Testimony of Paul De Muniz regarding Senate Bill 814

May 9, 2013

Before the House Committee on Consumer Protection and Government Efficiency

Introduction

My name is Paul De Muniz, I am currently a Distinguished Jurist in Residence at Willamette University College of Law. I previously served as an appellate judge in this state for 23 years, first as a judge on the Court of Appeals, then as a justice and chief justice of the Supreme Court. The Property Casualty Insurers Association of America contacted me and requested that I assess the constitutionality of certain provisions of SB 814. I have examined SB 814 in its present form and I have the following observations and conclusions.

Background

The Oregon Legislature enacted Senate Bill 1205, the Oregon Environmental Cleanup Assistance Act ("OECAA"), in 1999 with the stated legislative purpose as follows:

> "**465.478 Legislative findings**. The Legislative Assembly finds that there are many insurance coverage disputes involving insureds who face potential liability for their ownership of or roles at polluted sites in this state. The State of Oregon has a substantial public interest in promoting the fair and efficient resolution of environmental claims while encouraging voluntary compliance and regulatory cooperation." [1999 c.783 §3]

Since OECAA's enactment in 1999, there has been one amendment that occurred in 2003 and the only court decision to look at the constitutionality of OECAA, *Century Indemnity Co. v. The Marine Group, LLC,* 845 F.Supp.2d 1238, 1259 (D. Or. 2012), did so as an applied constitutional challenge to the word "suit" in the particular circumstances of that case. That court did not make a ruling regarding the facial constitutionality of OECAA.

SB 814 proposes multiple amendments to the OECAA. Section 8 of SB 814 provides in relevant part that the amendments "apply to all environmental claims, whether arising before, on or after the effective date [of the] Act." That means that the amendments are intended to apply not just to insurance policies negotiated and purchased after the effective date of SB 814, but to all policies regardless of when the policy was negotiated and purchased. I understand that in some cases the policies could be over 30 years old. It is the "retroactive" application of certain provisions of SB 814 to existing policies that poses serious constitutional questions.

Oregon's Contracts Clause

Article I, section 21 of the Oregon Constitution provides in part: "No... law impairing the obligation of contracts shall ever be passed." OR. CONST. art. I, § 21. Article 1, section 21 is a directive to the legislature not to knowingly pass a law that will impair an obligation under an existing contract. The Oregon Supreme Court has fashioned a two-part test to determine whether the Contracts Clause is violated: "First, it must be determined whether a contract exists to which the person asserting an impairment is a party; and, second, it must be determined whether a law of this state has impaired an obligation of that contract. General principles of contract law normally will govern both inquiries, even where the state is alleged to be a party to the contract at issue." *Hughes v. State*, 314 Or 1, 14 (1992) (citing *Eckles v. State*, 306 Or 380, 396-7 (1988), appeal dismissed 490 U.S. 1032 (1989)). In order to determine if an obligation is impaired, the court must determine whether the legislation would change or eliminate a party's obligation under the contract, not just mandate a breach of a contract term. *Strunk v. PERB*, 338 Or 145, 170 (2005). Ultimately, any "new law that alters retroactively the terms of [a] contract, (i.e., terms of contracts that were in existence before the effective date of the enactment) is unconstitutional insofar as it affects those terms." *Hughes*, 314 Or at 52 (internal quotations omitted).

Although the Contracts Clause of the Oregon Constitution was fashioned from the contracts clause in the U.S. Constitution, there is one significant difference. Unlike federal contract clause analysis, after a regulation is found to impair the obligation of a contract, Oregon does not conduct a balancing test to determine whether there is a significant and legitimate public purpose for the regulation. *Strunk*, 338 Or at 207.

U.S. Contracts Clause

Article I, section 10 of the United States Constitution provides in part: "No State shall...pass any Law impairing the Obligation of Contracts" U.S. CONST. art. I, § 10. The U.S. Supreme Court fashioned a three-part test to determine whether the Contracts Clause is violated: first, the court considers whether a state law has substantially impaired a contractual relationship; second, the court examines whether the state has a "significant and legitimate public purpose behind the regulation;" and third, the court determines "whether the adjustment of the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption." *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411-412 (1983) (internal citations omitted).

The determination of substantial impairment under federal constitutional analysis has three

components: "A court must first inquire whether a contract exists. If so, the court next must inquire whether the law in question impairs an obligation under the contract. If so, the court then must inquire whether the discerned impairment can fairly be characterized as substantial." *Robertson v. Kulongoski*, 359 F.Supp.2d 1094 (D. Or. 2004). Once substantial impairment is found, the federal constitutional analysis directs courts to defer to the legislature's judgment regarding the necessity and reasonableness of a particular measure. *Energy Reserves Group*, 459 U.S. at 413.

Anti-Assignment Provision (Section 2)

Section 2 of SB 814 invalidates any provisions in a general liability insurance policy that require the consent of an insurance company before the rights under the insurance policy or payment of an environmental claim may be assigned (also known as an "anti-assignment" clause). The Oregon Supreme Court has upheld anti-assignment clauses that bar the transfer of rights and duties under a policy without the insurer's written consent if the terms of the anti-assignment clause are unambiguous. *See Holloway v. Republic Indemnity Co.*, 341 Or 642 (2006) (attached). The court's enforcement of the anti-assignment clause in *Holloway* demonstrates that the anti-assignment language is fundamental to the benefit of the bargain to the insurer. The application of the anti-assignment provision (Section 2) of SB 814 to policies negotiated and purchased before the passage of SB 814 could constitute a retroactive impairment of the bargained for contract between the insurer and the insured. Under the Oregon Constitution SB 814's purported invalidation of the anti-assignment clauses in previously negotiated and purchased insurance contracts is likely unconstitutional because it explicitly impairs the bargained for obligation of the insured to obtain the consent of an insurer before assigning its rights to another.

Under the U.S. Constitution, the provision also may be unconstitutional because the invalidation of an anti-assignment clause in previously negotiated and purchased insurance contracts would result in the *substantial* impairment of the previously bargained for contractual relationship between an insurer and an insured. The legislature's public purpose behind Section 2 is not mentioned in the bill. However, if the legislature's purpose is based on the traditional justification for non-enforcement of anti-transfer clauses—an insurer's breach of its duty to defend—then it should be conditioned on an insurer's breach, not left to apply to all circumstances, even when insurers are defending claims.

Non-Cumulation Provision (Section 4(2)(d)

Section 4(2)(d) purports to invalidate insurers' non-cumulation clauses in previously purchased general liability insurance policies if an insured has an environmental claim with multiple policies or if an insurer is seeking contribution from other insurers involved in an environmental claim with multiple

policies.[1] This provision adopts the "all sums" rule of environmental insurance allocation (which favors the insured by permitting it to "recover fully from the policy or policies of its choice, up to the limits of the policy, after which the chosen insurer(s) may seek contribution from other insurers") and bars use of the "pro rata" rule (which favors insurers by allocating the total loss by dividing "proportionally among all insurers that covered the risk," which then "the insured must recover separately from each insurer"). Christopher R. Hermann, Joan P. Snyder, Paul S. Logan, *The Unanswered Question of Environmental Insurance Allocation in Oregon Law*, 39 WILLAMETTE L. REV. 1135-36 (2003). The "all sums" vs. "pro rata" debate is ongoing among the states with the majority of states following "all sums;" however, some of these states do not apply the "all sums" rule if there is a non-cumulation provision in the insurance contract. *See e.g. Safeco Ins. Co. v. Fireman's Fund Insurance Company* 148 Cal.App.4th 620 (2007).

Under the Oregon Constitution, this provision is likely unconstitutional because it impairs a previously bargained for obligation of the insurer. The bill alters the insurer's duty such that the targeted insurer(s) must seek contribution from other insurer(s), but the provision does not prevent the other insurer(s) from asserting non-cumulation provisions against the targeted insurer seeking contribution, resulting in a substantial burden on the targeted insurer that is selected on the claim.

Under the U.S. Constitution, although this provision substantially impairs the contractual relationship for the insurer, its constitutionality will likely be determined by the legislature's public purpose for the provision.

Owned Property Exclusion Provision (Section 4(2)(e))

In *Schnitzer Inv. Corp. v. Certain Underwriters at Lloyd's of London* the Oregon Supreme Court held that the insurers were not liable for the remediation costs of the insured's environmental damage to a third person's property because the insured was not *legally obligated* to remedy the contamination to that property (commonly known as an "owned property exclusion"). 341 Or. 128 (2006) (attached). Section 4(2)(e) appears to be in direct response to that case, providing that any costs related to remedial action taken by an insured to prevent the migration of hazardous substances into waters of the state or onto real property owned by a third party are remedial action costs that the insured must pay as part of the damages related to an environmental claim against it. This provision creates a legal obligation for the insured to clean up damage to the insured's own property as well, contrary to the previously bargained for exclusion, and could be held to violate Article 1, Section 21 of the Oregon Constitution.

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[1] SB 814 misuses the term "long-tail environmental claim" by defining it as when an environmental claim is covered by multiple general liability policies, instead of its common industry usage as being an environmental claim where the claim causing incident occurred in the past and was slow to result in a final settlement.

Under the U.S. Constitution, the provision would similarly substantially impair the contractual relationship between the parties and does not appear to have a significant and legitimate public purpose, other than to overturn the Oregon Supreme Court's decision in *Schnitzer* and provide for unfavorable decisions against insurance companies with owned-property exclusion provisions.

Automatic Right to Independent Counsel Provision (Section 7)

Section 7 of SB 814 provides to an insured the automatic right to independent counsel, "the insurer shall provide independent counsel to defend the insured who shall represent only the insured and not the insurer." This provision will retroactively impair a previously bargained for obligation of an insurer to appoint and control the defense on behalf of an insured under a reservation of rights, or if the insured has potential liability exceeding the limits of its general liability claim. See Ferguson v. Birmingham Fire Insurance Company, 254 Or 496 (1969) (attached).

Under the Oregon Constitution, Section 7 of SB 814 that provides insureds with an automatic right to independent counsel is likely unconstitutional because it explicitly impairs a previously bargained for obligation of the insurer by retroactively changing its ability to appoint and control the defense of claims.

Under the U.S. Constitution, the provision is likely unconstitutional because providing insureds an automatic right to independent counsel would result in the substantial impairment of the contractual relationship between an insurer and an insured. Regardless of the legislature's public purpose this provision seems likely to vastly increase the costs of defense, to the detriment of other policyholders who will bear these costs through premium increases; further, it likely will not produce any increase in efficiency of cleanup.

