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No. 66900-1-I

DIVISION I, COURT OF APPEALS  
OF THE STATE OF WASHINGTON

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NATIONAL FIRE & MARINE INSURANCE COMPANY, a Nebraska  
corporation,

Plaintiff-Respondent

v.

CERTAIN UNDERWRITERS AT LLOYD'S LONDON, an English  
corporation which issued Policy No. A99BF02 and LIBERTY MUTUAL  
INSURANCE COMPANY, a Massachusetts corporation,

Defendants-Appellants

and

MUTUAL OF ENUMCLAW INSURANCE COMPANY, a Washington  
corporation; THE OHIO CASUALTY INSURANCE CO., an Ohio  
corporation; WEST AMERICAN INSURANCE COMPANY, an Ohio  
corporation, MARYLAND CASUALTY COMPANY, a Maryland  
corporation, ASSURANCE COMPANY OF AMERICA, a New York  
corporation, AMERICAN HOME ASSURANCE COMPANY, a Texas  
corporation, UNITED STATES FIRE INSURANCE COMPANY, a New  
Jersey corporation and OLD REPUBLIC INSURANCE COMPANY, a  
Pennsylvania corporation,

Defendants

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ON APPEAL FROM KING COUNTY SUPERIOR COURT

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REPLY BRIEF OF APPELLANT LIBERTY MUTUAL INSURANCE  
COMPANY

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TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION.....	1
II. ARGUMENT.....	2
A. No Court Has Required an Umbrella Insurer to Contribute to Defense Costs With its Underlying Primary Insurer. ....	2
B. National Fire’s Interpretation of the Term “Covered” In Section III.A.2 of the Liberty Policy Is Unreasonable. ....	3
1. National Fire’s interpretation of “covered” does not comport with the common meaning of the term or the context of Section III.A.2 .....	4
2. National Fire’s interpretation of “covered” creates a logistical nightmare in determining an umbrella insurer’s duty to defend.....	7
3. National Fire’s interpretation of “covered” would frustrate Washington’s public policy promoting settlement.....	9
4. National Fire’s out-of-state cases are not on point and unpersuasive .....	14
5. Even under National Fire’s unreasonable interpretation of “coverage” both Lloyd’s and National Fire “covered” the claims against Wellington .....	15
III. CONCLUSION.....	16

**TABLE OF AUTHORITIES**

<b>CASES</b>	<b>Page(s)</b>
<i>American Safety Cas. Ins. Co. v. City of Olympia</i> , 162 Wn.2d 762, 174 P.3d 54 (2007).....	9
<i>Australia Unlimited, Inc. v. Hartford Cas. Ins. Co.</i> , 147 Wn. App. 758, 198 P.3d 514 (2008).....	6
<i>Bordeaux, Inc. v. American Safety Ins. Co.</i> , 145 Wn. App. 687, 186 P.3d 1188 (2008).....	3
<i>City of Seattle v. Blume</i> , 134 Wn.2d 243, 947 P.2d 223 (1997).....	9
<i>Federal-Mogul U.S. Asbestos Personal Injury Trust v. Continental Cas. Co.</i> , ____ F.3d ____, 2011 WL 2652232 (6 <sup>th</sup> Cir. 2011).....	4
<i>Hartford Ins. Co. v. Ohio Cas. Ins. Co.</i> , 145 Wn. App. 765, 189 P.3d 195 (2008).....	16
<i>Legacy Vulcan Corp. v. Superior Court</i> , 185 Cal. App. 4th 677, 110 Cal. Rptr. 3d 795 (2010) .....	14, 15
<i>Mutual of Enumclaw Ins. Co. v. USF Ins. Co.</i> , 164 Wn.2d 411, 191 P.3d 866 (2008).....	10, 13
<i>National Sur. Corp. v. Immunex Corp.</i> , 162 Wn. App. 762, 256 P.3d 439 (2011).....	passim
<i>Northwest Pipe Co. v. RLI Ins. Co.</i> , 734 F. Supp. 2d 1122 (D. Or. 2010) .....	14, 15
<i>Spratt v. Crusader Ins. Co.</i> , 109 Wn. App. 944, 37 P.3d 1269 (2002).....	7
<i>State Farm Fire &amp; Cas. Co. v. Ham &amp; Rye, L.L.C.</i> , 142 Wn. App. 6, 174 P.3d 11752007 .....	10

