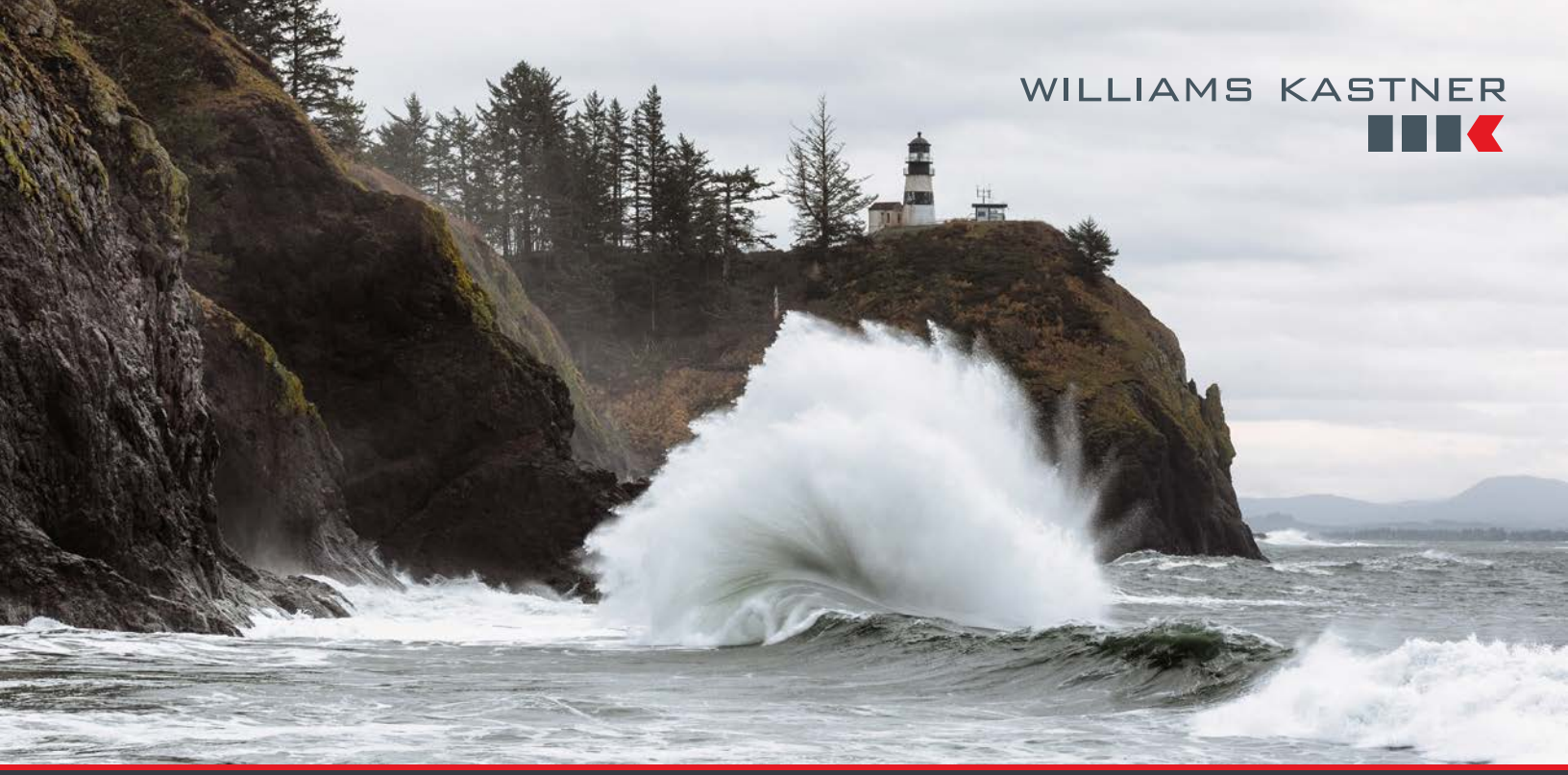


WILLIAMS KASTNER

NORTHWEST INSURANCE LAW

QUARTERLY NEWSLETTER WINTER 2019

Williams Kastner has been serving clients in the Pacific Northwest since our Seattle office opened in 1929. With more than 65 attorneys in offices in Washington, Oregon and affiliated offices in China, we offer global capabilities and vision with a local sensibility. We are attorneys, paralegals, litigation assistants and support staff dedicated to advancing the business and personal objectives of our clients. We are focused on building bridges—combining wisdom and creativity—both in and out of the courtroom and boardroom.