Unfair Claim Practices & Private Right of Action for Damages (Section 6)

Section 6 of SB 814 provides a list of unfair claims settlement practices against the insurer as well as a private right of action for damages against the insurer if the insured is aggrieved by one or more of the unfair claims settlement practices contained in the section. This does appear to create new obligations on the insurer and lists new unfair claims settlement practices. It is unclear from the text how this section would be applied to claims settlement practices under existing policies. However, it is very

possible that this section could give rise to impairment of contract claims under Article 1, Section 21 of the Oregon Consitution.

Savings Clause (Section 4(8))

Section 4(8) of SB 814 provides: "The rules of construction set forth in this section and sections 2 and 7 of this 2013 Act do not apply if the application of the rule results in an interpretation contrary to the intent of the parties to the general liability insurance policy." Apparently proponents of SB 814 believe that this purported savings clause resolves any potential constitutional issues of the kind I have previously described, because should a court determine that the parties' intent in bargaining the insurance contract is at odds with the provisions of SB 814 then the conflicting provisions of SB 814 do not apply. Unfortunately, that reasoning is undermined by the words of Section 4(8). First, in *Holloway v. Republic,* the Oregon Supreme Court stated "We determine the intention of the parties based on the terms and conditions of the insurance policy." With regard to section 2 of SB 814 (the anti-assignment provision) and section 4(2)(e) of SB 814 (owned property exclusion) the Oregon Supreme Court has already determined the intention of the parties to contracts with those provisions. Section 2 and 4(2)(e) are directly contrary to the law that applies to those contracts. Second, section 4(8) specifically refers to "rules of construction." The current provisions of ORS 465.480 can as a general matter be described as "rules of construction." However, the provisions that I have analyzed above, seem much more in the nature of "substantive law" than "rules of construction." Section 4(8)'s reference to "rules of construction" is unlikely to apply to provisions outside of Section 4--even though it states it will apply to Sections 2 and 7. That is so because the text and context of the statute it modifies (ORS 465.480) do not indicate that any rules of construction are set forth outside of Section 4. *See State v. Gaines*, 346 Or 160, 171 (2009). Looking at the text of the statute, Section 4 is the only section that contains the words "rules of construction" in its title and Section 4(2) is the only part that specifically refers to and provides "rules of construction" that "apply in the interpretation of general liability insurance policies involving environmental claims." ORS 465.480(2)(a-c), SB 814 § (4). Sections 2 and 7 do not mention rules of construction at all, but do contain substantive provisions that impair existing contractual obligations in environmental insurance contracts. Based on the plain text of the statute, SB 814's amendment in Section 4(8) referring to rules of construction in Sections 2 and 7 could be held to be an interpretive dead-end that cannot logically be applied to any other provisions. Moreover, Section 4(8) provides absolutely no guidance or direction to a court regarding a remedy, should a court find that one or more of the sections of SB 814 conflict with the parties' intent.

Conclusion

Although my time to review SB 814 has been limited, it is nevertheless clear to me that the purported "retroactive" application of the statutory amendments will give rise to a host of sub-constitutional and constitutional issues--some foreseen like the ones that I have described above and some yet to be understood. In my view it is likely that a court could conclude that Sections 2, 4(2)(d-e), and 7 of SB 814 appear to violate the Contracts Clause of the Oregon Constitution because they retroactively impair the obligations of insurers in existing general liability environmental insurance policies. The constitutionality of SB 814 under the U.S. Constitution's Contracts Clause is less clear due to the balancing test that courts use to determine whether the substantial impairment of a party to the contract is outweighed by a significant and legitimate public purpose by the legislature. However, even considering a court's deference to the legislature's public purpose it appears probable that SB 814 Sections 4(2)(e) and 7 lack a significant and legitimate public purpose and may be found unconstitutional under the federal constitution.

147 P.3d 329, 25 IER Cases 994

341 Or. 642
Supreme Court of Oregon.

Krystal HOLLOWAY, Respondent on Review,
v.
REPUBLIC INDEMNITY COMPANY OF AMERICA, Petitioner on Review.

(CC02 02323 CV; CA A123072; SC S52951). | Argued and Submitted Sept. 7, 2006. | Decided Nov. 16, 2006.

Synopsis

Background: After receiving an assignment of rights from insured restaurant, restaurant employee sued insurer for breach of its duties to defend and indemnify restaurant. Action was based on underlying claims by employee that she was subject to sexual harassment, constructive discharge, and intentional infliction of emotional distress based on the actions of a co-worker. The Circuit Court, Klamath County, Cameron F. Wogan, J., granted insurer's motion for summary judgment and denied employee's cross-motion, concluding that insurer had no duty to defend or indemnify restaurant because of coverage exclusions in policy. Employee appealed. The Court of Appeals, 201 Or.App. 376, 119 P.3d 239, reversed, and the Supreme Court allowed review.

[Holding:] The Supreme Court, Carson, J., held that anti-assignment provision in insurance policy rendered invalid insured's assignment of its rights under policy to employee.

Decision of the Court of Appeals reversed, and judgment of the circuit court affirmed.

West Headnotes (8)

[1] **Insurance**
⇐ Policy provisions, in general
Insurance
⇐ Assignment of claim or right to sue

Anti-assignment provision in insured restaurant's liability insurance policy, barring assignment of "your rights and duties," rendered invalid insured's assignment of its rights under policy to employee who sued insured for sexual harassment and who settled her claim against insured in exchange for insured's assignment of its rights under policy; term "you" in policy repeatedly referred to insured, and provision broadly barred assignment of all insured's rights, whether pre-loss or post-loss.

11 Cases that cite this headnote

[2] **Insurance**
⇐ Intention
Insurance
⇐ Questions of law or fact

Interpretation of an insurance policy is a question of law, and the court's task is to ascertain the intention of the parties to the insurance policy.

10 Cases that cite this headnote

[3] **Insurance**
⇐ Language of policies

When interpreting insurance policies, courts determine the intention of the parties based on the terms and conditions of the insurance policy.

6 Cases that cite this headnote

[4] **Insurance**
⇐ Definitions in policies

If an insurance policy explicitly defines the phrase in question, courts apply that definition.

5 Cases that cite this headnote

[5] **Insurance**
⇐ Language of policies

If the insurance policy does not define the phrase in question, courts resort to various aids of interpretation to discern the parties' intended meaning.

15 Cases that cite this headnote

[6] **Insurance**
Construction as a whole
Insurance
Plain, ordinary or popular sense of language
When a phrase is not defined in an insurance policy, courts first consider whether the phrase has a plain meaning, and if so, courts will apply that meaning and conduct no further analysis, but if the phrase has more than one plausible interpretation, courts will examine the phrase in light of the particular context in which it is used in the policy and the broader context of the policy as a whole.

21 Cases that cite this headnote

[7] **Insurance**
Ambiguity, Uncertainty or Conflict
If there is ambiguity in an insurance policy's term, any reasonable doubt as to the intended meaning of such a term will be resolved against the insurer.

4 Cases that cite this headnote

[8] **Insurance**
Ambiguity in general
An insurance policy's term is "ambiguous" only if two or more plausible interpretations of that term withstand scrutiny, i.e., continue to be reasonable, despite the court's resort to standard interpretive aids.

18 Cases that cite this headnote

**330 On review from the Court of Appeals. *

Attorneys and Law Firms

I. Franklin Hunsaker, Beaverton, argued the cause for petitioner on review. With him on the briefs were Paul J. Killion and Michael J. Dickman, Duane Morris LLP, San Francisco, and Bernard S. Moore, Frohnmayer, Deatherage, Pratt, Jamieson, Clarke & Moore PC, Medford.

Karen E. Duncan and Donald E. Oliver, Oliver & Duncan, Redmond, argued the cause and filed the briefs for respondent on review.

Before DE MUNIZ, Chief Justice, and CARSON, GILLETTE, DURHAM, BALMER, and KISTLER, Justices. **

Opinion

CARSON, J.

*644 The central issue in this insurance contract case is whether an anti-assignment clause providing that "[y]our rights or duties under this policy may not be transferred without our written consent[ ]" is ambiguous and thus should be construed against its drafter. A trial court held that the clause was not ambiguous. The Court of Appeals reversed. *Holloway v. Republic Indemnity Co. of America*, 201 Or.App. 376, 382, 119 P.3d 239 (2005). For the reasons that follow, we reverse the decision of the Court of Appeals and affirm the judgment of the trial court.

Fields (insured) owned and operated a restaurant as a sole proprietorship under the name "Loree's Chalet." During 1997, Republic Indemnity Company of America (Republic) undertook to insure the insured and issued her a "Workers' Compensation and Employers' Liability Policy." That insurance policy contained the following provisions:

"GENERAL SECTION

"A. The Policy

"[This policy] is a contract of insurance between you (the employer named in Item 1 of the Information Page) and us (the **331 insurer named on the Information Page). * * * [1]

"B. Who Is Insured

"You are insured if you are an employer named in Item 1 of the Information Page. * * *

" * * * * *

"PART TWO EMPLOYERS LIABILITY INSURANCE

" * * * * *

"B. We Will Pay

"We will pay all sums you legally must pay as damages because of bodily injury to your employees, provided the bodily injury is covered by this Employers Liability Insurance.

*645 " * * * * *

"C. Exclusions

"This insurance does not cover:

" * * * * *

"5. bodily injury intentionally caused or aggravated by you; [or]

" * * * * *

"7. damages arising out of * * * harassment, * * * discrimination against or termination of any employee * * *[.]

" * * * * *

"D. We Will Defend

"We have the right and duty to defend, at our expense, any claim, proceeding or suit against you for damages payable by this insurance. * * *

"We have no duty to defend a claim, proceeding or suit that is not covered by this insurance. * * *

" * * * * *

"PART SIX CONDITIONS

" * * * * *

"C. Transfer of Your Rights and Duties

"Your rights or duties under this policy may not be transferred without our written consent."

