

No. 66900-1-I

COURT OF APPEALS, DIVISION 1
OF THE STATE OF WASHINGTON

NATIONAL FIRE & MARINE INSURANCE COMPANY
A Nebraska corporation
Plaintiff-Respondents/

vs.

CERTAIN UNDERWRITERS AT LLOYDS 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,
MARYLAND CASUALTY INSURANCE, an Illinois 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.

APPEAL FROM SUPERIOR COURT
FOR KING COUNTY
The HONORABLE REGINA CAHAN

BRIEF OF Respondent-NATIONAL FIRE & MARINE INSURANCE
COMAPNY

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161 Wn.2d 43, 53 (2007).

I. INTRODUCTION

This is the case of an insurer that refuses to acknowledge its duty to defend. In response to the insureds' (the "Wellingtons") original tender of defense (CP 358), Liberty Mutual Insurance Company ("Liberty") wrote a ten page reservation of rights tender response letter explaining its policy exclusions related to indemnity. (CP 863-72.) Liberty's tender response was notable in its failure to address Liberty's duty to defend "drop down" provisions that it wrote into the broad umbrella policy which it sold to the Wellingtons. When the Wellingtons followed their initial tender letter to Liberty with a letter entitled: "Retender of Defense and Indemnity." (CP 910 – 11), Liberty did not respond. Liberty first took a definitive position and denied its duty to defend over three years after settling indemnity, in the relative safe haven of its answer to the National Marine and Fire Insurance Company's ("National Fire") third amended equitable contribution complaint (the "Equitable Contribution Complaint").¹

After defending the Wellingtons by unilaterally paying approximately \$1.5 million on 155 defense bills from seven law firms over a three and one half year period (CP 811-13), National Fire sued the

¹ (SUB 44, CP __.) Liberty's Answer to 3rd Amended Complaint, dated 10/2/09 (copy attached as Appendix Two), See Supplemental Record.

Wellingtons' other insurers for equitable contribution of defense costs. In response to National Fire's suit, Liberty continued to ignore its own policy's prominent duty to defend provisions. In that vein, Liberty answered the Equitable Contribution Complaint with the affirmative defenses: "Failure to state a claim upon which relief can be granted" and "Defendant, Liberty Mutual's obligation to defend commenced only when the limits of the Lloyd's primary insurance policy were exhausted. Those Lloyd's policy limits were never exhausted and therefore, Liberty Mutual's obligation to defend never arose."² Liberty's after-the-fact characterization of itself as an excess carrier with no duty to defend is consistent with the unsuccessful dispositive motion it filed in National Fire's equitable contribution suit.³ It is also consistent with Liberty's Appendix A coverage chart, attached to its appellate brief. That chart is notable in that it includes the term "commercial umbrella," but its depiction reveals only the excess portion of the Wellingtons' Liberty policy. Contrast this with National Fire's Appendix 1 (attached to this

² (SUB 44, CP __.) Liberty's Answer to 3rd Amended Complaint, dated 10/2/09 (copy attached as Appendix 2), See Supplemental Record.

³ (SUB 58, CP __.) Liberty's Motion for Summary Judgment, dated 1/22/10 (copy attached as Appendix 3), See Supplemental Record.

brief), which depicts the gap filling “drop down” provisions in Liberty’s umbrella policy which act as primary insurance when invoked.

Now, in its appeal, Liberty still denies that its policy language obligates it to defend. Liberty argues that under Washington law, the umbrella policy it issued does not require it to defend when insurers that issued primary policies provide a defense. However, as explained in this brief, in this case, Liberty’s duty to defend is based on the drop down provisions in its policy, where Washington law treats Liberty’s policy as a primary insurance policy. In this situation, Washington law assesses Liberty’s duty to defend based on the Wellingtons’ mere potential liability from the allegations in the Complaint, and the mere conceivability for coverage under the Liberty policy. Under this analysis, the trial court correctly ruled that Liberty had a duty to defend. This court should affirm the trial court’s rulings.

