GREGORY R. GIOMETTI & ASSOCIATES

PROFESSIONAL CORPORATION

50 South Steele Street
Suite 505
Denver, Colorado 80209

(303) 333-1957
(303) 377-3460 Fax
(888) 333-1957 Toll Free

GREGORY R. GIOMETTI
GGIOMETTI@GIOMETTILAW.COM

OCTOBER 18, 2006
NEWSLETTER

Re: Recent Developments in Colorado Insurance Law – Determination of When a Vehicle is Underinsured – Stacking of Policies[1]

On September 11, 2006, the Colorado Supreme Court decided the case of *State Farm Mut. Auto. Ins. Co. v. Progressive Mut. Ins. Co.*, ___ P.3d ____ (Colo. 2006). The case reached the supreme court by way of the Tenth Circuit Court of Appeals, which certified several questions for the court to address. Among the questions certified was which statute, C.R.S. § 10-4-609(2) or C.R.S. § 10-4-609(4), should be applied to determine whether a tortfeasor's vehicle is underinsured. In addition, the court was asked to decide whether, if § 10-4-609(4) is used to determine whether the tortfeasor's vehicle is undersinsured, the language in the statute stating that the limits of the tortfeasor's policies shall be compared to the limits of "the insured's policy" precludes stacking of any other policy with the insured's policy to decide whether the tortfeasor's vehicle is underinsured.

The case arose out of an accident that occurred in July 2002. Vicki Lee was a passenger on a motorcycle driven by Jerry Maggard, which was struck by a car driven by Sonja Madson. Madson was insured by Progressive under a policy with liability limits of $100,000 per person. Lee was insured by State Farm under a policy with uninsured/underinsured motorist (UM/UIM) limits of $100,000 per person. Maggard, who was not related to Lee, was also insured under a State Farm policy with UM/UIM limits of $100,000 per person. Lee was insured under Maggard's policy as a permissive occupant of the motorcycle.

After Lee received State Farm's permission to settle her claim against Madson for the Progressive policy limit of $100,000, she asserted a claim against State Farm for UIM benefits. Lee argued that Madson's vehicle was underinsured because, if the limits of the two State Farm policies

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were stacked together, the combined UIM limit of $200,000 exceeded Madson's liability insurance limit of $100,000. State Farm argued, on the other hand, that under C.R.S. § 10-4-609(4), the two State Farm policies could not be stacked, and that Madson's vehicle was not underinsured because the UIM limits of each of Lee's policies equaled the liability limit of Madson's policy. State Farm filed a declaratory judgment action in the U.S. District Court for the District of Colorado, and both parties filed motions for summary judgment. The district court granted summary judgment in favor of Lee and denied State Farm's motion for summary judgment. State Farm then appealed to the Tenth Circuit.

The supreme court began its opinion be reviewing the provisions of §§ 10-4-609(4)(a) and 10-4-609(2). The former defines an underinsured motor vehicle as "a motor vehicle the use of which, although insured, has liability coverage that is less than the limits for uninsured motorist coverage under the injured person's policy." ___ P.3d at ____. The latter contains language which permits policies to prohibit stacking under certain circumstances. Generally, policies may prohibit stacking of coverage under multiple policies issued by one insurer to the same insured and to the insured's resident relatives. However, § 10-4-609(2) "expressly bars insurers from disallowing the stacking 'of the uninsured or underinsured portions of a policy issued to an insured and a separate policy covering the insured which was not issued to the insured or a resident relative.'" ___ P.3d at ____. This section applied to Lee, since she was covered under two policies – one issued to herself and another issued to Maggard, who was not a resident relative. The court noted that the language of these two sections raises a question whether coverage may be stacked only for purposes of determining the amount of coverage once it has already been determined whether a vehicle is underinsured, or whether policies may be stacked to determine whether a vehicle is underinsured in the first instance. *Id.*

The court recognized that the resolution of this question depends ultimately

> on the meaning of the phrase "limits for uninsured motorist coverage under the insured's policy," in subsection (4)'s definition of "underninsured motor vehicle," and, more particularly, whether the word "limits" in this phrase refers *only* to the limits of the underinsured motorist coverage, per person and per accident, specified in the declarations of the injured person's policy. If so, the class of motor vehicles considered to be underinsured would be restricted to those vehicles with less liability coverage than the underinsured motorist coverage provided by any single policy of the injured party, standing alone, whether or not other policies also purport to cover the injured party.