While Republic's insurance policy was in effect, plaintiff below (Holloway) began working as a waitress for the insured's restaurant. The insured also employed Zullig as a manager and bartender for the restaurant. According to Holloway,[2] immediately after Zullig began working at the restaurant, he "approached [Holloway], made lewd and vulgar comments, physically interfered with [Holloway's] normal movements within her work environment, stated his intentions to engage in sexual activities with [Holloway], and subjected [Holloway] to unwelcome sexual advances and physical contact." Also, "Zullig engaged in a pattern of verbal *646 sexual comments and innuendos designed to annoy, harass, intimidate and demean [Holloway], including explicit sexual and abusive language." Additionally, "Zullig obtained [Holloway's] home telephone number from her employment files * * * and began harassing her at home." "Zullig came into [Holloway's] house in a drunken state on more than one occasion, refused to leave when asked, kissed her against her will and told her he intended to have sexual intercourse with her whether she wanted to or not." Finally,

> "Zullig gave [Holloway], over her objection, gifts of jewelry that * * * were stolen from [the insured's] jewelry display and sales case located in the restaurant. This made [Holloway] anxious and fearful that * * * Zullig intended to gain control over her by threatening to report that [Holloway] had stolen the items from the display case."

Holloway reported Zullig's conduct to the insured on several occasions, but the insured took no action to investigate or correct Zullig's harassing conduct. According to Holloway, Zullig's conduct was "known to, authorized and ratified by" the insured, and the insured "deliberately created, maintained and permitted the harassment with the specific intention that it would force [Holloway] to resign." In fact, Holloway eventually did resign, allegedly due to Zullig's harassment.

Holloway subsequently brought an action against the insured, alleging employment discrimination by means of sexual harassment, **332 constructive discharge, and intentional infliction of emotional distress. The insured notified Republic of the action and tendered her defense to Republic. Republic, however refused to defend the insured.

Following that refusal, the insured and Holloway reached a settlement agreement. Under that agreement, the insured and Holloway stipulated to the entry of a $50,000 judgment

against the insured, and Holloway entered into a covenant not to execute on the judgment against the insured for more than $6,000. The insured paid Holloway the agreed-upon $6,000, and Holloway entered a satisfaction of the judgment as to the insured. Also under that settlement agreement, the insured purported to assign to Holloway all the insured's rights to any claim that she might have ***647** against Republic for breach of the insurance contract or for indemnity.

Upon receiving that purported assignment, Holloway brought the present breach of contract action against Republic, asserting that Republic had breached its duty to defend the insured and its duty to indemnify the insured. Through that action, Holloway sought to recover from Republic the insured's attorney fees and costs incurred while defending against Holloway's tort action, Holloway's attorney fees and costs incurred in her tort action against the insured, the remaining unsatisfied part of the judgment that she had received against the insured ($44,000), and Holloway's attorney fees and costs incurred in the contract action against Republic.

Holloway and Republic filed cross-motions for summary judgment. In support of its motion, Republic presented two arguments. First, Republic claimed that it had no duty to defend or indemnify the insured because, under two exclusions in the insurance policy, the tortious conduct that Holloway had alleged in her action against the insured was not covered by Republic's policy. Specifically, Republic asserted that the conduct alleged in Holloway's action against the insured fell within both the intentional acts exclusion and the harassment, discrimination, and termination exclusion of the insurance policy. According to Republic, because the alleged conduct was not covered under the terms of the insurance policy, Republic had no duty to defend or indemnify. Second, Republic maintained that, in any event, Holloway had acquired no rights from the insured under the purported assignment that was part of the settlement agreement between Holloway and the insured.

In its letter opinion, the trial court agreed with Republic's first argument and held that Republic had no duty to defend or indemnify. Accordingly, the trial court granted Republic's motion and denied Holloway's motion. The trial court did not address Republic's second argument, apparently because it found Republic's first argument to be persuasive and dispositive.

Holloway appealed the trial court's judgment, arguing that the trial court had erred in granting Republic's ***648** motion and in denying Holloway's motion. The Court of Appeals agreed with Holloway, holding that Holloway's complaint against the insured alleged conduct that did not fall within the insurance policy's exclusions and that the purported assignment to Holloway was valid. *Holloway,* 201 Or.App. at 382, 391, 119 P.3d 239.

As to the Court of Appeals' first conclusion, that court examined the text of the insurance policy's exclusions and the nature of the factual allegations that Holloway had made in her complaint against the insured. *Id.* at 384 91, 119 P.3d 239. Ultimately, the Court of Appeals reasoned that Holloway's complaint alleged an unpleaded battery claim that did not fall within the insurance policy's exclusions. *Id.* at 390 91, 119 P.3d 239.

Regarding its second conclusion, the Court of Appeals explained:

> "[T]he insurance policy at issue in this case provides that the 'rights or duties under this policy may not be transferred without [Republic's] written consent.' Nothing in the policy states what 'rights or duties' may not be 'transferred.' The 'rights or duties' could refer to pre-loss rights or duties, post-loss rights or duties, or both. We must choose among those understandings.
>
> ****333** "If the provision prohibits the assignment of pre-loss rights or duties, then it would 'protect the insurer against increased risks of loss resulting from an assignment of coverage to a new insured.' *Conrad Brothers v. John Deere Ins. Co.,* 640 N.W.2d 231, 237 (Iowa 2001). The insurer has bargained to accept the risk presented by the particular insured with whom it has contracted, and it makes sense for the insurer to seek to protect itself from the unknown risks to which an assignee insured might expose it. However, it would also be reasonable for the policy to insulate the insured from exposure to claims for indemnification from third-party claimants after a loss has occurred. The context of the policy provides little guidance, and, on the whole, it would be reasonable to read the provision to apply to either pre-loss or post-loss rights and duties, or both. In short, the provision is ambiguous.

> "Because the provision is ambiguous, we construe it against its drafter and conclude that it prohibits only the assignment of pre-loss rights and duties. Our conclusion is ***649** consistent with what appears to be the majority rule. *See, e.g., Conrad Brothers,* 640 N.W.2d at 236 38 (citing cases); *Insurance,* 44 Am. Jur. 2d 102 § 801 (2003) ('In the absence of an express provision to the contrary, provisions relating to the consent of the insurer to an assignment do not relate to assignments after loss or to assignments as collateral security.' (footnotes omitted.)). *But see High Tech Enterprises, Inc. v. Gen. Accident Ins. Co.,* 430 Pa.Super. 605, 635 A.2d 639 (1993) (holding that assignment of insured's rights to coverage for property damage under automobile insurance policy to automobile repairer was invalid because of anti-assignment provision). Consequently, nothing in the policy affects the validity or effectiveness of the assignment, and we reject [Republic's] argument on that point."

Id. at 381 82, 119 P.3d 239. Based upon those two conclusions, the Court of Appeals held that the trial court had erred in granting Republic's motion for summary judgment and in denying Holloway's motion for summary judgment.[3] *Id.* at 391, 119 P.3d 239. We allowed review.

[1] On review, the issues before us are whether Holloway alleged facts in her complaint against the insured sufficient to trigger Republic's duty to defend or duty to indemnify and whether the purported assignment from the insured to Holloway was valid. However, our analysis begins, and ends, with our decision respecting whether the purported assignment from the insured to Holloway was valid. Because we hold that it was not, we need not decide the issue respecting the allegations in Holloway's complaint.

[2] **[3]** Deciding the validity of the purported assignment in this case turns on the proper interpretation of the anti-assignment clause contained in the insurance policy between Republic and the insured. Interpretation of an insurance policy is a question of law, and our task is to ascertain the intention of the parties to the insurance policy. *Hoffman Construction Co. v. Fred S. James & Co.,* 313 Or. 464, 469, 836 P.2d 703 (1992). "We determine the intention of the parties ***650** based on the terms and conditions of the insurance policy." *Id.* (citing ORS 742.016).

[4] **[5]** **[6]** **[7]** **[8]** If an insurance policy explicitly defines the phrase in question, we apply that definition. *See Groshong v. Mutual of Enumclaw Ins. Co.,* 329 Or. 303, 307 08, 985 P.2d 1284 (1999) (so indicating). If the policy does not define the phrase in question, "we resort to various aids of interpretation to discern the parties' intended meaning."*Id.* Under that interpretive framework, we first consider whether the phrase in question has a plain meaning,*i.e.,* whether it "is susceptible to only one plausible interpretation." *Id.* at 308, 985 P.2d 1284. If the phrase in question has a plain meaning, we will apply that meaning and conduct no further analysis. *Id.* If the phrase in question has more than one plausible interpretation, we will proceed to the second interpretive aid. ****334** *Id.* at 312, 985 P.2d 1284. "That is, we examine the phrase in light of 'the particular context in which that [phrase] is used in the policy and the broader context of the policy as a whole.' " *Id.* (quoting *Hoffman,* 313 Or. at 470, 836 P.2d 703 (altered text in original)). "If the ambiguity remains after the court has engaged in those analytical exercises, then 'any reasonable doubt as to the intended meaning of such [a] term[ ] will be resolved against the insurance company * * *.' " *North Pacific Ins. Co. v. Hamilton,* 332 Or. 20, 25, 22 P.3d 739 (2001) (quoting, among other cases, *Hoffman,* 313 Or. at 470, 836 P.2d 703 (altered text in original)). However, as this court has stated consistently, "a term is ambiguous * * **only* if two or more plausible interpretations of that term withstand scrutiny, *i.e.,* continue[ ] to be reasonable," despite our resort to the interpretive aids outlined above. *Hoffman,* 313 Or. at 470, 836 P.2d 703 (emphasis in original).

The phrase in question here-the text of the insurance policy's anti-assignment clause-provides that "[y]our rights or duties under this policy may not be transferred without our written consent." The policy does not provide an explicit definition for the phrase "rights or duties"; therefore, we must decide whether that phrase has a plain meaning.

As discussed above, the Court of Appeals concluded that "[n]othing in the policy states what 'rights or duties' may not be 'transferred.' The 'rights or duties' could refer to pre-loss rights or duties, post-loss rights or duties, or both." ***651** *Holloway,* 201 Or.App. at 381, 119 P.3d 239. The Court of Appeals further concluded that the "context of the policy provide[d] little guidance, and, on the whole, it would be reasonable to read the provision to apply to either pre-loss or post-loss rights and duties, or both." *Id.* at 382, 119 P.3d 239. Republic argues that the Court of Appeals erred in reaching

those conclusions, and we agree. Contrary to the Court of Appeals' assertion, the policy makes perfectly clear which "rights or duties" may not be assigned.

The anti-assignment clause specifically states that "*[y]our* rights or duties" may not be assigned. (Emphasis added.) The only plausible interpretation of the word "your" is that it refers to the insured. That conclusion is supported by the text of the policy. Specifically, the policy provides that "[i]t is a contract of insurance between you (the employer named in Item 1 of the Information Page) and us (the insurer named on the Information Page)." The policy further provides that "[y]ou are insured if you are an employer named in Item 1 of the Information Page." The policy consistently uses the words "you" and "your" to refer to the insured. Thus, the anti-assignment clause restricts the assignment of the *insured's* "rights or duties."