TABLE OF CONTENTS

WASHINGTON FEDERAL COURT FIND INSURER CANNOT REFUSE TO COVER DEFENSE COSTS WITHOUT SHOWING OF "ACTUAL PREJUDICE"

Washington, like many states, requires an insurer to show that its rights have been prejudiced before it can refuse to cover costs incurred by the insured without the insurer's consent. Defining prejudice under the circumstances is an often debated (and litigated) topic.

Recently, a Washington federal judge weighed in on this issue when he held that an insurer may be liable for costs incurred by Costco in post-settlement arbitrations related to a gender bias class action. One of the insurer's main arguments in seeking to avoid paying an undisclosed amount of the retailer's $15 million-plus in arbitration costs is that Costco flouted the terms of its policy by failing to obtain the insurer's written consent before incurring the expenses in question.

The underlying litigation dates back to 2004, when Costco employees first filed suit in California federal court alleging that Costco discriminates against female warehouse employees by using a uniform, corporate-directed system that fails to promote equally qualified or better-qualified women into the positions of assistant general manager and general manager instead of men. After a decade of litigation, a settlement was approved in 2014. At the time of the alleged wrongdoing, Costco held an insurance "tower" consisting of $15M in primary coverage, $15M in excess coverage, and a second $10M excess coverage layer. After the primary and first excess carrier paid their limits toward Costco's defense and other costs, Costco notified the second level excess carrier that its excess coverage would be implicated. The present lawsuit arose when the second level excess carrier declined to pay any of the settlement sum or other costs.

In his ruling, U.S. District Court Judge Robert S. Lasnik said Costco's failure to secure the insurer's written consent does not extinguish the insurance company's duty to cover arbitration expenses because it must show that it suffered "actual prejudice," which the court generally defined as a deprivation of its ability to protect its own interests. The Court noted that the insurer was told about the arbitrations more than a year in advance and "had an opportunity to take corrective action, and it was free to pay or not pay invoices submitted to it as it saw fit." Judge Lasnik noted that the insurer "has not identified any particular expenditure for which it would have refused its consent, instead opting to pay the invoices as they were submitted under a reservation of rights."

It was not all bad news for the insurer, however, as Judge Lasnik allowed the insurer to challenge the reasonableness of the costs. The Court found some merit in the insurer's argument that it may be unreasonable for Costco to shell out in excess of $15M in the arbitration proceedings to distribute $8M in settlement proceeds, though noted that an argument based solely on "overpayment" by the underlying insurers "is not a valid defense to Costco's request for payment." On a somewhat related issue, Judge Lasnik found that the policy excludes coverage for any sums Costco paid to implement "programmatic relief," such as the retailer's costs to hire a consultant to develop changes to Costco's internal practices. Finally, the Court refused to rule on the bad faith claims because there is insufficient information in the record.

WASHINGTON FEDERAL COURT ENFORCES ENDORSEMENT ALLOWING INSURER TO RECOUP DEFENSE COSTS FOR UNCOVERED CLAIMS

In 2013, the Washington Supreme Court rendered a decision in *Nat'l Sur. Corp. v. Immunex Corp.*, 297 P.3d 688, 691 (Wash. 2013) that an insurer could not seek recoupment of defense costs incurred for uncovered claims when it defended an insured under a reservation of rights. While the *Immunex* decision rejected the attempt to recoup defense costs, that Court specifically noted that the policy at issue did not include a provision allowing an insurer to recoup such costs. Thus, the Court held that the insurer could not reserve a right to recoup defense costs that was not specifically provided for in the policy. The *Immunex* decision left open the issue of whether an insurer could recoup defense costs when a policy specifically provided such a right.