[Emphasis in original.]. ___ P.3d at ____. While the court pointed out that State Farm's interpretation of the statutory language was reasonable, it was also reasonable to understand the language to mean that all coverage available to the insured should be combined to determine whether the tortfeasor's vehicle is underinsured. *Id.*

Since the statutory language lends itself to more than one reasonable interpretation, the court employed various aids of statutory construction to resolve the ambiguity. First, the court noted that construing the statute as suggested by Lee would avoid conflict between subsections (2) and (4) of

§ 10-4-609, while State Farm's interpretation would result in disharmony.

Even more importantly, State Farm's interpretation of the statute would place it in conflict with the intent of the general assembly. In *Shelter Mut. Ins. Co. v. Thompson*, 852 P.2d 459, 463 (Colo. 1993), the court recognized that § 10-4-609(4) allows "'an injured insured to recover for loss caused by an underinsured motorist to the same extent the insured would recover if the underinsured motorist had no insurance.'". ___ P.3d at ____. For instance, if Madson's vehicle had been completely uninsured, the total amount of coverage available to Lee would have been $200,000, since the uninsured motorist coverage under the two State Farm policies clearly could have been stacked pursuant to § 10-4-609(2). On the other hand, under State Farm's argument, Lee could only recover a total of $100,000 – the amount she recovered under Madson's liability coverage with Progressive – since the determination whether Madson's vehicle was underinsured would be made by comparing Madson's liability limit of $100,000 separately with each State Farm policy. Since in both instances the State Farm policy limits were equal to Madson's liability limit, under State Farm's interpretation, Madson's vehicle would not be underinsured under either policy. The supreme court concluded that this interpretation of the statute was not consistent with the purpose of § 10-4-609(4). The court also noted that the statutory history of § 10-4-609(4)(a), as discussed in *Thompson*, supported the broader interpretation of the word "limits" in that statute, rather than the narrower interpretation urged by State Farm. ___ P.3d at ____.

Taking all these considerations together, the court held that § 10-4-609(4)(a)

> must be construed to intend that the initial determination whether a tortfeasor's vehicle is underinsured be made by comparing the liability limits of the tortfeasor's vehicle with the sum of the uninsured or underinsured portions of the injured's party's policy and the uninsured or underinsured portions of any other applicable policies.

____ P.3d at ____.

GREGORY R. GIOMETTI & ASSOCIATES

PROFESSIONAL CORPORATION

50 South Steele Street
Suite 505
Denver, Colorado 80209

(303) 333-1957
(303) 377-3460 Fax
(888) 333-1957 Toll Free

GREGORY R. GIOMETTI
GGIOMETTI@GIOMETTILAW.COM

NOVEMBER 9, 2006
NEWSLETTER

Re:Recent Developments in Colorado Insurance Law – Stacking of Uninsured/Underinsured Motorist Policies Issued by Affiliated Companies

In *Roberts v. American Family Mut. Ins. Co.*, ___ P.3d ____ (Colo. 2006), the Colorado Supreme Court affirmed in part and reversed in part the decision of court of appeals in *Roberts v. American Family Ins. Co.*, 113 P.3d 164 (Colo. App. 2004).

The case arose out of a dispute over underinsured motorist benefits. Randall Roberts and his wife, Cindy ("the plaintiffs"), were riding on a motorcycle that was struck by a pickup driven by Chet Ray. The plaintiffs, who were seriously injured, sued Ray and settled their claims against him for $50,000 each, the limits of his liability coverage. In addition, they were insured under seven policies of their own. Six of the policies were car policies issued by American Family Mutual Insurance Company and the last policy, which covered a motorcycle, was issued by American Standard Insurance Company. All of the policies provided UM/UIM coverage in the amount of $100,000 per person, and the plaintiffs made a claim against the two insurers, seeking to stack all of the policies. When the carriers denied their claim, the plaintiffs brought a declaratory judgment action and both sides filed motions for summary judgment.

The insurers argued that anti-stacking language in all of the policies limited their liability to the policy limit under any single policy, or $100,000 per person. The insurers conceded that the plaintiffs were entitled to coverage in the amount of $50,000 per person, the difference between the limits of Ray's liability policy and the limits of coverage under each one of their UM/UIM policies. The plaintiffs asserted that the anti-stacking language in the policies was too inconspicuous to be enforceable and that the limits of all of the policies should be stacked together. The trial court agreed with the insurers and granted their motion for summary judgment. The plaintiffs then appealed.