Reaching that conclusion does not end our analysis, however, because we have not addressed the Court of Appeals' "pre-loss" and "post-loss" dichotomy. Nevertheless, as we shall see, we conclude that that court's interpretation is not reasonable on the face of the contractual text or in the broader context of the policy as a whole.

The anti-assignment clause here is worded broadly; it contains no exceptions or qualifications. It explicitly prohibits, without Republic's written consent, the assignment of "[y]our [the insured's] rights or duties under this policy[.]" According to those terms, the clause applies to whatever rights or duties the insured may have under the policy. Nothing in the clause suggests a limitation to pre-loss rights or duties or provides an exception for post-loss rights or duties. Reading such an exception into the policy would not be reasonable and would "insert what has been omitted." *See* ORS 42.230 (providing that "[i]n the construction of an instrument, the office of the judge is simply to ascertain and ***652** declare what is, in terms or in substance, contained therein, not to insert what has been omitted * * * ").

Pacific First Bank v. New Morgan Park Corp., 319 Or. 342, 876 P.2d 761 (1994), illustrates our point. In that case, this court considered the proper interpretation of a lease anti-assignment clause. *Id.* at 345, 876 P.2d 761. The anti-assignment clause, in part, provided that "Tenant shall not assign, sell, mortgage, pledge, or in any manner transfer the Lease or any interest herein whether voluntary or involuntary or by operation ****335** of law * * * without the prior written consent of Landlord." *Id.* (ellipsis in original). On review, the tenant argued that it had not violated the anti-assignment clause's prohibition when it merged with and became a different corporate entity because the anti-assignment clause did not refer expressly to mergers. *Id.* at 349, 876 P.2d 761. This court rejected that argument, explaining that the anti-assignment clause, "which [was] worded in a broad and all-encompassing manner, [did] not exclude mergers." *Id.* at 349, 876 P.2d 761. Therefore, according to *Pacific First Bank,* reading an exclusion into a broadly worded anti-assignment clause based upon the clause's silence regarding its application to a particular situation would be an unreasonable interpretation.

In sum, the only reasonable interpretation of the anti-assignment clause at issue in this case is that it prohibits the assignment of the insured's rights or duties without regard to whether they arose pre-loss or post-loss. In other words,*none* of the insured's rights or duties could be assigned without Republic's written consent.

In reaching its conclusion that the anti-assignment clause was ambiguous as to whether it referred to pre-loss or post-loss rights or duties, the Court of Appeals cited a number of authorities that the court asserted supported its interpretation. *See Holloway,* 201 Or.App. at 382, 119 P.3d 239 (citing *Conrad Brothers,* 640 N.W.2d at 237, and *Insurance,* 44 Am. Jur. 2d 102 § 801 (2003)). According to the Court of Appeals, the majority rule for interpreting insurance policy anti-assignment clauses is that those clauses prohibit the assignment of only pre-loss rights or duties. *Id.* at 382, 119 P.3d 239. In her brief, Holloway extensively relies upon those same authorities to support her claim that the anti-assignment clause is ambiguous. ***653** Holloway also directs our attention to *National Memorial Serv. v. Metropolitan Life Ins. Co.,* 159 Pa.Super. 292, 48 A.2d 143 (1946), and *Egger v. Gulf Ins. Co.,* 864 A.2d 1234 (Pa.Super.2004). Although those authorities may support Holloway's argument, the courts in *Conrad Brothers, National Memorial*, and *Egger* did not follow this court's analytical approach to insurance contract construction, set out above. For that reason, we find those decisions unpersuasive.*See Hoffman,* 313 Or. at 475 77, 836 P.2d 703 (rejecting use of cases from other jurisdictions, because analyses in those cases differed from this court's established case law). [4]

When considered in context, the anti-assignment clause in question is not ambiguous. The Court of Appeals therefore erred in declaring that the clause was ambiguous and in construing the anti-assignment clause against its drafter, Republic. Applying the proper interpretation of the anti-assignment clause, we conclude that that clause prohibited the assignment of rights from the insured to Holloway because the insured had not obtained Republic's written consent. Because the assignment was not valid, Holloway obtained no rights against Republic. The trial court did not err in granting Republic's motion for summary judgment and in denying Holloway's motion for summary judgment. The contrary conclusion of the Court of Appeals was erroneous.

The decision of the Court of Appeals is reversed. The judgment of the circuit court is affirmed.

Parallel Citations

147 P.3d 329, 25 IER Cases 994

Footnotes

* On appeal from Klamath County Circuit Court, Cameron F. Wogan, Judge. 201 Or.App. 376, 119 P.3d 239 (2005).

** Riggs, J., retired September 30, 2006, and did not participate in the consideration or decision of this case. Walters, J., did not participate in the consideration or decision of this case.

1 The policy's information page listed the insured as the employer and Republic as the insurer.

2 Holloway made the allegations set out in the text in the complaint by which she initiated the action against the insured.

3 Ultimately, the Court of Appeals reversed the trial court's judgment on Republic's duty to defend and reversed and remanded the trial court's judgment on Republic's duty to indemnify. *Holloway v. Republic Indemnity Co. of America,* 201 Or.App. 376, 392, 119 P.3d 239 (2005).

4 We recognize, of course, that even unambiguous contract provisions may be held invalid when they are inconsistent with statutes or with certain overriding public policies. *See* ORS 72.2100(2), (4) (Uniform Commercial Code provisions limiting certain anti-assignment clauses in contracts for the sale of goods). Holloway, however, identifies no statute that would invalidate the anti-assignment provisions of the insurance contract here, and our prior cases provide no basis for arguing that an anti-assignment provision in a commercial insurance contract is unenforceable.

137 P.3d 1282

341 Or. 128
Supreme Court of Oregon,
En Banc.

SCHNITZER INVESTMENT CORP., Petitioner on Review,
v.
CERTAIN UNDERWRITERS AT LLOYD'S OF LONDON and Certain London Market Insurance Companies, The Insurance Company of the State of Pennsylvania, Transportation Insurance Company; Continental Casualty Company; Insurance Company of North America; and Phoenix Insurance Company, Respondents on Review.

(CC 9902 02004; CA A116662; SC S52422). | Argued and Submitted March 10, 2006. | Decided June 30, 2006.

Synopsis

Background: Insured landowner sued comprehensive general liability (CGL) insurers to recover costs of environmental cleanup in compliance with orders of Department of Environmental Quality (DEQ). The Circuit Court, Multnomah County, David Gernant, J., granted insurers summary judgment, but denied some insurers' requests for attorney fees. Insured appealed, and insurers cross-appealed. The Court of Appeals, 197 Or.App. 147, 104 P.3d 1162, affirmed in part, reversed in part, and remanded. Review was granted.

[Holding:] The Supreme Court, Kistler, J., held that there was no physical damage to groundwater during policy period legally obligating insurers to indemnify insured for cleanup costs.

Affirmed.

West Headnotes (3)

[1] Insurance

Property Damage

Insured landowner's expenditures to prevent future environmental contamination of groundwater, that did not involve remedying existing contamination, were not incurred as a result of "property damage" within meaning of comprehensive general liability (CGL) policies, and thus insurers were not legally obligated to indemnify landowner for costs of environmental cleanup in compliance with orders of Department of Environmental Quality (DEQ).

7 Cases that cite this headnote

[2] Environmental Law

Scope of Inquiry on Review of Administrative Decision

Unless an ambiguity exists, Supreme Court determines the meaning of Records of Decision of the Department of Environmental Quality (DEQ) as a matter of law, based on those decisions only and without reference to extrinsic evidence.

2 Cases that cite this headnote

[3] Environmental Law

Scope of Inquiry on Review of Administrative Decision

If a Record of Decision of the Department of Environmental Quality (DEQ) is ambiguous, Supreme Court may look to the record before DEQ to help determine the decision's meaning.

1 Cases that cite this headnote

Attorneys and Law Firms

****1283** Charles F. Hinkle, Stoel Rives, LLP, Portland, argued the cause and filed the brief for petitioner on review. With him on the brief was Joan P. Snyder.

I. Franklin Hunsaker, Portland, argued the cause and filed the briefs for respondent on review Certain Underwriters at Lloyd's of London and Certain London Market Insurance

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Company. With him on the briefs were Paul J. Killion and Bruce J. Rome, Duane Morris LLP, San Francisco.

Peter J. Mintzer, Cozen O'Connor, Seattle, filed the response and brief for respondent on review The Insurance Company of the State of Pennsylvania. With him on the brief were Thomas M. Jones and Helen A. Boyer.

David E. Prange, Abbott & Prange, PC, Portland, filed the response and brief for respondents on review Transportation Insurance Company and Continental Casualty Company. With him on the brief was Nicholas A. Nardi.

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Timothy R. Volpert, Davis Wright Tremaine, LLP, Portland, filed the response for respondent on review The Phoenix Insurance Company. With him on the response was Everett W. Jack, Jr.

William H. Walters, Miller Nash, LLP, Portland, filed the brief for amici curiae Northwest Natural Gas Company, ZRZ Realty Company, Zidell Remediation Funding Trust, Zidell Marine Corporation, and Tube Forgings of America, Inc. With him on the brief was Gayle Patterson, attorney for Northwest Natural Gas Company.

Opinion

KISTLER, J.

***131** Plaintiff owns property in Portland near the Willamette River. After the Oregon Department of Environmental Quality (DEQ) ordered plaintiff to clean up environmental contamination on its property, plaintiff brought this action seeking, among other things, indemnification from defendants for the costs that it had incurred in complying with DEQ's orders. The trial court granted defendants' summary judgment motion and entered judgment in their favor. Although the Court of Appeals disagreed with some aspects of the trial court's judgment, it upheld the trial court's ruling that defendants had no duty, under the terms of certain insurance policies that they had issued, to indemnify plaintiff. *Schnitzer Investment Corp. v. Certain Underwriters,* 197 Or.App. 147, 104 P.3d 1162 (2005). We allowed plaintiff's petition for review to consider that issue and now affirm the Court of Appeals decision.