*Woo v. Fireman's Fund Ins. Co.*,  
161 Wn.2d 43, 164 P.3d 454 (2007).....5, 6

**COURT RULES**

Fed. R. Civ. P. 12(b)(6) .....4

## **I. INTRODUCTION**

National Fire does not dispute that both it and Lloyd's were obligated to defend all claims asserted against Wellington in the underlying lawsuit. Moreover, National Fire does not, and cannot, point to a single case in any jurisdiction requiring an umbrella insurer to contribute to defense costs where the underlying primary insurer was already obligated to defend all claims against the insured. Following the Sixth Circuit's recent, well-reasoned decision, this ends the inquiry. Because two primary insurers were obligated to provide a full defense to Wellington, Liberty had no duty to defend under its umbrella policy, and National Fire's contribution claim must fail.

Instead, National Fire proffers a tortured and unreasonable interpretation of the term "covered" as used in Section III.A.2 of the Liberty policy, arguing that when determining Liberty's duty to defend, the term "covered" refers solely to the primary insurers' duty to *indemnify*, and not to the primary insurers' duty to defend. However, this interpretation is unreasonable, as it does not interpret the term "covered" in context, does not comport with the purpose of umbrella insurance policies, and would create significant problems for the administration of any defense, as well as frustrate Washington's important public policy of settlement.

## II. ARGUMENT

### A. No Court Has Required an Umbrella Insurer to Contribute to Defense Costs With its Underlying Primary Insurer.

National Fire asks this Court to hold that Liberty, as an umbrella insurer, had a duty to defend claims against Wellington, even though there is no dispute that two primary insurers, National Fire and Lloyd's, had a duty to defend each and every such claim. Unsurprisingly, National Fire cannot point to a single case endorsing this result. The reason is simple: umbrella policies are intended to cover costs that underlying primary insurance policies do *not* pay, whether because the primary insurance is "exhausted," or because the primary insurer has no contractual obligation to pay in light of its policy language and applicable law. Conversely, where the primary insurer *is* obligated to pay, the umbrella insurer is not. It is an either-or proposition. National Fire can point to no case, and counsel is aware of none, holding that an underlying primary policy and the umbrella policy above it must contribute to the *same* costs.

Here, the trial court held that Lloyd's, the underlying primary insurer, had a duty to defend Wellington, [CP 1258,] and that in discharging this duty, Lloyd's could not allocate between "covered" and "non-covered" claims because they were "reasonably related" and "it is impossible to distinguish fees between covered and uncovered claims." [CP 1258-59.] This holding is a verity on appeal. Under well-established

Washington law, Lloyd's was therefore obligated to defend *all* claims against Wellington, and pay *all* defense costs. *Bordeaux, Inc. v. American Safety Ins. Co.*, 145 Wn. App. 687, 698, 186 P.3d 1188 (2008) (“No right of allocation exists for the defense of non-covered claims that are ‘reasonably related’ to the defense of covered claims.”).<sup>1</sup> Liberty’s duty to defend those very same claims and pay those very same defense costs, as an umbrella insurer, was not triggered.

**B. National Fire’s Interpretation of the Term “Covered” In Section III.A.2 of the Liberty Policy Is Unreasonable.**

Section III.A of the Liberty Policy provides that Liberty has a duty to defend when “damages are sought for any ‘occurrence’ which is covered by this policy but not covered by any underlying policies listed in the Schedule of Underlying Insurance or any other policy providing coverage to the ‘Insured.’” [CP 316.] National Fire argues that, although the trial court held that Lloyd’s had a duty to defend all claims against Wellington and to pay all defense costs, it made no determination whether there was “coverage” under the Lloyd’s policy as that term is used in Section III.A.2. National Fire reaches this result by interpreting the term

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<sup>1</sup> National Fire’s extended discussion of exclusions in its policy and the Lloyd’s primary policies, which it claims may have relieved them of their obligation to indemnify Wellington if the underlying case had proceeded to judgment, is entirely irrelevant.

“covered” in Section III.A.2 to refer to the underlying primary insurer’s duty to indemnify only, and not its duty to defend.