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After oral argument in the court of appeals, the court requested supplemental briefing on the issue whether the limits of coverage of the two affiliated companies, American Family and American Standard, could be stacked, to increase the total coverage available to $200,000 per person. However, a majority of the court declined to address this issue, holding that it had not been specifically raised in the trial court. Thus, the court of appeals affirmed the trial court's decision, ruling that the anti-stacking language in the policies was enforceable and that the limits of the seven policies could not be stacked. The plaintiffs then filed a petition for certiorari, seeking review by the Colorado Supreme Court.

As to the issue of conspicuousness, the plaintiffs argued that authorities from other jurisdictions supported their contention that the anti-stacking provisions were too inconspicuous to be enforceable. However, the supreme court affirmed the rulings of the trial court and the court of appeals that "the anti-stacking provisions at issue here were separately titled and positioned with sufficient prominence to satisfy virtually any requirement of conspicuousness, and they were unambiguous according to existing precedent in this jurisdiction." ___ P.3d at ____.

The focus of the court's decision was whether the trial court properly granted summary judgment to the insurers to the extent that the trial court's judgment precluded stacking of the policies issued by the two affiliated insurers. The supreme court pointed out that the "[t]he seven policies at issue here, by their own terms, only purported to limit the insurer's liability arising from policies issued to the same insured by the same company." ___ P.3d at ____. Each of the policies "expressed their limitations on stacking in terms of 'our liability under all policies issued to *you* by *us*,' and all expressly defined the terms 'we, us, and our' to mean 'the company providing the insurance.'" *Id.* Moreover, the court noted that both "the motorcycle and car policies characterized themselves as having been issued by two different companies." *Id.* Neither the American Standard policy nor the American Family policies referred specifically to the other company, except for stating that the particular company issuing each policy was part of the American Family Insurance Group.

The supreme court recognized that the uninsured motorist statute, C.R.S. § 10-4-609(2) "would not have barred individual policies from prohibiting the stacking of coverage provided in policies issued by affiliated insurers . . . ." ___ P.3d at ____. The statute provides that uninsured/underinsured motorist policies "'may contain provisions which prohibit stacking . . . if such provisions are included in . . . multiple polices issued by one insurer or an affiliated insurer, under common ownership or management . . . .'" *Id.* at n. 2. However, despite the fact that the statute would have allowed anti-stacking language, "the insurance policy itself determines the extent of agreed upon coverage." ___ P.3d at ___. Here, "the policies issued to the Roberts clearly prohibited no more than the stacking of benefits provided in policies issued by the same company." *Id.* Thus, the supreme court held that the trial court improperly granted summary judgment in favor of the insurers insofar as the trial court's order precluded stacking of the limits of one of the American Family policies with the limits of the American Standard policy. ___ P.3d at ___.

In sum, this case stands for the proposition that anti-stacking language in a UM/UIM policy must clearly state that the policy precludes stacking of coverage with policies issued both by the company issuing the particular policy and also by any other affiliated company. If such specific language is not included in the policies, then the insured will be permitted to stack the limits of policies issued by affiliated companies, as occurred in *Roberts*.

GREGORY R. GIOMETTI & ASSOCIATES

PROFESSIONAL CORPORATION

50 South Steele Street
Suite 505
Denver, Colorado 80209

(303) 333-1957
(303) 377-3460 Fax
(888) 333-1957 Toll Free

GREGORY R. GIOMETTI
GGIOMETTI@GIOMETTILAW.COM

NOVEMBER 30, 2006
NEWSLETTER

Re: Recent Developments in Colorado Insurance Law – Court of Appeals Broadens Scope of Duty to Defend in Construction Disputes; Measure of Damages for Breach of Duty to Defend[1]

Recognizing equitable subrogation as a potential claim in a construction defect dispute, where one homeowner purchases property from another without discount for the defect, the Colorado Court of Appeals in *Bainbridge, Inc. v. Travelers Cas. Co. of Conn.*, ___ P.3d ___ (2006), appears to have expanded the scope of liability coverage available to contractors. The court decided the case on November 2, 2006.

