) (in a dispute between a telephone company and paging companies arising out of the use of facilities, the award of attorney's fees was not appropriate because the parties had each prevailed on some issues and lost on others); Weaver v. Millard, 120 Idaho 692 (Ct. App. 1991) (where partnership and contractor each prevailed on one of the two issues between them, but each received far less than the respective relief they sought, the court did not abuse its discretion in concluding that neither party prevailed against the other).

In order that Donnelly be awarded costs and fees as requested, they must have prevailed in the action as a whole. Because each party prevailed in part, no party to this action is the overall prevailing party. As such, Donnelly is not entitled to any award of costs or fees.

IV. THE DISTRICT COURT PROPERLY DETERMINED THAT ATTORNEY FEES COULD NOT BE AWARDED, PURSUANT TO IDAHO CODE § 12-120(3), TO DONNELLY BECAUSE THERE WAS NO COMMERCIAL TRANSACTION BETWEEN EMC AND DONNELLY.

Donnelly has not challenged on appeal the District Court's determination that Donnelly was not entitled to an award of attorney fees or court costs in this action based upon IDAHO CODE § 12-120(3). Therefore, that aspect of the District Court's determination ought to be affirmed.

V. IT WAS NOT ERROR FOR THE DISTRICT COURT TO ENTER A FINAL JUDGMENT PROVIDING DECLARATORY RELIEF, BUT PROVIDING FOR NO MONEY DAMAGE AWARD.

Donnelly argues that the District Court erred in entry of its final judgment by providing only for declaratory relief and not providing Donnelly was a specific judgment for money damages in the amount of $296,933.89. This argument lacks merit.

The District Court entered a memorandum decision on cross-motions for reconsideration, and then the parties reached a stipulation as to all issues not encompassed by the Court's decision. R Vol. 3, p. 473-491, 504-508. As a result, all issues of this action reached finality and the District Court appropriately entered a final judgment. R Vol. 3, p. 514-516. The final judgment was based upon the parties' stipulation that dismissed all claims except those related to declaratory relief. In other words, every claim that sought monetary damages was dismissed by stipulation, the parties instead leaving at issue only those claims that sought the District Court's declaratory judgment. There being no claim for monetary damages or relief before the District Court at the time the final judgment was entered, there was no adequate basis for entry of a money damage award.

Donnelly urges the Court to hold that money damages are impliedly encompassed as part and parcel of a declaratory judgment action, and in so arguing relies upon Sweeney v. American National Bank, 62 Idaho 544 (1941). While the Court in Sweeney interpreted a contract and then awarded damages based upon that interpretation, Sweeney does not stand for the proposition urged by Donnelly. The reason that the Court in Sweeney permitted the construction of a contract and subsequent award of damages was because the initiating complaint requested such relief. Id. at 548, 551. Sweeney only establishes that a party may include in a declaratory judgment action a request for entry of monetary relief. In this action, Donnelly made no request, instead only asking the District Court to interpret the Applicable Policy.

The operative pleading of Donnelly before the District Court at the time of entry of the final judgment was the *Second Amended Answer, Counterclaim and Cross-Claim* filed on or about July 12, 2010. R Vol. 3, p. 398-406. The *Second Amended Answer* included a

counterclaim against EMC for a declaratory judgment on the insurance coverage issues. Id. That counterclaim specifically sought relief for "a declaration that EMC has a contractual duty to pay and/or indemnify RCI, in whole or in part, for the Donnelly judgment." Id., at 401. That counterclaim does not seek an award of money damages payable by EMC to Donnelly. In addition, the prayer for relief in the *Second Amended Answer* does not include any prayer for entry of a money judgment or money damages award. Id., at 405. Given these circumstances, there was no appropriate basis for the District Court to now amend or alter the judgment to grant Donnelly relief it did not affirmatively seek by way of its counterclaim.[9]

Additionally, counsel directly negotiated terms to finalize the action for purposes of cross-appeal by Donnelly and EMC of the District Court's decisions with respect to the insurance coverage issues encompassed in the Court's *Order Re: Motion for Reconsideration*. Those negotiations resulted in preparation of a stipulation and order that addressed all claims and issues in the action not resolved by the Court's *Order Re: Motion for Reconsideration*. Those negotiations also resulted in preparation of a final judgment for appeal purposes. Counsel for Donnelly was of course included in all negotiations. R Vol. 3, Clerk's Exhibits (*Memorandum in Opposition to Motion to Amend Judgment*, Ex. A, filed Apr. 8, 2011). Counsel for Donnelly ultimately approved the form of the stipulation, order and judgment. The stipulation was submitted to the District Court and filed. R Vol. 3, p. 504-509. The form of conforming order agreed to by counsel was also submitted to the District Court and the District Court entered the

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[9]The *Second Amended Answer* also included a counterclaim for fraudulent conveyance that arguably could have provided a basis upon which to award money damages to Donnelly payable by EMC. However, Donnelly dismissed, with prejudice, the fraudulent conveyance counterclaim before entry of the final judgment. R Vol. 3, p. 504-507.

same. R Vol. 3, p. 510-513. Finally, the form of judgment agreed to by counsel was submitted to the District Court and the District Court entered the same. R Vol. 3, p. 514-517. Having agreed to the form of the final judgment, it was disingenuous for Donnelly to seek alteration or amendment of the judgment.

Finally, Donnelly alleged alteration or amendment of the judgment was necessary under Rule 59(e), but Donnelly never alleged any error of fact or law in the final judgment. Rather, Donnelly complained that the judgment did not include monetary relief. The purpose of Rule 59(e) is to provide a means to "circumvent an appeal" by providing "a mechanism to correct **legal and factual errors** occurring in proceedings." Slaathaug v. Allstate Ins. Co., 132 Idaho 705, 707 (1999) (emphasis added). Donnelly never illustrated any error of fact in the final judgment, or in the orders upon which the final judgment is based. More importantly, Donnelly never pointed to any error of law reflected in the final judgment or in the orders upon which the final judgment is based.

Given the foregoing, the District Court correctly entered a final judgment providing only for declaratory relief and declining to enter an award of money damages.

ATTORNEY FEES ON APPEAL

EMC makes no request for an award of attorney fees on appeal. Donnelly requests an award of attorney fees on appeal pursuant to IDAHO CODE § 41-1839. EMC asserts, for the reasons argued above, that Donnelly is not entitled an award of fees pursuant to said statute.

CONCLUSION

For the foregoing reasons, and for those reasons articulated in the Brief for the Appellant (filed September 21, 2011), EMC respectfully requests that this Court **REVERSE** the district court's determination that EMC has a duty to indemnify its insured with respect to the fees and costs taxed against its insured in the litigation with Donnelly. EMC respectfully requests that this Court **AFFIRM** all other aspects of the district court's determination.

RESPECTFULLY SUBMITTED this 23rd day of November, 2011.

RINGERT LAW CHARTERED

James G. Reid

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CERTIFICATE OF SERVICE

I hereby certify that two (2) true and correct copies of the foregoing brief were served on the following on this 23rd day of November, 2011 by the following method:

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