This interpretation was squarely rejected by the Sixth Circuit in *Federal-Mogul U.S. Asbestos Personal Injury Trust v. Continental Cas. Co.*, \_\_\_ F.3d \_\_\_, 2011 WL 2652232 (6<sup>th</sup> Cir. 2011) (slip copy). The *Federal Mogul* court held, pursuant to Fed. R. Civ. P. 12(b)(6), that the umbrella insurer, with indistinguishable policy language, had no duty to defend “because other underlying primary insurance policies are defending the Vellumoid claims.” *Id.* at \*3. This holding was made *solely* based on the insured’s allegation that the primary insurers had a duty to *defend* the claims – no mention was made of an allegation that the primary insurers had a duty to *indemnify* on the claims:

For Continental's duty to defend to arise, the Vellumoid claims must not be covered by either Travelers or any other underlying insurance collectible by the Trust. The Trust alleged that the defense of those claims is currently covered by both Liberty Mutual and Globe Indemnity; therefore, Continental's duty to defend under the DSSP has not yet been triggered.

*Id.* at \*4. This Court should follow the Sixth Circuit’s common-sense holding, and dismiss National Fire’s contribution claim against Liberty.

1. National Fire’s interpretation of “covered” does not comport with the common meaning of the term or the context of Section III.A.2. National Fire’s interpretation of “covered” in Section III.A.2 does

not comport with the common meaning of the term. National Fire does not address the dictionary definition of the term “coverage,” or explain how the definitions previously quoted by Liberty support its interpretation. There can be no dispute that a policyholder who receives a defense – even under a reservation of rights - would say that its defense costs for the claim at issue were “covered.”

The irrationality of National Fire’s interpretation is highlighted by its suggested re-writing of Section III.A.2. Under Washington law, an insurer providing primary coverage has a duty to defend “if the insurance policy conceivably covers the allegations in the complaint.” *Woo v. Fireman's Fund Ins. Co.*, 161 Wn.2d 43, 52, 53, 164 P.3d 454 (2007). National Fire therefore suggests that for analytical clarity, the Court should insert the word “conceivably” into Section III.A.2 of the Liberty Policy before the first occurrence of the word “covered.” [Appellant’s Brief, pp. 26-27.] National Fire would thus read Section III.A.2 in relevant part as “which is [conceivably] covered by this policy but not covered by any underlying policies.” [See CP 316.] Liberty concedes, for the purposes of this appeal, that if Wellington’s defense costs were not covered by a primary insurer such as Lloyd’s or National Fire, Liberty

would have had a duty to defend like a primary insurer.<sup>2</sup> However, the salient issue on appeal is not whether Liberty *would* have a duty to defend *if* it provided primary coverage, but whether it provides primary coverage in the first instance. And that issue hinges on the *second* occurrence of the term “covered” in Section III.A.2.

Because the term “covered” appears in Section III.A.2 twice, National Fire’s proposed insertion tells only half the story. National Fire interprets the second occurrence of “covered” as referring to the underlying primary insurer’s duty to indemnify. Under Washington law, the duty to indemnify “exists only if the policy *actually* covers the insured's liability.” *Woo*, 161 Wn.2d at 53 (emphasis in original). Applying National Fire’s interpretive technique to Section III.A.2 results in language reading “which is [conceivably] covered by this policy but not [*actually*] covered by any underlying policies.” [See CP 316.] The irrationality of National Fire’s interpretation is apparent: it requires the

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<sup>2</sup> National Fire quotes extensively from *Australia Unlimited, Inc. v. Hartford Cas. Ins. Co.*, 147 Wn. App. 758, 198 P.3d 514 (2008), arguing that the Court should apply the *Woo* standard to umbrella policies. However, Hartford issued both the primary and umbrella policies to Australia Unlimited. *Id.* at 764. Moreover, the policyholder conceded that “its underlying CGL insurance policy with Hartford contains an exclusion that applies” to the claims against it. *Id.* at 767. Finally, the *Australia Unlimited* Court did not address whether the term “covered” in an umbrella policy’s “Duty to Defend” section refers to the underlying policy’s duty to defend, and is therefore of extremely limited relevance, at best, to the issues presented in this appeal.

Court to assign two different meanings to the word “covered” six words apart in the very same sentence.

Rather than torture the policy language to reach this strained result, the Court should interpret *both* instances of the term “covered” – occurring in a section of the Liberty policy entitled “Duty to Defend” as referring to the respective insurers’ duty to defend. *Spratt v. Crusader Ins. Co.*, 109 Wn. App. 944, 951, 37 P.3d 1269 (2002) (rejecting interpretation that was “not reasonable in the context of the policy or of the common definitions of the terms”). This interpretation is consistent with Washington law and the language, structure, and purpose of Liberty’s umbrella policy. Because there is no dispute that both Lloyd’s and National Fire had a duty to defend all claims against Wellington, Liberty had no such duty, and National Fire’s contribution action must fail.