II. ISSUES PRESENTED

National Fire agrees with Liberty’s description of the first issue presented. National Fire disagrees with Liberty’s description of the second issue presented, because the trial court never found that “Lloyd’s and National Fire undisputedly each had a duty to defend all claims.” (Liberty Brief, pg. 4) (*emphasis added*). In paragraph one of its summary judgment order, the trial court ruled that Lloyds and Liberty had a duty to

defend each defendant. (CP 1258.) In paragraph four, where the trial court determined allocation, it ruled that it is impossible to distinguish fees between covered and uncovered claims, so it allocated defense costs for all claims to Lloyds, Liberty and National Fire. *Id.* Thus, the trial court's allocation ruling required the parties to pay for covered and uncovered claims. However, the trial court never ruled that National Fire had a duty to defend and never ruled that Lloyds had a duty to defend all claims. Accordingly, National Fire presents the second issue as: Issue Two: Did Liberty have a duty to defend?

III. STATEMENT OF THE CASE

National Fire generally agrees with Liberty's statement of the case, subject to several clarifications. Liberty's statement of the case commences with the statement, "The coverage dispute arises * * * ." (Liberty Brief, pg. 4). National Fire disagrees with Liberty's characterization of this matter. Liberty's appeal arises from National Fire's judgment in an equitable contribution case regarding Liberty's duty to defend.

In its Statement of the Case and Appendix A, Liberty's brief contains errors on the dates and scope of the insurance policies at issue in this appeal. To clarify, Lloyds issued insurance policies to the Wellingtons in: (1) Year-one from February 1, 2000 to February 1, 2001

(CP 97-124), and; (2) Year-two from February 1, 2001 to February 1, 2002, extended to March 10, 2002. (CP126-74.) The Wellingtons also purchased an umbrella policy in year two from Liberty, from February 1, 2001 to February 1, 2002, extended to March 10, 2002. (CP 314-52.) National Fire issued its policy in year three from March 10, 2002 to March 10, 2003. (CP176-259.)

Liberty's brief describes the Wellingtons' tender to Lloyds on March 2, 2005 and Lloyds' response of December 29, 2005. Liberty then states, "Lloyd's agreed to defend some, but not all Wellington entities." (Liberty Brief pg. 6, ¶ 2). However, there is more to the story.

The Wellingtons' March 2, 2005 tender to Lloyds was only from the defendants named in the original Complaint, which were the developer and its parent company. (CP 307 -12.) Lloyds equivocally responded on December 29, 2005, without accepting or denying its insureds' tender. (CP 76-85.) On August 11, 2005, the insureds made their initial tender to Liberty. (CP358.) Liberty's tender response of September 19, 2005, like Lloyds tender response, was equivocal. (CP 863-72.) Like Lloyds, Liberty neither accepted nor rejected the tender of defense. *Id.* Instead, Liberty responded by asserting reservations of rights based strictly on policy exclusions excusing Liberty's duty to indemnify. (CP 863-72.) Liberty now states that, "because the Liberty Policy is an umbrella policy,

Wellington did not tender the defense of the underlying suit to Liberty when it tendered to its primary insurers, Lloyd's and National Fire. " (Liberty Brief pg 8, line 1). Actually, the Wellingtons made staggered tenders to National Fire (CP 263-86), to Lloyds (CP307 – 12) and to Liberty (CP 358 - 63), perhaps based on when its counsel discovered the existence of each policy. In its August 11, 2005 tender to Liberty, the Wellingtons wrote, "we have learned that Liberty issued an umbrella policy * * *." (CP 358.)