The plaintiff, Bainbridge, Inc. ("Bainbridge"), was insured by Travelers under several CGL policies that were in effect from March 31, 1995 to March 31, 1998. In 1996, Bainbridge built and sold a house in an area where expansive soils were present. The original owners, the Deals, soon noticed structural defects in the home, which Bainbridge tried to repair. In 1997, the Deals sold the house to the Goshas, and the structural damage soon reappeared. Bainbridge again tried to repair it just before the expiration of Travelers policy. The Goshas sold the house to David and Elizabeth Ray ("the Rays) in August, 1998, for $920,000, the appraised value of the property. Within two years, the structural damage reappeared, and the estimated cost to repair it was $904,000.

The Rays brought suit against Bainbridge under theories of negligence and violation of the Colorado Consumer Protection Act (CCPA). Bainbridge tendered the defense of the suit to Travelers, which refused to defend because the letter tendering the suit (but not the complaint itself) stated that Rays had purchased the property after the date on which the Travelers policies had expired. In denying coverage, Travelers relied upon the general rule, set forth in *Browder v. U.S.*

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Fid. & Guar. Co., 893 P.2d 132, 134 (Colo. 1995), that "'a third party must suffer actual damage within the policy period to recover under a liability policy.'" ____ P.3d at _____. The insuring agreement in the Travelers policies contained typical language found in CGL policies:

> 1. Insuring Agreement
> a. We will pay on behalf of the insured [those sums] the insured becomes legally obligated to pay as damages because of "bodily injury" [or] "property damage" to which this insurance applies. This insurance applies only to:
> (1) "Bodily injury" or "property damage":
> (a) Occurring during the policy period; and Caused by an "occurrence."

____ P.3d at ____. Travelers did not dispute the fact that the structural damages caused by the expansive soils was "property damage." However, Travelers asserted that no coverage existed because this "property damage" suffered by the Rays did not occur within the policy period, since the damage did not appear until after the Rays had purchased the house in August, 1998.

After Travelers rejected the tender of defense, Bainbridge hired its own counsel to defend itself. After Bainbridge ran out of money, these attorneys withdrew. The case proceeded to trial, and the court entered judgment in favor of the Rays. The Rays and Bainbridge then entered into a *Bashor* agreement.[2] Bainbridge brought an action against Travelers for breach of contract based upon the breach of the duty to defend, bad faith, and violation of the CCPA, and the Rays, as Bainbridge's assignees, moved to intervene in the action. Travelers moved for summary judgment, asserting that it had no duty to defend Bainbridge against any of the claims, and the trial court, relying upon the information as to the date when the Rays purchased the property contained in the tender of defense letter, granted summary judgment in favor of Travelers. Bainbridge and the Rays then appealed.

On appeal, Bainbridge asserted that the trial court erred by considering information outside the four corners of the complaint (*i.e.*, the information in the tender letter) in determining that Travelers had no duty to defend. In addition, Bainbridge asserted that the trial court erred by granting summary judgment because the Rays' complaint against it in the underlying action set forth a possible claim for equitable subrogation, which arguably fell within the scope of Travelers' coverage. The court of appeals agreed with Bainbridge and held that Travelers breached the duty to defend because the underlying complaint could be construed as containing an equitable subrogation claim. Because it decided the case on this latter issue, it was not necessary for the court to decide whether the trial court had improperly considered information outside the four corners of

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[2] A *Bashor* agreement draws its name from *Northland Ins. Co. v. Bashor*, 177 Colo. 463, 494 P.2d 1292 (1972). When a judgment in excess of an insured's liability policy limits is entered, the insured and the plaintiff may enter into a *Bashor* agreement. Typically, a *Bashor* agreement involves an assignment by the insured of the insured's rights to recover damages against the insurer for bad faith breach of its duties under the liability policy, including the duty to settle, in exchange for a covenant by the plaintiff not to execute upon the excess judgment against the insured.

the complaint in determining that there was no duty to defend.[3]

Citing *Browder*, the court recognized that "'[s]ubrogation occurs when one person is substituted in the place of another with reference to a lawful claim, demand or right of the other in relation to the debt or claim and its rights, remedies or securities.'" ____ P.3d at _____. A right of subrogation may arise by contract or through principles of equity. *Id.* The court noted that "if stated in terms of a claim, one becomes an equitable subrogee by paying to a claimant (subrogor) the value of the claim, entitling the subrogee to recover from the liable third party by stepping into the shoes of the claimant." ___ P.3d at ____. Although it has long been established that a right of equitable subrogation exists where an insurer pays its insured the value of the insured's claim and then steps into the insured's shoes *vis a vis* a third party, the parties disagreed whether a purchaser of property, such as the Rays, could assert an equitable subrogation claim based upon the rights of a predecessor in title. ____ P.3d at ____.