2. National Fire’s interpretation of “covered” creates a logistical nightmare in determining an umbrella insurer’s duty to defend. National Fire’s interpretation of “covered” in Section III.A.2 is also unreasonable because under that interpretation Liberty would be unable to determine whether it had a duty to defend until after liability had actually been imposed on its policyholder. Under Washington law, “the duty to indemnify hinges on the insured’s *actual* liability to the claimant and *actual* coverage under the policy.” *National Sur. Corp. v. Immunex Corp.*,

162 Wn. App. 762, 774, 256 P.3d 439 (2011) (internal quotation marks omitted; emphasis added). Thus, if the term “covered” in Section III.A.2 refers solely to the underlying primary’s duty to indemnify, Liberty would be unable to determine whether the requisite conditions for its duty to defend are met – i.e., whether an underlying primary insurer has a duty to indemnify – until *after* resolution of the underlying claim. Needless to say, after summary judgment or trial, any duty to defend would be entirely useless to the policyholder, since its liability has already been fixed. Conversely, at the time when an insurer’s duty to defend is discharged – after the filing of the complaint against the policyholder and before liability is imposed – the duty to defend is the *only* “coverage” that the policyholder may be provided or to which it is entitled.

Nor has National Fire provided any explanation how this quandary, created by its unreasonable interpretation of the word “covered,” may be resolved. Instead, it argues that where an underlying case is resolved by settlement – as most cases, including this one, are – the parties can *never* prove whether the claims against the insured were “covered” by primary insurers. [Respondent’s Brief, p. 26 n.6.] Under National Fire’s interpretation, the policyholder would never be able to prove the requisite conditions for the umbrella insurer’s duty to defend, and would therefore

never be entitled to a *post hoc* defense, if such a thing could even be meaningful.

Conversely, the primary insurer's duty to defend is determined at the outset of the case, by comparing the allegations in the complaint to the policy language. *Immunex*, 162 Wn. App. at 774-75 ("The duty to defend attached here at the point that a complaint was filed against Immunex alleging a potentially covered claim."). Thus, if the word "covered" in Section III.A.2 refers to the primary insurer's duty to *defend*, the umbrella will be able to determine and discharge its duty to defend (if any) at the outset of the lawsuit against the policyholder. The umbrella insurer would therefore be able to discharge its duty to defend (if any) at a time that is actually helpful to the policyholder.

In addition, National Fire's interpretation of "covered" would have significant negative consequences for Washington policyholders by frustrating Washington's public policy favoring settlement.

3. National Fire's interpretation of "covered" would frustrate Washington's public policy promoting settlement. Washington has a strong public policy encouraging settlement of litigation. *American Safety Cas. Ins. Co. v. City of Olympia*, 162 Wn.2d 762, 772, 174 P.3d 54 (2007) (holding that negotiations did not waive contractual rights); *City of Seattle v. Blume*, 134 Wn.2d 243, 258, 947 P.2d 223 (1997) ("[T]he express

public policy of this state . . . strongly encourages settlement.”). National Fire’s interpretation of “covered” would frustrate this policy by providing an economic incentive for insurers not to contribute to the settlement of claims against their policyholders.

Under Washington law, a policyholder bears the burden of proving that an “occurrence” comes within the policy’s insuring agreement – i.e., that the basic conditions triggering the insurer’s contractual obligations are met. *See State Farm Fire & Cas. Co. v. Ham & Rye, L.L.C.*, 142 Wn. App. 6, 13, 174 P.3d 11752007) (“an insured must show that a loss is within the scope of her coverage”). An insurer seeking contribution stands in the shoes of the policyholder. *Mutual of Enumclaw Ins. Co. v. USF Ins. Co.*, 164 Wn.2d 411, 419, 191 P.3d 866 (2008). Thus, to obtain contribution from Liberty for defense costs, National Fire bears the burden of proving that the claims against Wellington were “not covered” under either its policy or the Lloyd’s policy. [CP 316.] As demonstrated above, an insurer’s duty to indemnify cannot be determined until there is a resolution of the policyholder’s liability in the underlying case. *Immunex*, 162 Wn. App. at 774.