Plaintiff's property is environmentally contaminated as a result of industrial and chemical ****1284** manufacturing. Most of the contaminants are in the soil, but the groundwater also contains some contamination above background levels.[1] Beginning in 1988, plaintiff and DEQ started investigating the extent of the contamination and the appropriate means to remedy it.

After notice, DEQ included plaintiff's property on a list of sites that needed further investigation or cleanup. DEQ divided the property into three parts, Units A, B, and C. In 1993 and 1995, DEQ issued Records of Decision directing plaintiff to remedy environmental contamination on Units A and C. DEQ determined that no remedial measures were necessary for Unit B.

Over the years, defendants have issued various comprehensive general liability policies to plaintiff. Some of those polices provided primary coverage; others were excess ***132** or umbrella policies. All the policies, however, contain essentially the same provision, which gives rise to this litigation. Defendants agreed to pay all sums "which the insured shall become legally obligated to pay as damages because of * * * property damage." The policies defined "property damage" as:

> "(1) physical injury to or destruction of tangible property which occurs during the policy period including the loss of use thereof at any time resulting therefrom, or (2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period[.]"[2]

Finally, the policies contained a number of exclusions from coverage, including an exclusion for property damage to "property owned or occupied by or rented to the insured[.]"

The terms of defendants' policies frame the issue in this case. Under the terms of those policies, defendants had no duty to indemnify plaintiff for the costs that it incurred because of contamination to its own property. That much follows from the "owned property" exclusion. Groundwater, however, is the property of the state. *See* ORS 537.110 (recognizing state

ownership of water). Defendants do have a duty to indemnify plaintiff for the costs that plaintiff became "legally obligated to pay because of property damage" to the groundwater.

[1] It follows from the terms of defendants' policies that this case presents two issues. The first issue is whether there was "property damage" to the groundwater-*i.e.,* whether physical damage (environmental contamination) had occurred to the groundwater during the policy period. The second issue is whether plaintiff was legally obligated to incur clean-up costs because of existing contamination to the groundwater. If it were, then defendants' policies required them to indemnify plaintiff for those costs.

***133** On the first issue, defendants do not dispute, for the purposes of summary judgment, that the environmental contaminants on plaintiff's property resulted in some contamination, above background levels, to the groundwater during the policy period; that is, defendants assume that some "property damage" occurred to the groundwater during the policy period. The issue that this case turns on is the second one-whether plaintiff was "legally obligated" to incur certain costs because of property damage to the groundwater. On that issue, the 1993 and 1995 Records of Decision that DEQ issued define the scope of plaintiff's legal obligation.

[2] [3] Unless an ambiguity exists, we determine the meaning of those Records of Decisions as a matter of law, based on those decisions only and without reference to extrinsic evidence. *See State v. Swain/Goldsmith,* 267 Or. 527, 530, 517 P.2d 684 (1974) (signed order, rather than judge's statements, controls). If the decision is ambiguous, we may look to the record before DEQ to help determine the decision's meaning. ****1285** *See Bennett v. Bennett,* 208 Or. 524, 529, 302 P.2d 1019 (1956) (stating proposition). We begin with the terms of the 1995 Record of Decision directing plaintiff to remedy the contamination to Unit A of its property. [3]

The 1995 Record of Decision sets out the following findings. Unit A is approximately 3.4 acres. Except for the northeast corner, Unit A lies approximately 200 feet from the Willamette River and is not subject to seasonal flooding. Previous owners of that part of the property had manufactured pesticides and agricultural chemicals on it. They also had used it for a plate and structural steel warehouse.

As a result of those activities, the soil in Unit A contained various metals, organic chemicals, and pesticides that exceeded background levels. The metals, semi-volatile organic chemicals, and pesticides were concentrated in specific locations or "hot spots" around the property (primarily around the former pesticide plant and what had been a surface impoundment pond). Concentrations of volatile organic ***134** chemicals were "relatively low" but were not restricted "to a particular subsurface unit or location within Unit A."

In assessing the degree to which those pollutants were subject to migration, DEQ found that the "organic contaminants present, particularly the chlorinated pesticides and [carcinogenic polycyclic aromatic hydrocarbon] compounds [,] generally have low solubilities in water and absorb to soil." Consistently with that finding, DEQ determined that "[l]eaching of contaminants from the soil into the dissolved phase via infiltrating precipitation is not a significant contaminant transport mechanism * * *."

DEQ also determined that "[r]elatively low metals concentrations (both total and dissolved) were found in groundwater samples." None of the dissolved metal concentrations exceeded current federal maximum contaminant levels for safe drinking water. The same conclusion was true for volatile organic compounds. DEQ found low concentrations of those compounds and one chlorinated herbicide, all of which were below the current maximum contaminant levels. Finally, DEQ noted that concentrations of hydrogen sulfide gas exceeding 10 parts per million were measured at two well heads but that the "concentrations of sulfur species in groundwater have not been quantified."

Based on those findings, DEQ found that "Unit A poses no significant risk of adverse impact on the environment"-*i.e.,* DEQ did not find a significant risk of adverse impact on the groundwater. Rather, DEQ found that the environmental contamination posed risks to human health; specifically, it found that the risk to human health derived from "long-term direct contact with near-surface soil" to which the contaminants had bound. DEQ observed that "[t]he routes of exposure included soil ingestion, dermal contact, and inhalation of particulates." Applying certain risk factors, DEQ concluded that "Unit A soils pose a potential chronic risk from

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surficial contamination for children under an uncontrolled residential site usage scenario because of possible ingestion, inhalation and dermal absorption of soil contaminants."[4] It also found that certain levels of carcinogenic risk may occur from "surficial exposure to pesticides *135 and [carcinogenic polycyclic aromatic hydrocarbon compounds] * * * resulting from ingestion, dermal contact, and inhalation of soil."

Finally, DEQ noted that it had not considered whether hydrogen sulfide was migrating to the surface by way of the groundwater. It found that "[g]roundwater monitoring will be conducted as part of the selected remedy to evaluate the potential presence of hydrogen sulfide or other sulfur species."

In directing plaintiff to remedy the environmental contamination on Unit A, DEQ sought to determine the most cost-effective remedy in light of the magnitude of the risks **1286 that the contaminants on Unit A posed. After considering several possible remedies, DEQ directed plaintiff (1) to excavate the top four feet of any soil that contains specified levels of six chemical compounds; (2) to remove certain sludge, crushed drums, and an underground storage tank; (3) to use a soil cap[5] to prevent direct exposure to any residually contaminated soil and to prevent erosion and runoff of contaminated soil; and (4) to monitor hydrogen sulfide gas to ensure that "the objectives of long term [hydrogen sulfide] gas management are maintained." Finally, DEQ required plaintiff to monitor the groundwater for at least five years. DEQ suggested that, "[i]f groundwater quality has not been degraded [during that period]," no additional monitoring would be necessary.

In explaining why the remedial measures that it selected would protect human health and the environment, DEQ reasoned that excavation and removal of the soil "will significantly reduce the threat of exposure from ingestion, dermal contact, and inhalation of contaminants adhered to soil particulates." It also explained that

> "[c]apping will significantly reduce the potential for reasonable exposures to contaminated soil by eliminating direct *136 exposure pathways, preventing erosion and runoff, and limiting infiltrations of water, thereby reducing the potential of contaminants to leach to groundwater."

Having considered the terms of the 1995 Record of Decision, we agree with both the trial court and the Court of Appeals that DEQ's decision did not require plaintiff to clean up existing contamination in the groundwater; DEQ found that the contamination on plaintiff's property did not pose a significant adverse risk to the environment. Rather, the decision required plaintiff to remove and cap the soil to prevent the health risks resulting from contact with environmental contamination in the soil-ingestion, inhalation, and dermal contact with the soil. That conclusion follows both from the specific risks that DEQ identified and from the measures that it required plaintiff to take to remedy those risks.

Plaintiff argues, however, that removing and capping the soil will benefit the groundwater. It points to DEQ's statement that capping the soil will "reduc[e] the potential of contaminants to leach [into the] groundwater" and also DEQ's requirement to monitor the groundwater to ensure that the groundwater quality does not worsen. The difficulty with plaintiff's argument is that, at most, those remarks reflect a concern about future harm to groundwater. As the Court of Appeals correctly recognized, however, the terms of defendants' policies require defendants to indemnify plaintiff only if DEQ's Records of Decision legally obligated plaintiff to remedy "property damage" to the groundwater, and defendants' policies define "property damage" as an injury that occurs during the policy period, not an injury that may occur in the future. Under the terms of the policies, defendants had no obligation to indemnify plaintiff for the costs that it incurred in complying with DEQ's orders.

On review, plaintiff advances essentially three contrary arguments. The first two are factual. Plaintiff notes that, when DEQ initially proposed listing plaintiff's property, and also at other points during the investigative stage, it directed plaintiff to determine whether it was necessary to clean up existing contamination to the groundwater. Plaintiff reasons from that premise that DEQ's final order required it to clean up existing contamination to the groundwater. In *137 investigating that issue, however, plaintiff's consultant, CH2M Hill, found that the groundwater contained low levels of volatile organic

compounds, no semi-volatile compounds, and a trace amount of a herbicide. A later investigation revealed that none of those contaminants exceeded maximum contaminant levels. The fact that DEQ required plaintiff to investigate whether plaintiff needed to remedy existing groundwater contamination does not mean that DEQ later directed plaintiff to do so.

Plaintiff's other factual argument is based on an affidavit that the DEQ project manager, **1287 Gilles, provided plaintiff as part of this litigation. In that affidavit, Gilles explained that DEQ had ordered plaintiff to remove and cap the soil to prevent environmental contaminants from leaching into the groundwater. Not only does the affidavit focus on future harm to the groundwater, but plaintiff's reliance on Gilles's affidavit suffers from a more fundamental problem. The relevant document to determine whether DEQ required plaintiff to clean up the contamination on its property because of existing contamination to the groundwater is the DEQ decision and, if that decision is ambiguous, the record leading up to it. *See Swain/Goldsmith,* 267 Or. at 530, 517 P.2d 684; *Bennett,* 208 Or. at 529, 302 P.2d 1019 (stating those propositions). Gilles's post-hoc explanation of what DEQ's decision meant is no more relevant to that determination than a legislator's subsequent statement concerning the meaning of a law. *Cf. DeFazio v. WPPSS,* 296 Or. 550, 561, 679 P.2d 1316 (1984) (later legislature's understanding not relevant to meaning of earlier enacted law).