The court of appeals rejected Travelers' argument that "because the Rays did not suffer actual damage during the policy period, they cannot acquire through equitable subrogation a liability claim of the previous owner who owned the house when Bainbridge was an insured under the Travelers policy." ___ P.3d at ____. Again citing *Browder*, the court pointed out that there the supreme court explained that a property owner had no right of recovery as a subrogated party because the party from whom it acquired the property did not possess any claim. ___ P.3d at ____. "In reaching this conclusion, the court was necessarily recognizing the possibility of an owner acquiring through equitable subrogation claims of the previous owner." *Id.* The court of appeals interpreted *Browder* "as recognizing a possible equitable subrogation claim in a context where, as here, a homeowner did not own the home during the relevant policy period."[4] *Id.* Further, the court of appeals disagreed with Travelers' contention that both *Hoang v. Monterra Homes (Powderhorn) LLC*, 129 P.3d 1028 (Colo.App. 2005) (*cert granted* March 20, 2006) and *Ford v. Summertree Lane Ltd. Liab. Co.*, 56 P.3d 1206 (Colo.App. 2002), supported its conclusion that a homeowner cannot acquire claims of a previous owner through equitable subrogation.

Applying these principles of equitable subrogation to the issue of Travelers' duty to defend Bainbridge in this case, the court of appeals stated as follows:

> Thus, to set forth an equitable subrogation claim for "property damage" arguably covered by the Travelers policy, the Rays' complaint needed only to support the inferences that (1) the previous owners could have rightfully asserted a claim against Bainbridge that

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[3] Ordinarily, "[a]n insurer looks to the four corners of the complaint, together with the policy, to determine its rights and duty to defend. *Constitution Assocs. v. N.H. Ins. Co.*, 930 P.2d 556 (Colo. 1996); *Hecla Mining Co. v. N.H. Ins. Co.*, 811 P.2d 1083, 1089 (Colo. 1991)." ___ P.3d at ____. This is known as the "complaint rule."

[4] The court of appeals distinguished equitable subrogation from assignment. As the court stated: "[B]ecause it is an equitable doctrine, no additional actions are needed before equitable subrogation can occur. Thus, unlike in an assignment, a subrogor need not intend to equitably subrogate the claims to its subrogee." ___ P.3d at ____.

> was within the Travelers policy coverage (that is, property damage occurred during their ownership); and (2) the Rays purchased the home from the claimholders at a price which was not discounted for the damage (that is, they paid the previous owners for the claim or, stated differently, they discharged Travelers' debt).

____ P.3d at ____. Reviewing the allegations contained in the Rays' complaint, the court of appeals concluded that "such allegations set forth a possible claim under the doctrine of equitable subrogation that was potentially within the policy coverage." ___ P.3d at ____. The court rejected Travelers' argument that no subrogation claim existed simply because the previous owners had not filed a lawsuit. Likewise, the court disagreed with Travelers that the Rays had no subrogated claim because Bainbridge had repaired the damage sustained by the previous homeowners. The issue before the court was not whether the previous damage had in fact been repaired, but "whether allegations in the Rays' complaint stated a *possible* claim that was arguably within the policy coverage so as to trigger Travelers' duty to defend . . . ." ___ P.3d at ____.

Thus, the court of appeals concluded that Travelers had breached the insurance contract by failing to defend Bainbridge. In reversing the trial court's judgment on the breach of contract issue, the court of appeals also "necessarily" reversed its grant of summary judgment to Travelers as to the issues of willful and wanton breach of contract and bad faith. Likewise, the court reversed the trial court's summary judgment on the CCPA claim. ____ P.3d at ____. However, citing *McGowan v. State Farm Fire & Cas. Co.*, 100 P.3d 521, 527 (Colo.App. 2004), the court also recognized that Travelers still possessed a right to dispute its duty to indemnify Bainbridge, even though it had breached its duty to defend. ___ P.3d at ____.