On an issue of first impression, a Washington federal judge recently ruled that an insurer can recoup defense costs when the policy contains an endorsement that provides such a right. In *Massachusetts Bay Ins. Co. v. Walflor Industries, Inc.,* 2019 WL 1651659 (W.D. Wash, April 17, 2019), Judge James Robart held that an insurer is entitled to reimbursement of the monies it has already paid to defend the insureds in the underlying lawsuit because the policy provided such a right and because the claims against the insureds in the underlying lawsuit were not covered under the policy.

The underlying lawsuit arose out of a business dispute from an alleged breach of a distributorship agreement by selling trade-name-marked products to multiple parties in the United States and Canada resulting in millions of dollars of lost profit. In addition to breach of contract, the alleged claims in the underlying lawsuit included tortious interference with a business expectancy, trade name infringement,

and a violation of Washington's Consumer Protection Act. The claim for trade name infringement was later replaced with a trademark violation claim, and a claim of alter ego or piercing the corporate veil was added. The insurer defended the underlying lawsuit under a reservation of rights because the allegations in the complaint did not fall within the policy's coverage for damages for "bodily injury," "property damage," or "personal or advertising injury." The reservation of rights letter specifically informed the insureds that the insurer was reserving the right "to seek reimbursement of any defense costs paid if it is later determined that none of the claims or damages sought are covered under the policies," and quoted from the policies' "WASHINGTON CHANGES – DEFENSE COSTS" endorsement, which provided that:

> If we initially defend an insured or pay for an insured's defense but later determine that none of the claims, for which we provided a defense or defense costs, are covered under this insurance, we have the right to reimbursement for the defense costs we have incurred. The right to reimbursement under this provision will only apply to the costs we have incurred after we notify you in writing that there may not be coverage and that we are reserving our rights to terminate the defense or payment of defense costs and to seek reimbursement for defense costs.

The insurer filed a separate declaratory judgment action, and the parties cross-moved for summary judgment, which led to the current ruling.

The Court initially found that claims in the underlying lawsuit were not covered because they did not constitute "personal and advertising injury" under the policy. In a lengthy discussion, the Court found that allegations of product disparagement, use of another's advertising idea, and infringing upon another's trade dress or slogan were not covered. The Court then addressed the issue of whether the insurer could seek reimbursement of the costs paid to defend the insureds.

The Court first declined to certify this issue to the Washington Supreme Court because the Court found sufficient guidance in prior decisions to resolve this issue. The Court then noted that the insureds did not take issue with the intended effect of the endorsement or assert that the endorsement is ambiguous, nor did they dispute that the insurer failed to notify them in its reservation of rights letters of its intent to rely on the endorsement to recoup its defense costs. The Court noted how *Immunex* differed from the current case because of the inclusion of the reimbursement of costs endorsement in the policy at issue in the present case, as well as its specific reservation of this right in its reservation of rights letter. The Court noted that the insurer in *Immunex* attempted to reserve its right to recoup its defense costs in the event a court determined that it did not owe a duty to defend, but the policy at issue did not contain any language allowing such recoupment.

The Court rejected the insured's argument that the *Immunex* ruling still applies where the policy contains explicit language reserving the right to recover defense costs if a court ultimately determines that no such duty exists. The Court also rejected the insureds reliance on *Attorneys Liability Protection Society, Inc. v. Ingaldson Fitzgerald, PC,* 370 P.3d 1101, 1112 (Alaska 2016), to argue that the defense costs reimbursement endorsement is against public policy because Alaska, unlike Washington, enacted an independent counsel statute that precludes the enforcement of language in a professional liability policy granting the insurer the right to recoup defense costs. The Court found that "[n]othing in the endorsement at issue here interferes with an insurer's obligations to comply with [Washington common law's] 'specific criteria' while defending under a reservation of rights" and that Washington common law "does not prohibit an insurer from including such a provision in a business owners policy." Thus, the Court found no recognized public policy grounds for invalidating the endorsement.