Indeed, Gilles executed an earlier affidavit for one of defendants that is at odds with the affidavit that he executed for plaintiff.[6] The conflict between those two after-the-fact *138 explanations illustrates why neither affidavit provides a reliable basis for understanding what DEQ required in its 1993 and 1995 Records of Decision. Rather, the terms of those decisions control.

Plaintiff's third argument is a legal one. Plaintiff relies on *dictum* in *Wyoming Sawmills v. Transportation Ins. Co.,* 282 Or. 401, 407, 578 P.2d 1253 (1978) to argue that defendants' policies provide coverage. The *dictum* in that case assumed that the insured was legally obligated to incur costs because of property damage to a third person's property*Id.* Given that assumption, this court suggested (but did not hold) that the insurer would have a duty to indemnify the insured both for the cost of repairing the damage to the third person's property and also for the cost of replacing the insured's property, which the policy otherwise would not have covered. *Id.* The assumption that underlies the *dictum* in *Wyoming Sawmills* is absent here. As we have explained, DEQ's records of decision did not "legally obligat[e]" plaintiff to clean up property damage to the groundwater. Accordingly, this case does not require us to decide whether we would follow the *dictum* in *Wyoming Sawmills.*

Plaintiff also cites cases from other jurisdictions in which an insured was legally obligated, as a result of pollution emanating from the insured's property, to remedy environmental contamination to a third person's property. *See, e.g., Bankers Trust Co. v. Hartford Acc. & Indem.,* 518 F.Supp. 371, *vacated on other grounds,* 621 F.Supp. 685 (S.D.N.Y.1981). In those cases, the courts required the insurer, despite the owned-property exclusion, to pay both for the cost of cleaning up the third person's property and for at least some part of the cost of cleaning up the source of the pollution on the insured's property. *Id.* Plaintiff's reliance on those cases suffers from the same problem that its reliance on *Wyoming Sawmills* does. The premise underlying all those cases-that the insured was legally obligated to clean up existing contamination to a third person's property-is absent here.[7] We *139 agree with **1288 both the trial court and the Court of Appeals that defendants had no obligation under the terms of their policies to indemnify plaintiff for the costs of complying with DEQ's 1993 and 1995 Records of Decision.

Plaintiff advances a second, separate argument. It contends that, because the Court of Appeals held that defendants have a duty to pay plaintiff's defense costs, the Court of Appeals should have addressed an issue concerning certain "lost policies"-policies that plaintiff claims existed but that neither plaintiff nor defendants can find. Defendants respond that the question of which defendant pays plaintiff's defense costs presents only a question of contribution among defendants and is of no concern to plaintiff. Without some showing that the existing policies are insufficient to cover plaintiff's defense costs, a showing that plaintiff has not made, we agree with defendants that the issue is one for only them to raise. Because they did not do so, there was no need for the Court of Appeals to address that issue. The Court of Appeals correctly resolved the two issues that plaintiff pursues on review.

The decision of the Court of Appeals is affirmed.

Parallel Citations

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Footnotes

1 Because the chemical components of soil and groundwater vary, DEQ first determines the level of chemicals that occur naturally in the soil or groundwater (the background levels) and then measures whether chemicals or other contaminants exceed those background levels.

2 The policies define "occurrence" as "an accident, including continuous or repeated exposure to conditions, which results in * * * property damage neither expected nor intended from the standpoint of the insured."

3 That decision is more favorable to plaintiff than the 1993 Record of Decision regarding Unit C. If, as the Court of Appeals held, the 1995 Record of Decision does not require defendants to indemnify plaintiff, then neither does the 1993 Record of Decision.

4 When DEQ issued its 1995 Record of Decision, plaintiff's property was unoccupied. Plaintiff, however, intended to develop it, and DEQ determined the risk of contamination to both persons and the environment based on plaintiff's intended use of the property.

5 DEQ recognized that plaintiff proposed to develop the property. The proposed structures and parking lots would result in an "asphalt cap" over some residually contaminated soil.

6 In the affidavit that he filed for one of defendants, Gilles averred:

> "As project manager, I did not consider groundwater to be contaminated by hazardous substances at levels posing significant risk to human health or the environment. The risk assessments completed for Units A and C eliminated the groundwater pathway as one of potential concern. If the DEQ ever had significant concern for groundwater, we would have required cleanup alternatives for groundwater to be developed in the Feasibility Study. The removal of soil contamination at Units A and C, site grading, placement of a soil cap on the Site, and installation of a diversion and collection system were designed to clean up soil contamination and to minimize direct exposure of contaminants to humans."

7 Plaintiff also cites a few cases that have required insurers, on the basis of public policy rather than the terms of the insurance policy, to pay the cost of cleaning up environmental contamination on the insured's property to prevent the imminent contamination of neighboring properties. That is so even though no contamination of the neighboring properties had occurred. To the extent that plaintiff relies on those cases, they are inconsistent with the definition of "property damage" in defendants' policies. That definition requires, at a minimum, existing damage to a third person's property and defines the obligation that defendants owe plaintiff.

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460 P.2d 342

254 Or. 496
Supreme Court of Oregon, En Banc.

Helen L. FERGUSON, Appellant,
v.
BIRMINGHAM FIRE INSURANCE COMPANY, Respondent.

Argued and Submitted Nov. 13, 1968. | Decided Oct. 22, 1969. | Rehearing Denied Dec. 16, 1969.

Action by insured against insurer. The Circuit Court, Multnomah County, J. R. Campbell, J., dismissed the complaint and insured appealed. The Supreme Court, O'Connell, J., held that where injured parties alleged willful trespass on part of insured, and, under complaint, injured parties were entitled to recover double damages for nonwillful trespass, tender of complaint to insurer put it on notice that although policy excluded coverage for willful conduct of insured there was possibility of liability being imposed upon insured for conduct covered by policy and insurer was under duty to defend, and that insured's insistence that insurer undertake defense without any reservation of rights relating to coverage, while breach of contract of insurance, did not preclude insured from recovering judgment paid and cost of defense if coverage question was resolved in favor of insured.

Reversed and remanded.

West Headnotes (16)

[1] **Insurance**
⇐ Personal property in care, custody or control

Insured's nonbusiness activity in clearing brush from back of his land during course of which four trees on adjoining land were cut down did not constitute an "exercise of control over property" within personal liability policy exclusion relating to property in care, custody or control of insured.

4 Cases that cite this headnote

[2] **Insurance**
⇐ Personal property in care, custody or control

Phrase "property as to which insured for any purpose is exercising physical control" as used in exclusion contained in personal liability policy meant property over which insured assumed control, knowing that it belonged to another.

2 Cases that cite this headnote

[3] **Insurance**
⇐ Personal property in care, custody or control

Where insured while engaged in nonbusiness activity, unwittingly exercises control over another person's property and in course of doing so damages it, there is no reason for applying personal liability policy exclusion relating to property in control of insured.

3 Cases that cite this headnote

[4] **Insurance**
⇐ Pleadings

Obligation of insurer to defend is to be determined by allegations of complaint filed against insured.

3 Cases that cite this headnote

[5] **Insurance**
⇐ Matters beyond pleadings

Insurer's knowledge of facts not alleged in complaint is irrelevant in determining existence of duty to defend and consequently insurer need not speculate as to what actual facts of alleged occurrence may be.

3 Cases that cite this headnote

[6] **Insurance**
⇐ Intentional Acts or Injuries; Crimes and Abuse

If recovery under complaint is limited to damages arising out of willful conduct of insured, personal liability policy which contained exclusion relating to damage caused intentionally

by or at direction of insured would not cover loss and insurer would not be under any duty to defend.

31 Cases that cite this headnote

[7] **Insurance**

Pleadings

Fact that complaint by injured party charges insured with conduct falling under exclusion clause of policy does not necessarily mean that insurer will not have duty to defend.

[8] **Insurance**

Several Grounds or Causes of Action

If complaint contains two counts, one based upon willful conduct which is excluded from coverage of policy and one based upon negligent conduct, insurer has duty to defend because of allegations falling within policy coverage.

8 Cases that cite this headnote

[9] **Insurance**

Pleadings

If complaint, without amendment, may impose liability for conduct covered by policy, insurer has duty to defend even though complaint contains only one count which, on its face, falls within policy exclusion.

17 Cases that cite this headnote

[10] **Insurance**

Intentional Acts or Injuries; Crimes and Abuse

Insurance

Pleadings

Where injured parties alleged willful trespass on part of insured and under complaint injured parties were entitled to recover double damages for nonwillful trespass, tender of complaint to insurer put it on notice that although policy excluded coverage for willful conduct of insured there was possibility of liability being imposed upon insured for conduct covered by policy and insurer was under duty to defend. ORS 105.810, 105.815.

44 Cases that cite this headnote

[11] **Insurance**

Fulfillment of Duty and Conduct of Defense

Generally insurer, when tendered defense of action, cannot, as condition of its assumption of defense, reserve right to later question coverage.

[12] **Insurance**

Conclusiveness and Effect of Prior Adjudication

Where there is conflict of interest between insurer and insured, doctrine of estoppel by judgment should not be applied to judgment rendered in action against insured.

7 Cases that cite this headnote

[13] **Insurance**

Particular matters concluded

Where insured defended action and paid judgment obtained against him after having refused to permit insurer to undertake defense with reservation of rights as to coverage, insurer was not barred from raising question of coverage in action by insured to recover costs of defense and monies paid to satisfy judgment.

6 Cases that cite this headnote

[14] **Insurance**

Fulfillment of Duty and Conduct of Defense

Insured's insistence that insurer defend action only if it waived right to later litigate question of coverage constituted unreasonable condition breach of contract of insurance.

2 Cases that cite this headnote

[15] **Insurance**

Fulfillment of Duty and Conduct of Defense

Insured's insistence that insurer undertake defense without any reservation of rights relating to coverage, while breach of contract of insurance, did not preclude insured from recovering judgment paid and cost of defense if coverage question was resolved in favor of insured.

[16] **Insurance**

Defense of Action Against Insured

In order for insurer to undertake defense of action and reserve right to later question coverage, insured must expressly or impliedly agree to such reservation of rights.

1 Cases that cite this headnote

Attorneys and Law Firms

***498** ****343** Donald H. Pearlman, Portland, argued the cause for appellant. With him on the briefs were Keane, Haessler, Bauman & Harper, and David W. Harper, Portland.

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***499** Before PERRY, C.J., and McALLISTER, SLOAN, O'CONNELL, DENECKE, HOLMAN and LANGTRY*, JJ.