Having determined that Travelers had breached its duty to defend as a matter of law, the court of appeals next considered the measure of damages to remedy the breach. The court recognized that "damages for a breach of the duty to defend pertain to all claims for which the insured was wrongfully denied a defense." ___ P.3d at ____. Such damages "include those flowing naturally from the breach: the costs and reasonable attorney fees incurred by the insured in defending itself against the claims asserted." *Id.* Under contract principles, the insured may also recover "those damages that arose naturally from the breach and were reasonably foreseeable at the time of contract." *Id.*. In addition, if the breach rose to the level of a tort (*i.e.*, bad faith), "then the consequential damages include all damages that were proximately caused by the breach, regardless of foreseeablility." *Id.* The issue of what damages Bainbridge could recover for breach of the duty to defend was one that would have to be decided on remand in the trial court.

GREGORY R. GIOMETTI & ASSOCIATES

PROFESSIONAL CORPORATION

50 South Steele Street
Suite 505
Denver, Colorado 80209

(303) 333-1957
(303) 377-3460 Fax
(888) 333-1957 Toll Free

GREGORY R. GIOMETTI
GGIOMETTI@GIOMETTILAW.COM

JANUARY 11, 2007
NEWSLETTER

Re: Recent Developments in Colorado Insurance Law – Court of Appeals Slightly Opens Pandora's Box – Holds That in Bad Faith Action, Evidence of Insurer's Litigation Tactics May Be Admissible to Prove Bad Faith in "Some Circumstances."[1]

Before the court of appeals' recent decision in *Parsons v. Allstate*, ___ P.3d ____ (Colo.App. Nov. 30, 2006), no Colorado appellate court had ever wrestled with the question of whether evidence of an insurer's post-litigation conduct, including the conduct of its counsel, is admissible in an insurance bad faith action to prove that the insurer engaged in bad faith. *Parsons* arose out of a dispute over uninsured motorist (UM) benefits. The court of appeals held that the trial court did not abuse its discretion by failing to permit evidence of the insurer's post-litigation conduct. However, the court held that such evidence may be admissible in some extraordinary circumstances. Although the court discussed why public policy generally precludes such evidence, the court's opinion does open the door in some circumstances for evidence of an insurer's post-litigation conduct to come into evidence in bad faith cases.

Elissa Parsons and her daughter, Jessica Parsons, were injured in an accident involving an intoxicated, uninsured motorist. At the time of the accident, they were insured by Allstate under a policy with UM coverage limits of $25,000 per person and $50,000 per accident. They brought an action against both the at-fault motorist and Allstate. Their claims against Allstate included bad faith breach of contract, outrageous conduct and violation of the Colorado Consumer Protection Act. At trial, the jury awarded $19,500 to Elissa and $10,000 to Jessica, and ruled in favor of Allstate on all other claims. The trial court found that since each side prevailed with respect to some issues, each was entitled to recover partial costs.

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On appeal, the Parsons asserted that the trial court erred in failing to enter a default judgment against the uninsured motorist and in letting the case go to trial on the issue of damages. The trial court entered default against the uninsured motorist but held that Allstate would be allowed to participate in the damages hearing held at the time of trial. The court of appeals ruled that under the standard set forth in *State Farm Mut. Auto. Ins. Co. v. Brekke*, 105 P.3d 177 (Colo. 2004), the trial court did not abuse its discretion in allowing Allstate to participate in a damages hearing. Moreover, in this case, the Parsons withdrew their request for a damages hearing and requested that the jury decide the issue of damages. Therefore, they waived any objection to Allstate's participation.

Elissa Parsons also argued that the trial court erred by limiting the damages awarded against the uninsured motorist to $25,000 – the per person limit in Allstate's UM coverage. With pre-judgment interest, the jury's award against the at-fault motorist added up to $26,649.67. The court of appeals recognized that Allstate was not required to pay more than the limit of its UM coverage. However, citing *Brekke*, the court held that the Parsons were entitled to collect the full amount of their damages from the uninsured motorist. Thus, the trial court erred by reducing Elissa Parsons' damages against the uninsured motorist to the $25,000 policy limit.

The Parsons' main argument on appeal was that the trial court erred by holding that evidence of the conduct of Allstate's attorney during the litigation was not admissible to show that Allstate acted in bad faith. The trial court entered judgment on the pleadings and dismissed the Parsons' bad faith claim arising from the conduct of Allstate's attorney. The court of appeals noted that the Parsons' bad faith claim enumerated several categories of alleged misconduct, including:

> Allstate's counsel filed an answer denying all responsibility and consisting of groundless denials and defenses; refused to allow discovery to proceed until a case management order was entered; declined to sign a case management order; asked the court to vacate the default judgment hearing; would not make himself available for this hearing; forced an unnecessary jury trial to be held; and refused to be deposed.