On February 24, 2006, after failing to reach settlement in the underlying construction defect lawsuit, the homeowners' association amended its complaint (the "Complaint") to add the builder and five individual principals as defendants, along with an ownership entity. This resulted in a second wave of tender letters, including the Wellingtons' re-tender to Liberty on June 16, 2006. (CP 910 – 11.) Rather than respond to the insureds' re-tender, Liberty now states for the first time that it "understood that its duty to defend was not triggered, and it therefore declined to participate in the defense." (Liberty Brief pg. 8). Liberty never filed a declaratory action and, as previously stated, first denied its duty to

defend three years later on October 2, 2009, when it answered the Equitable Contribution Complaint.⁴

Lloyds responded to the post-amended Complaint tender on August 1, 2006, at which time it first acknowledged a duty to defend some of the Wellington parties by accepting the tenders from the five individual principals and one of the Wellington entities. (CP 566-634.) At that time, Lloyds expressly denied the builder's tender of defense. The builder was one of Liberty's named insureds. (CP 915 – 24.) Lloyds never updated its December 29, 2005 equivocal tender response to the developer and its principal, each of whom Liberty also insured. (CP 76 - 85.)

Liberty's coverage chart, at Appendix A to its opening brief, contains an erroneous inception date for Lloyds' year one policy and, more important, it is misleading to the extent that it only depicts the excess insurance attributes of Liberty's policy. Liberty's policy is actually an excess umbrella policy. In addition to providing \$9 million of excess coverage above and beyond the Wellingtons' self-insured retention of \$25,000 and Lloyds' year-two underlying policy with \$1 million per occurrence and \$2 million aggregate limits, Liberty's umbrella policy

⁴(SUB 44, CP _) Liberty's Answer to 3rd Amended Complaint, dated 10/2/09 (copy attached as Appendix 2), See Supplemental Record.

contains broader coverage than Lloyds' underlying policy. Liberty's policy's broad umbrella coverage causes Liberty to act as a primary insurer with zero ("nil") deductible for its insured in the event of gaps in coverage arising from coverage exclusions in the underlying Lloyds policy "or any other insurance providing coverage to the 'insured'." (CP 316 & 322.) When such exclusions are covered by Liberty's broader umbrella policy, Liberty acts as a primary insurer and drops down to fill the insured's gaps in coverage. Attached as Appendix One is National Fire's coverage chart, which more accurately depicts the true nature of Liberty's umbrella policy by depicting not only the excess "vertical coverage" aspects of Liberty' excess umbrella policy, but also the umbrella's "horizontal coverage," which provides broader protection than the underlying policy.

IV. STANDARD OF REVIEW

National Fire agrees with Liberty that the Court should apply a *de novo* review.

V. RESPONSE ARGUMENT

1. Umbrella Insurance Policies in Washington

A. Umbrella Policies Provide Vertical "Excess" Coverage and Horizontal "Drop Down" Coverage

Commercial and general liability insurance policies ("CGL policies) provide basic insurance coverage which is limited in scope and dollar

amount. Insureds often purchase additional layers of insurance in “excess policies” to provide additional coverage in the event that a catastrophic loss exceeds the primary CGL policy in its dollar limits or scope of coverage. Insured parties often purchase their excess coverage in the form of “umbrella policies.” Umbrella policies provide not only excess coverage in the event that a claim exceeds underlying policy limits (“vertical coverage”), but also provide broader coverage against loss (indemnity), in the event that a claim is outside the scope of coverage of an underlying CGL policy (“horizontal coverage”). “In the ordinary case, excess or umbrella coverages (sic) are designed to pick up where the primary insurance coverage leaves off, providing an excess layer of coverage above the limit of the primary policy. In fact, such excess policies are designed to protect against gaps in coverage.” *Weyerhaeuser Co. v. Commercial Union Ins. Co.*, 142 Wn.2d 654, 707 (2000) (*internal citations and quotations omitted*). Like the name implies, umbrella policies provide broad coverage and drop down to fill gaps in primary coverage. In such instances, the umbrella policy acts as a primary policy.

It should be noted that catastrophe and umbrella policies often provide a primary coverage in areas which might not be included in the basic coverage, since it is the intent of the company to afford a comprehensive protection in order that such peace of mind may truly be enjoyed. In those areas, such coverage will, in fact, be primary.^{8A} J. Appleman, *Insurance* § 4909.85, at 452-53 (1981).

Prudential Property & Casualty Ins. Co. v. Lawrence, 45 Wn.