OREGON COURT OF APPEALS FINDS COVERAGE DEPENDENT ON THE NATURE OF INJURY, REGARDLESS OF LIABILITY THEORY ALLEGED

In a recent case, the Oregon Court of Appeals analyzed whether an "occurrence" under an insurance policy was the alleged negligence or the resulting injury. In light of the plain language of the exclusion, the Court determined the resulting injury, not the nature of the claim, dictated coverage.

Epps v. Farmers Insurance Exchange, 295 Or App 385 (2018) arises from a lawsuit filed by a minor through his mother ("Plaintiff") against Alta and John Pollard ("Insureds"). Alta agreed to babysit Plaintiff's two-year old son while she ran errands. Despite knowing John was under the influence of alcohol, Alta allowed him to place the child between John's knees on an ATV and drive around the premises. The child was not wearing a helmet or other protective gear. John ultimately rolled the ATV, causing the child serious bodily injury. After Plaintiff sued, the Insureds tendered defense of the lawsuit to their insurance company ("Defendant").

At the trial court, the basis for Plaintiff's negligence claim was that both Alta's failure to reasonably supervise her son on the insured premises, and John's actions on and off the premises, caused the child's injuries. The trial court granted summary judgment in favor of Defendant on the basis of a motor vehicle exclusion to coverage in the policy. On appeal, Plaintiff did not dispute that the motor vehicle exclusion applied to exclude coverage of John because he was driving the motor vehicle. Plaintiff's sole argument on appeal was Alta's alleged failure to reasonably supervise was a covered occurrence because it took place on the Insureds' premises and not in/on a motor vehicle.

The Oregon Court of Appeals ultimately rejected Plaintiff's argument, reasoning that the exclusion was based on an occurrence and that the occurrence was the event that caused the injury—John's use of the motor vehicle. The Court looked to the plain language of the policy, which defined "occurrence" as "an accident including exposure to conditions which result during the policy during the policy period in bodily injury or property damage." The applicable exclusion provided in relevant part, "[w]e do not cover bodily injury, property damage or personal injury which: . . . results from the ownership, maintenance, use, loading or unloading of: . . . motor vehicles[.]" An ATV undisputedly was a motor vehicle.

Plaintiff argued that Alta's negligent supervision was an occurrence because it exposed the child to injury and that the exclusion did not apply because the negligent supervision did not involve use of a motor vehicle. The Court determined the exclusion applied to the resulting injury, regardless of the claim. Thus, the Court affirmed summary judgment in favor of Defendant.

This case is important because it emphasizes the importance of the policy's plain language in interpreting coverage. From an underwriting standpoint, it is important to phrase exclusions in terms of the resulting injury. When analyzing coverage, it is important to look to the plain language to confirm that the exclusion and therefore resulting coverage is based on the nature of the injury, rather than the type of claim.

WILLIAMS KASTNER

INSURANCE TEAM

For over eighty years Williams Kastner attorneys have represented clients in the insurance industry, including primary and excess insurers, reinsurers, self-insurers, agents, brokers, and insurance pools. Our attorneys have advised clients on regulatory and claim handling issues, and have assisted insurers in countless claims from the claim investigation through trial on cases involving coverage and bad faith claims. Please feel free to contact us if you have any questions regarding insurance law in Washington, Oregon or Alaska.

ELIOT HARRIS

OFFICE
(206) 233-2977
EMAIL
eharris@williamskastner.com

JERRY EDMONDS

OFFICE
(206) 628-6639
EMAIL
jedmonds@williamskastner.com

THOMAS PED

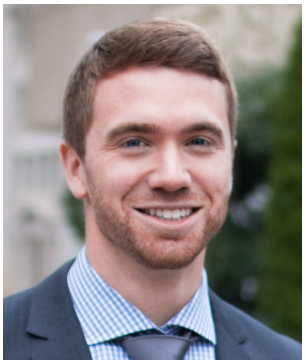
OFFICE
(503) 944-6988
EMAIL
tped@williamskastner.com

MEREDITH DISHAW

OFFICE
(206) 628-6658
EMAIL
mdishaw@williamskastner.com

TARYN BASAURI

OFFICE
(503) 546-1414
EMAIL
tbasauri@williamskastner.com



SEAN JAMES

OFFICE
(206) 233-2989
EMAIL
sjames@williamskastner.com