___ P.3d at _____.

The Parsons argued that the trial court erred by relying upon an out-of-state case, *Timberlake Construction Co. v. U.S. Fidelity & Guaranty Co.*, 71 F.3d 335 (10th Cir. 1995), to grant judgment on the pleadings to Allstate. The court of appeals disagreed. The court noted that some courts have allowed evidence of certain types of litigation conduct to support bad faith claims. Other courts, such as *Timberlake*, have not. The court of appeals pointed out that in *Timberlake* the court stated that "while evidence of litigation conduct 'may, in some rare instances, be admissible on the issue of bad faith, such evidence will generally be inadmissible, as it lacks probative value and carries a high risk of prejudice.'" ___ P.3d at ____.

The court of appeals also found that the Colorado cases relied upon by the Parsons did not support their argument. The Parsons cited three cases, *Southerland v. Argonaut Ins. Co.*, 794 P.2d 1101 (Colo.App. 1990), *Dale v. Guaranty National Ins. Co.*, 948 P.2d 545 (Colo. 1997), and *Tait v. Hartford Underwriters Ins. Co.*, 49 P.3d 337 (Colo.App. 2001). None of these cases addressed the issue of whether evidence of the conduct of an insurer's litigation counsel was admissible as evidence to support a bad faith claim. In *Tait*, the court of appeals held that evidence of an insurer's improper litigation tactics was properly considered by the trial judge in deciding whether to increase an award of exemplary damages in a bad faith action. However, this evidence was considered not by the jury, but by the trial judge, after the end of trial.

The court of appeals then reviewed various public policy considerations. The court recognized that because the focus of a bad faith claim "is on the decision to refuse to make or to delay making payments owed under an insurance policy . . ., the relevance of litigation conduct by an attorney after the refusal or delay has occurred may be limited." ___ P.3d at ____. The court noted that while several of the unfair claims settlement practices identified in C.R.S. § 10-3-1104(1)(h) "might form the basis for admission of some kinds of evidence of an insurer's post-filing settlement conduct, they do not address others, such as many acts attorneys take in the course of litigation." *Id.* Furthermore, the court recognized that permitting evidence of an attorney's litigation conduct could generate conflict with the attorney's litigation privilege or "could result in ethical dilemmas for attorneys representing insurance companies" since "they would be forced to withdraw from representing their clients if they were likely to become necessary witnesses." *Id.*

After reviewing these policy considerations, the court of appeals adopted a test for determining the admissibility of attorney litigation conduct. This standard is based upon a 1992 law review article. Under this test, "evidence of an attorney's post-filing conduct may be admitted if the risks of unfair prejudice, confusion of the issues, or misleading the jury, and considerations of undue delay, waste of time, or the presentation of unnecessary cumulative evidence, are substantially outweighed by the probative value of the evidence." ___ P.3d at _____.

The court of appeals then applied this test to the alleged misconduct of Allstate's litigation counsel. In considering whether the trial court correctly held that Allstate's attorney's litigation conduct was inadmissible, the court noted that the conduct in this case was similar to conduct that many other courts have found to be inadmissible. This conduct did not amount to the "extraordinary facts" that would justify admission of such evidence. The probative value of the attorney's litigation conduct was slight, whereas the risks of unfair prejudice, misleading the jury and confusion of the issues were significant. ____ P.3d at ____.

In sum, although the result in *Parsons* was favorable to the insurance company, the door has now been opened, even if slightly, to allegations that an attorney's litigation conduct on behalf of an insurance company can constitute bad faith. How much farther this door will be pried open remains to be seen.

GREGORY R. GIOMETTI & ASSOCIATES

PROFESSIONAL CORPORATION

50 South Steele Street
Suite 505
Denver, Colorado 80209

(303) 333-1957
(303) 377-3460 Fax
(888) 333-1957 Toll Free

GREGORY R. GIOMETTI
GGIOMETTI@GIOMETTILAW.COM

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NEWSLETTER

Re: Recent Developments in Colorado Insurance Law – What Constitutes a "Material" Misrepresentation in a Policy Application[1]

Nationwide Mut. Ins. Co. v. Mrs. Condies Salad Co., Inc., 141 P.3d 923 (Colo.App. 2006), *cert. denied*, was a declaratory judgment action brought by an insurer, which had issued a commercial auto policy, to determine whether an admitted misrepresentation by the insured regarding the ownership of one of 12 vehicles covered under the policy was material to the risk assumed, entitling the insurer to void the policy. The trial court granted summary judgment in favor of the insured, and the court of appeals affirmed.