Opinion

O'CONNELL, Justice.

This is an appeal from a judgment dismissing the complaint of Helen L. Ferguson, executrix of the estate of Thomas E. Ferguson in which she sought damages under an insurance policy issued by defendant Birmingham Fire Insurance Company.

The parties filed an agreed narrative statement of the proceedings pursuant to ORS 19.088.

Mr. Ferguson purchased from defendant company a policy insuring him in the following terms (among others):

> 'Coverage L-Personal Liability: (Insurer agrees) To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage, and the company shall defend any suit against the insured alleging such bodily injury or property damage and seeking damages which are payable under the terms of this endorsement, even if ****344** any of the allegations of the suit are groundless, false or fraudulent; but the company may make such investigation and settlement of any claim or suit as it deems expedient.'

The following exclusions are recited with reference to Coverage L:
'This endorsement does not apply: * * *

'(c) * * * to bodily injury or property damage caused intentionally by or at the direction of the insured.

'* * *

***500** '(g) * * * to property damage to property used by, rented to or in the care, custody or control of the insured or property as to which insured for any purpose is exercising physical control.'

Mr. Ferguson died February 14, 1962. Kenneth W. Guenther and Marva Guenther filed a claim against his estate, contending that about September 1, 1961, Mr. Ferguson had cut four trees on their property. The evidence showed that Mr. Ferguson had employed a laborer to clean brush off the back of his lot. The line separating his lot from the Guenther's adjoining land was unmarked. The laborer cleared beyond the line and in doing so cut down the trees. Ferguson did not exercise any direct control over the workman and did not know that a trespass was being committed. Mrs. Ferguson, as executrix, rejected the claim and notified the Birmingham Fire Insurance Company that the claim had been asserted.

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In June, 1962, the company informed Mrs. Ferguson that it would not extend coverage under the policy, reciting the two exclusions quoted above, along with others, as the basis for its refusal.

The Guenthers filed a complaint against the estate. Mrs. Ferguson requested that the company defend the action. The company denied that the claim was covered under the policy, but offered to defend on the understanding that its defending and conducting settlement negotiations would not have the effect of waiving its right to deny liability under the policy. Mrs. Ferguson answered that she would not accept the company's offer to defend under a reservation-of-rights agreement. Her response was 'We will expect you to defend under the terms of the policy with no reservations.' After renewing her demand that the company defend, she defended at her own expense ***501** and won an involuntary nonsuit at the close of the Guenther case.

The Guenthers again filed the same complaint. Mrs. Fersguson again demanded that the company defend her and the company responded as it had in the first action. The cause went to trial in February, 1965 and the jury returned a verdict for the Guenthers. The jury found that actual damage caused by the trespass was $1,000. In answer to a special interrogatory, the jury found that the trespass was not committed 'willfully and intentionally.' The judgment was for $2,189, representing double damages as provided for inORS 105.815, and costs. Mrs. Ferguson paid the judgment.

Mrs. Ferguson demanded that the insurance company pay (1) the costs of her defense in the first action ($1,578.10), (2) the cost of her defense in the second action ($1,272.50), and (3) the judgment recovered against the estate ($2,189). The company refused to pay whereupon Mrs. Ferguson brought this action to recover the above amounts plus interest and attorney fees. The case was tried on a stipulated statement of facts.

The trial court dismissed plaintiff's complaint on the ground that the insurance contract did not cover the Guenther actions. This ruling was made upon the ground that plaintiff's employee was exercising physical control over the property damaged and therefore the case fell within the clause of the policy excluding 'property damage to * * * property as to which insured for any purpose is exercising physical control.'

The trial court felt that the present case was controlled ***502** by Crist v. Potomac Insurance Co., 243 Or. 254, 263, 413 P.2d 407, 411 (1966). In that case the insured hired Roberts, the owner of a shovel loader, to load and deck logs at the site of the insured's logging operations. Insured's employee ****345** operated the loader without Roberts' consent and damaged it. We held that the insured, through his employee, exercised physical control over the loader within the meaning of the policy exclusion and that it was 'of no consequence that the insured acted without the consent of the owner of the property.'[1]

In the present case, as in Crist, the damage to the property arose out of a trespassory invasion by the insured. It is argued, however, that the conduct of Ferguson's employee did not amount to possession or control of the land but merely the infliction of an injury upon it. To appraise this argument it is necessary to consider the purpose which the exclusion clause was intended to serve.

The reason for adopting this type of exclusion clause is not entirely clear. The first part of the clause excluding coverage as to damage to property in the 'care, custody or control of the insured's has long been a standard part of the general liability ***503** policy.[2] One purpose of this clause was to avoid the 'adverse selection of risks.' Those buying insurance often seek coverage for certain types of losses common to their particular enterprise. The underwriters felt that the premium of a general liability policy should not be burdened with these special risks; separate policies with appropriate premiums for the risks involved are available.[3] Another reason given for the 'care, custody and control' provision is the 'moral hazard' involved when property which has been entrusted to the insured's care, custody or control is injured; the insured 'feels morally responsible for any damage caused by him and is more interested in seeing the owner is generously compensated by his company.'[4]

In the interpretation of the 'care, custody and control' provision as it originally appeared in standard policies the courts held that if the insured did not have Complete dominion and the Legal right to control the damaged property the exclusion clause would not apply. To avoid this interpretation the insurers added the clause 'or property as to which the insured for any purpose is exercising physical control.'[5]

Although the latter clause is interpreted as extending the exclusion *504 to cases in which the insured's possession is wrongful, it is still necessary to show that the insured was 'exercising physical control' before the clause is operative.

There remains, however, the crucial question: What kind of control is contemplated under this clause? The answer is not to be found in an abstract analysis of the word 'control.' We must turn to the reasons for the adoption of the exclusion clause and **346 determine whether in light of those reasons the policy was intended to exclude coverage in the circumstances of the particular case. We have mentioned the 'moral hazard' as one of the factors considered in adopting the exclusion clause. That factor would not be present in the case at bar because Ferguson did not take charge of Guenthers' property under circumstances which would generate a feeling of moral responsibility to reimburse him for damage caused to it. It has been observed that one of the purposes in the adoption of the exclusion clause in a general liability policy was to eliminate from coverage the ordinary business risk of damaging property, whether owned by the insured or others, which was used or otherwise involved as a usual incident of carrying on the insured's business.[6] Thus the holding in Crist that the damage fell within the exclusion clause can be explained on the ground that the shovel loader was a piece of equipment ordinarily used in carrying on a logging operation. The damage to Guenthers' property did not arise out of any business activity carried on by Ferguson; he was simply attempting to clear the brush off the back of his lot.

*505 [1] But the exclusion clause is in broad terms and does not by its terms, at least, purport to exclude business risks only. Can we say, then, that Ferguson's non-business activity in clearing the brush on Guenthers' land constituted an exercise of control over the property within the meaning of the policy. We think not.

[2] [3] We interpret the phrase 'property as to which the insured for any purpose is exercising physical control' to mean property over which the insured assumes control, knowing that it belongs to another. Where the insured knowingly assumes control over another person's property, either with or without permission, there are reasons for excluding coverage.[7] But we are unable to think of any valid reason for excluding coverage where the insured, while engaged in a non-business activity, unwittingly exercise control over another person's property and in the course of doing so damages it.

If our interpretation of the exclusion clause does not comport with the purpose which defendant insurance company intended it to serve, then we would say only that our reading of the clause was made possible by the defendant's employment of ambiguous language in drafting its policy.

[4] [5] Defendant, relying upon Isenhart v. General Casualty Co., 233 Or. 49, 377 P.2d 26 (1962), contends that it had no duty to defend the two Guenther suits. Isenhart establishes the rule that the obligation of the insurer to defend is to be determined by the allegations of the complaint filed against the insured. The insurer's knowledge of facts not alleged in the complaint is irrelevant in determining the existence of the duty to defend and consequently the insurer need not speculate *506 as to what the 'actual facts' of the alleged occurrence may be.[8]

Defendant claims that there was no duty to defend because the complaint alleged that Ferguson 'without the consent or permission of the plaintiffs, and without any legal authority whatsoever, willfully, intentionally, and unlawfully trespassed upon **347 said premises' and that 'by virtue of the provisions of Section 105.810 ORS (providing for damages in the case of willful trespass) plaintiffs are entitled to recover triple the amount of damages * * *.'

[6] [7] [8] If Guenthers' recovery under this complaint were limited to damages arising out of the willful conduct of Ferguson, the policy clearly would not cover the loss and, applying the principle laid down in Isenhart v. General Casualty Co., Supra, defendant would not have a duty to defend. However, the fact that the complaint charges the insured with conduct falling under the exclusion clause of the policy does not necessarily mean that the insurer will not have a duty to defend. A complaint may charge the insured not only with misconduct excluded under the policy, but also with conduct which is covered by the policy. Thus, if a complaint contains two counts, one based upon willful conduct and one based upon negligent conduct, the insurer would have a duty to defend because of the allegation falling within policy coverage.

[9] Similarly, the duty to defend will also arise under *507 some circumstances when the complaint contains only one

count which, on its face, falls within a policy exclusion. If the complaint, without amendment, may impose liability for conduct covered by the policy, the insurer is put on notice of the possibility of liability and it has a duty to defend. For example, in an action of trespass brought against the insured, if the complaint alleges a willful entry (in order to support a claim for punitive damages), the plaintiff could, without amending the complaint, recover ordinary damages for a non-willful entry. The insurer, therefore, would have the duty to defend. The innocent trespass may be treated as a 'lesser included offense' by analogy to the criminal law.

[10] The present case falls within this principle. Although the Guenther complaint alleged a willful trespass (to bring the intrusion within ORS 105.810 permitting the recovery of treble damages), the Guenthers, without amending the complaint, were entitled to recover double damages under ORS 105.815 for a non-willful trespass. When the complaint in the action was tendered to defendant insurer it was put on notice of the possibility of liability being imposed upon their insured for conduct covered by the policy. The defendant therefore had a duty to defend.