Although National Fire does not say so explicitly, it suggests that *Liberty* bears the burden of proving that the “occurrence” was “not covered” by primary insurance – i.e., that the requisite for its duty to

defend was *not* met. This allocation of the burden is not only contrary to Washington law, but would place a strong incentive on umbrella insurers *not* to contribute to settlement on behalf of its policyholder. Such settlement would preclude a determination of the claim on the merits, which would make it easy to determine whether the underlying primary insurer had a duty to indemnify the policyholder's actual liability, if any.<sup>3</sup> An umbrella insurer's contribution to such a settlement would therefore ironically expose it to *additional* liability for defense costs. Worse, this situation would only arise in cases where, as here, the primary insurer(s) refuse to fund settlement, either in whole or in part.

Furthermore, primary insurers defending under a reservation of rights would have an economic incentive *not* to fully fund settlement on behalf of their policyholders and necessitate a contribution from umbrella insurers. Such a course of action would produce two "benefits." First, the

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<sup>3</sup> National Fire's interpretation results in an even more absurd consequence: Because the duty to indemnify applies only where the policyholder is actually found to be liable, *Immunex*, 162 Wn. App. at 774, it does not apply where the claim against the policyholder is dismissed or the jury returns a defense verdict. Under these circumstances, National Fire's interpretation of "not covered" would mean that Liberty's duty to defend would be (retroactively) triggered. As such, a primary insurer could seek contribution for defense costs from an umbrella insurer simply because its defense of the policyholder was successful, whether or not the allegations were within its policy terms, of whether it would have owed indemnity if the defense had been unsuccessful. This absurd result is not the law in Washington or elsewhere.

primary insurer(s) would save money on the settlement. Second, they would create the conditions for a contribution claim for defense costs against an umbrella insurer by arguing, as National Fire does here, that their refusal to fund settlement was evidence that they owed no duty to indemnify under their policies. The result, of course, is a wealth transfer to primary insurers from the umbrella insurer, who must choose to either leave its policyholder exposed, or expose itself to a claim for defense costs by contributing to settlement of the policyholder's liability. This Court should not adopt an interpretation that will *discourage* insurers from settling claims on behalf of their policyholders.

Indeed, this dynamic is at play in this here. National Fire and Lloyd's each refused to contribute more than 60% of their policy limits to settle the claims against Wellington. [CP 70.] Liberty's participation was therefore necessary to protect Wellington, and Liberty contributed \$300,000 toward that settlement even though neither the Lloyd's nor the National Fire primary policies were close to exhausted. [*Id.*]<sup>4</sup> National Fire now seeks to use this very settlement as a sword against Liberty, arguing that it precludes Liberty from demonstrating that the claims

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<sup>4</sup> Liberty's umbrella policy contains a provision specifically providing that Liberty may contribute to the settlement of a claim against its policyholder even where it has no duty to defend. [CP 317, Section III.D.]

against Wellington were “not covered” by Lloyd’s or National Fire. [Respondent’s Brief, p. 26 n. 6 (“[b]ecause indemnity settled, no determination has been or will be made as to whether National Fire or Lloyds [*sic*] actually owed a duty to provide coverage on any claim”).]<sup>5</sup>

If National Fire’s argument is accepted, umbrella insurers will be deterred from participating in settlements extinguishing the potential liability of their policyholders, thereby frustrating important Washington public policy to the detriment of policyholders. Conversely, primary insurers will be rewarded for holding the policyholder’s settlement hostage by receiving both (a) Liberty’s willing contribution to settlement, and (b) contribution toward defense costs as a result of Liberty’s action to protect its policyholder.

Moreover, contribution between insurance companies is an equitable action. *Mutual of Enumclaw Ins. Co. v. USF Ins. Co.*, 164 Wn.2d 411, 420, 191 P.3d 866 (2008). National Fire cannot equitably recover defense costs from Liberty on the basis of a settlement that Liberty helped fund in order to protect the interests of their mutual policyholder, particularly where National Fire, as a primary insurer, refused to do so.

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<sup>5</sup> Indeed, if this argument is correct, then National Fire is unable to carry its burden in this contribution action of demonstrating that a requisite condition for Liberty’s duty to defend – that the claims were “not covered” by National Fire or Lloyd’s – has been satisfied. National Fire’s contribution claim against Liberty therefore fails.