In 2001, the insured, Mrs. Condies Salad Company, Inc. ("Mrs. Condies"), purchased a commercial auto policy from Nationwide covering 12 vehicles. The policy provided five types of coverage, including liability coverage. The liability coverage, which had limits of $1,000,000, provided coverage for Mrs. Condies for damages for which Mrs. Condies was responsible resulting from the use of "'any auto.'" 141 P.3d at 924. One of the covered vehicles was a 1967 Ford truck. In applying for coverage, Mrs. Condies had falsely represented to Nationwide that it owned the vehicle, when, in fact, the vehicle was owned by the company's president, Gary Cucarola. Cucarola sold the truck on an installment basis to a company employee, Alfredo Andrade. On August 3, 2001, Andrade was driving the truck when he struck and killed a pedestrian. When the pedestrian's family indicated they intended to bring a wrongful death action, Nationwide brought a declaratory judgment action, seeking a declaration that the policy was void based upon the insured's misrepresentation as to the true ownership of the 1967 Ford truck. While the action was pending, Nationwide, Mrs. Condies and the victim's heirs entered into a settlement agreement whereby Nationwide agreed to pay the heirs $100,000 on Mrs. Condies' behalf pending the outcome of the declaratory judgment action. The only issue in dispute was whether the misrepresentation regarding ownership was

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material to the risk assumed by Nationwide. If Nationwide prevailed, Mrs. Condies would have been obligated to reimburse Nationwide for the $100,000 payment.

Both parties moved for summary judgment. In support of its position, Nationwide submitted an affidavit from a commercial underwriter, who stated that Nationwide would not have added the truck to the policy had it known the true ownership. The trial court accepted this affidavit as true, but it nevertheless granted summary judgment in favor of Mrs. Condies. The trial court based its ruling upon the fact that Nationwide would have been required to cover Mrs. Condies for its liability arising from the accident regardless of the ownership of the truck, since the policy provided coverage for Mrs. Condies' liability resulting from the use of "any auto." The court of appeals agreed with this ruling.

Citing *Safeco Ins. Co. v. Gonacha*, 142 Colo. 170, 175, 350 P.2d 189, 191 (1960), the court of appeals observed that "[w]here a policyholder misrepresents material facts to obtain insurance, the provisions obtained under those circumstances are void from their inception." 141 P.3d at 925. "Materiality is established if a false or concealed fact materially affected either the risk accepted or the hazard insured against such that the insurer would not have included the coverage provision had it been truthfully informed." *Id.* The court of appeals indicated that the risk associated with liability coverage must be assessed independently of the risks associated with the other coverages under the policy. *Id.* The court observed that "[t]he risk accepted by an insurer when underwriting automobile liability coverage is the possibility that the insured will incur liability for damage caused to a third party." *Id.*

Applying these principles, the court of appeals noted that, for purposes of liability coverage, Mrs. Condies was an insured with respect to the use of any "covered auto," which was defined to include "any auto." *Id.* at 926. Because Mrs. Condies was covered under the policy for liability arising from the use of "any auto," the court of appeals agreed "with the trial court that the fact that Mrs. Condies may not have owned the vehicle at issue here had no material effect on the risk Nationwide accepted when underwriting the liability coverage provision." *Id.*

Nationwide argued that it might not have issued the policy at all if it had known of the true ownership of the 1967 Ford truck. However, the court of appeals rejected this argument, observing that there was "no evidence in the record to support the assertion that Nationwide would not have issued a policy to Mrs. Condies." *Id.* The underwriter's affidavit only claimed that Nationwide "would not have added the truck to the policy, not that it would have declined to issue the policy or that it would have sought to void or alter other provisions of the policy." *Id.*

Concluding that "Mrs. Condies's misrepresentation regarding the true ownership of the truck, under the circumstances here, did not affect the risk accepted by Nationwide," the court of appeals held that "the trial court correctly ruled Mrs. Condies had no obligation to reimburse Nationwide for the $100,000 Nationwide paid to the victim's heirs." *Id.*