The foregoing analysis of the insurer's duty to defend requires us to amend what we said on this subject in City of Burns v. Northwestern Mutual Ins.Co., 248 Or. 364, 434 P.2d 465 (1967). In that case the city sought to recover under a liability insurance policy issued to it by the defendant insurance company. The city had paid a judgment in an action brought by Mrs. Hovis, a widow, to recover damages for emotional injury when, without her authorization, the city moved the body of her deceased husband from ***508** one grave to another. In the action brought by her the complaint alleged that the disinterment 'was done willfully, wantonly and maliciously,' and therefore entitled 'plaintiff to punitive damages in the sum of $10,000.' The city tendered to the insurance company the defense of the action which the company refused on the ground that the alleged injury was excluded from coverage under its policy. We said, '(t) he complaint upon which the Hovis case went to trial stated a cause of action for intentional harm and therefore alleged an excluded injury and not one within the policy coverage. The complaint alleged the removal of the body was malicious. This is an allegation that it was done with the intent to harm. Therefore, there was no duty upon defendant to defend Mrs. Hovis's claim against plaintiff at the trial court leve.' (248 Or. at 367-368, 434 P.2d at 467.) This conclusion was erroneous because the complaint, although alleging a malicious injury would, without amendment, permit a recovery for an unintended injury since it could be analogized to a 'lesser included offense.' Since the unintended injury fell within the policy coverage the insurer on that issue had a duty to defend.

****348** Our clarification of the insurer's duty to defend does not, in any way, modify the rule laid down in Isenhart. In that case the complaint in the action against the insured alleged the commission of an assault and battery which was outside the coverage of the policy. The complaint, unless amended, would not permit recovery for an unintended harm.

In the present case, when plaintiff tendered to defendant the defense of the Guenther action defendant responded by asserting that the claim was not covered by the policy but offered to defend the action upon the understanding that by assuming the defense ***509** defendant would not waive its right to later raise the question of coverage. Plaintiff replied, 'We will expect you to defend under the terms of the policy with no reservations.'

[11] It is generally held that the insurer, when tendered the defense of an action, cannot, as a condition of its assumption of the defense, reserve the right to later question coverage. The insured must expressly or impliedly agree to such a reservation of rights.

If the insurer assumes the defense in the face of the insured's refusal to accede to insurer's request for a reservation of rights, it is said that the insurer 'waives' or is 'estopped' to assert the defense of noncoverage.[9] And if the insurer, in order to avoid the loss of its right to question coverage, rejects the tender of the defense, it loses the benefits that accrue from being represented by its own counsel who ordinarily is experienced in the defense of such actions. And if it guesses wrong on the question of coverage, it will be required to pay the judgment and the costs of defense. Thus the insurer is forced to choose between two alternatives either of which exposes it to a possible detriment or loss.

[12] What is the justification for imposing this dilemma upon the insurer? Where there is a conflict of interest between the insurer and insured and the judgment in the action against the insured can be relied upon as an estoppel by judgment in a subsequent action on the issue of coverage, the control of

the action by the insurer could adversely affect the insured if the judgment was based upon conduct of the insured not falling within the coverage of the policy. Likewise, the insurer could be adversely affected by *510 a judgment based upon conduct for which there is coverage. But we see no reason for applying the rule of estoppel by judgment in such cases. The judgment should operate as an estoppel only where the interests of the insurer and insured in defending the original action are identical-not where there is a conflict of interests. [10] If the judgment in the original **349 action is not binding upon the insurer or insured in a subsequent action on the issue of coverage, there would be no conflict of interests between the insurer and the insured in the sense that the insurer could gain any advantage in the original action which would accrue *511 to it in a subsequent action in which coverage is in issue. [11]

It is argued that a conflict or divergence of interests may exist even though the insurer is free to set up the defense of noncoverage in a subsequent action. It is feared that if the insurer knows that it can later assert non-coverage, it may offer only a token defense in the action brought against the insured, or be less prone to effect a settlement advantageous to the insured. [12]

We think that this danger is minimal. The insurer knows that when it is the defendant in a lawsuit brought by one of its policy holders the jury's sympathy for the insured frequently produces a plaintiff verdict even when the insurer's case is strong. Knowing this, the insurer is not likely to relax its efforts in defending the action against the insured. If the insurer feels certain that it can successfully defend an action brought against it by the insured, it is not likely to accept the insured's tender of the defense in the first place.

[13] We turn now to the disposition of the present case. Since the trial court erroneously held applicable the exclusion clause relating to the insured's control over the property which is damaged, the cause must be reversed and remanded. Defendant still has the right to raise the question of coverage based upon the clause of the policy excluding coverage for intentional conduct; defendant is not barred from raising this question *512 of coverage as a consequence of its refusal to defend the Guenther actions.

[14] Plaintiff's insistence that the defendant defend only if it waived the right to later litigate the question of coverage constituted an unreasonable condition to which the defendant had a right to respond by withdrawing from the case. It is true that by the terms of the policy defendant was obligated to defend, but the policy also reserves to the defendant the control over the litigation. The unreasonable condition imposed by plaintiff upon defendant constituted a breach of the contract as we now interpret it.

[15] However, we do not feel that this breach on the part of plaintiff should exonerate defendant from liability if there is coverage. When plaintiff refused to permit defendant to defend the action and at the same time reserve its right to raise the question of coverage, plaintiff was acting in accordance with the rule adopted by most, if not all, courts. Our rejection of that rule and our holding that plaintiff breached his contract when he relied upon that rule should not prejudice plaintiff to any greater extent than is necessary in this case. We hold, therefore, that if on remand the question of coverage is resolved in favor of plaintiff, defendant will be liable for the amount of the judgment in the Guenther actions and the costs of defense.

The record indicates quite plainly that plaintiff trespassed on the Guenthers' land. It would appear, then, that if defendant had defended the action it is not likely that it would have fared any better than plaintiff did on the issue of liability. The only possible disadvantage defendant could have **350 suffered would have been in not having an opportunity through its own counsel to attempt to obtain a verdict for an *513 amount of damages less than those the jury actually found in this case. But the chances that the damages could have been reduced were minimal. The character of the damage was such that it is not likely that defendant could have reduced the verdict by any significant amount.

Reversed and remanded.

Parallel Citations

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Footnotes

* Langtry, J., did not participate in this decision.

1 The court quoted from P & M Stone Co. v. Hartford Accident & Indemnity Co., 251 Iowa 243, 249, 100 N.W.2d 28, 31 (1959):
'The operation or attempted operation of a bulldozer is a physical act or acts and one who takes bodily possession of such machine and operates or attempts to operate it is exercising physical control over it.
'The provision of the exclusion clause that such physical control may be exercised 'for any purpose' expressly negatives any limitation in such exercise, and neither this nor any other language in this part of the exclusion clause connotes that the exercise of such physical control must be based upon the legal right to so act or that it is otherwise limited.'

2 See 7A Appleman, Insurance Law and Practice, s 4493.4 (1942); Anno.: Scope of clause excluding from contractor's or similar liability policy damage to property in care, custody, or control of insured, 62 A.L.R.2d 1242 (1958); Cooke, Care, Custody or Control Exclusions, 1959 Ins.L.J. 7; Gowan, Provisions of Automobile and Liability Insurance Contracts, 30 Ins.Coun.J. 96 (Jan. 1963); Levit, Care, Custody and Control: What It Is and What To Do About It, 1957 Ins.L.J. 727; Ramsey, The Care, Custody, Control Exclusion of Liability Insurance Policies, 25 Ins.Coun.J. 288 (July 1958).

3 Gowan, Provisions of Automobile and Liability Insurance Contracts, 30 Ins.Coun.J. 96 (Jan. 1963).

4 Gowan, Supra note 3, at 103.

5 Gowan, Supra note 3, at 104.

6 Elcar Mobile Homes, Inc. v. D. K. Baxter, Inc., 66 N.J.Super. 478, 169 A.2d 509 (1961); Cooke, Care, Custody or Control Exclusions, 1959 Ins.L.J. 7; Gowan, Provisions of Automobile and Liability Insurance Contracts, 30 Ins.Coun.J. 96 (Jan. 1963).

7 For example, see Cooke, Care, Custody and Control Exclusions, 1959 Ins.L.J. 7 at 9.

8 In our previous cases we have deemed it significant that the insurance contract obligates the company to defend any suit against the insured Alleging the injuries covered by the policy. See e.g., City of Burns v. Northwestern Mutual Ins. Co., 248 Or. 364, 434 P.2d 465 (1967); McKee v. Allstate Ins. Co., 246 Or. 517, 426 P.2d 456 (1967). See also Harbin v. Assurance Co. of America, 308 F.2d 748 (10th Cir. 1962); Wilson v. Maryland Casualty Co., 377 Pa. 588, 105 A.2d 304, 50 A.L.R.2d 449 (1954). Note, The Duty of an Insurer to Defend its Insured, 5 Willamette L.J. 321 (1969).

9 It would seem apparent that neither the elements of waiver or estoppel are present in these situations.

10 '* * * The underlying purpose of the doctrine (of estoppel by judgment) is to obviate the delay and expense of two trials upon the same issue-one by the injured party against the indemnitee and the other by the indemnitee * * * against the indemnitor. This is possible because it is assumed that the interests of the parties to the contract of indemnity in opposing the injured person's claim are identical; and it is accomplished by giving the indemnitor an opportunity to appear in the first suit on behalf of the indemnitee so that everything that can be offered in exculpation of the indemnitee * * * may be presented. * * *
'It is, however, obvious that the binding effect of a judgment against the insured does not extend to matters outside the scope of the insurance contract, and that the Insurance Company is neither obligated to defend nor bound by the findings of the court if the claim against the insured is not covered by the policy. * * *
'In accord is Restatement of the Law of Judgments, Section 107(a), where the rights of indemnitee and indemnitor inter se after judgment against one of them are set out, and it is stated that if the third person has obtained a valid judgment against the indemnitee, both indemnitor and indemnitee are bound as to the existence and extent of the liability if the indemnitor has been given reasonable notice of the action and requested to defend; but in Comment (g) it is stated that this rule is binding only as to issues relevant to the proceeding; and that the judgment against the indemnitee does not decide issues as to the existence and extent of the duty to indemnify, and that in a subsequent action the indemnitor may show that the circumstances under which he was required to give indemnity do not exist.' Farm Bureau Mut. Automobile Ins. Co. v. Hammer, 177 F.2d 793, 799-800 (4th Cir. 1949)

11 '* * * If the (insurer) could not rely on the results of his conduct, there would be no reason for him to assert a defense contrary to the interest of the insured.' Comment, Liability Insurer's Duty to Defend Suits for Intentional Injury, 24 Wash. & Lee L.Rev. 271 at 282-283 (1967).

12 Comment, Liability Insurance Policy Defenses and the Duty to Defend, 68 Harv.L.Rev. 1436 at 1448 (1955)

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