4. National Fire's out-of-state cases are not on point and unpersuasive. In support of its unreasonable interpretation of Section III.A.2 of the Liberty policy, National Fire cites two out-of-state cases. However, neither case presents the factual situation before this Court: where the primary insurance policy directly below Liberty's umbrella policy undisputedly had a duty to defend all claims against the policyholder. For example, *Northwest Pipe Co. v. RLI Ins. Co.*, 734 F. Supp. 2d 1122, 1129 (D. Or. 2010), involved claims against the policyholder for liability arising out of pollution, and the court determined that the policyholder was not entitled to coverage by the underlying primary policy due to the "absolute pollution exclusion" found therein. Similarly, in *Legacy Vulcan Corp. v. Superior Court*, 185 Cal. App. 4th 677, 685, 110 Cal. Rptr. 3d 795 (2010), no primary insured defended against the underlying claims for environmental contamination. Moreover, the Legacy Vulcan court addressed only three legal questions, *id.*, none of which are presented in this appeal. Neither case interprets the Liberty policy language or even suggests that an umbrella insurer may be required to contribute to the same defense costs that its underlying primary insurer is required to pay.

Even if these cases were on point, they are unpersuasive. The *Northwest Pipeline* court concluded that the term "coverage" referred

solely to the duty to indemnify virtually without analysis. It did not examine dictionary definitions or the context in which the term was used, much less consider the logistical consequences of its interpretation, discussed above. Because *Northwest Pipeline* did not consider any of the arguments raised in this appeal, its persuasive value is, at most, marginal. Moreover, *Legacy Vulcan* does not address the issues addressed in this appeal, even in passing.

Instead, the Court should follow the more recent, better-reasoned decision of the Sixth Circuit, holding that pursuant to similar policy language, where primary insurers have a duty to defend all claims, an umbrella insurer's duty to defend those same claims is not triggered.

5. Even under National Fire's unreasonable interpretation of "coverage" both Lloyd's and National Fire "covered" the claims against Wellington. Even if, as National Fire suggests, the term "covered" in Section III.A.2 of the Liberty policy refers only to the primary insurers' duty to indemnify, there can be no dispute that both Lloyd's and National Fire "covered" the "occurrence" from which the claims against Wellington arose. The Association's claims against Wellington were settled in August 2006. [CP 70.] Lloyd's and National Fire each contributed \$600,000 to discharge Wellington's alleged liability – funds that can only be characterized as indemnity. [*Id.*] The claims against Wellington arose

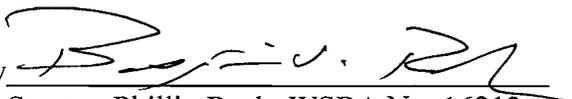
from a single “occurrence,” and no party in this case has contended otherwise. National Fire cannot now contend that despite providing a complete defense to all claims against Wellington and contributing with Wellington’s other insurers to settle those claims, the “occurrence” from which the claims arose was not “covered” under its policy.<sup>6</sup>

### **III. CONCLUSION**

For the reasons stated above, Liberty respectfully requests that the Court reverse the trial court’s grant to summary judgment to National Fire, and remand for entry of judgment dismissing National Fire’s claims against Liberty.

RESPECTFULLY SUBMITTED this 4<sup>th</sup> day of January, 2012.

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<sup>6</sup> Moreover, National Fire makes no attempt to explain why, if it did not have a duty to defend or indemnify, its actions in doing precisely that do not render it a volunteer, and therefore preclude its contribution claim against Liberty. *Hartford Ins. Co. v. Ohio Cas. Ins. Co.*, 145 Wn. App. 765, 774, 189 P.3d 195 (2008).

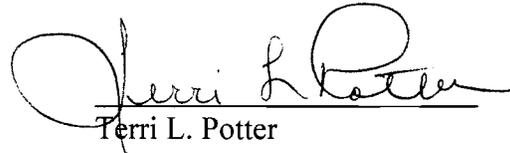
**CERTIFICATE OF SERVICE**

I, Terri L. Potter, under penalty of perjury under the laws of the State of Washington, that on January 4, 2012, I served a copy of the foregoing document on all counsel of record as indicated below:

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Executed on this 4<sup>th</sup> day of January, 2012, at Seattle, Washington.

  
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Terri L. Potter