App. 111, 119 (1986) (*internal brackets omitted*).

By contrast, a pure excess policy has no duty to defend because it strictly provides vertical coverage. “[T]he excess insurer’s duty to defend does not arise until the primary insurer has exhausted its obligation.”

United States Fire Ins. Co. v. Roberts & Schaefer Co., 37 Wn. App. 683, 689 (1984).

B. Once an Umbrella Policy’s Drop Down Provisions are Triggered, Washington Courts Apply the Same Duty to Defend Legal Analysis for an Umbrella Policy as for Any Other Primary Policy.

When gaps in an underlying policy’s coverage trigger the drop down provisions in an umbrella policy, Washington courts treat the umbrella policy as a primary policy for the purposes of duty to defend and duty to indemnify analysis. In such situations, Washington law applies the same duty to defend analysis for an umbrella policy as for any other primary policy. That is, the duty to defend must be determined from the insured’s potential for liability from the allegations in the complaint and the conceivability for coverage under the insurance policy, all as of the commencement of the case. *Woo v. Fireman’s Fund Ins. Co.*, 161 Wn.2d 43, 53 (2007). The Washington Court of Appeals verified this in a case where the appeal was based solely on the duty to defend contained in an umbrella policy, where the insured conceded that the underlying policy

excluded coverage. See *Australia Unlimited, Inc. v. Hartford Casualty Ins. Co.*, 147 Wn. App. 758, 767 (2008). The *Australia* Court applied the *Woo* Court’s duty to defend analysis for the subject Hartford umbrella policy, just like the *Woo* Court did for a primary policy. The Court held, “[u]nder the principles of *Woo* and the authority it cites, Hartford had a duty to defend if Crocs’s complaint against AU, construed liberally, alleged facts that could, if proved, impose liability upon AU within the policy’s coverage. *Australia Unlimited, Inc.* 147 Wn. App. at 767.

Applying *Woo* to Hartford’s umbrella policy, the Court held:

There are two exceptions to the rule that the duty to defend must be determined only from the complaint, and both the exceptions favor the insured. First, if it is not clear from the face of the complaint that the policy provides coverage, but coverage could exist, the insurer must investigate and give the insured the benefit of the doubt that the insurer has a duty to defend. Notice pleading rules, which require only a short and plain statement of the claim showing that the pleader is entitled to relief, impose a significant burden on the insurer to determine if there are any facts in the pleadings that could conceivably give rise to a duty to defend. Second, if the allegations in the complaint conflict with facts known to or readily ascertainable by the insurer, or if the allegations ... are ambiguous or inadequate, facts outside the complaint may be considered. The insurer may not rely on facts extrinsic to the complaint to deny the duty to defend—it may do so only to trigger the duty.

... Although the insurer must bear the expense of defending the insured, by doing so under a reservation of rights and seeking a declaratory judgment, the insurer avoids breaching its duty to defend and incurring the potentially greater expense of defending itself from a claim of breach.

Australia Unlimited, Inc. 147 Wn. App. at 766 - 767 (citing *Woo*, 161 Wn.2d at 53-54 (internal citations omitted)).

While not binding authority in Washington State Courts, California courts treat umbrella insurers as primary insurers when their policies drop down to fill gaps in underlying insurance. See *Legacy Vulcan Corp. v. Superior Court*, 185 Cal. App. 4th 677, 689 (2010). California is not alone in this analysis. The United States District Court for the District of Oregon provided a concise explanation of the distinction between primary insurance, excess insurance and umbrella insurance. There is nothing in the District Court's explanation that is contrary to Washington law.

Primary insurance provides coverage immediately upon the occurrence of a loss or an event giving rise to liability, while excess insurance provides coverage only upon the exhaustion of specified primary insurance. . . . Umbrella insurance provides coverage for claims that are not covered by the underlying primary insurance. An umbrella insurer "drops down" to provide primary coverage in those circumstances. Thus, a policy that provides both excess and umbrella insurance provides both excess and primary coverage.

Northwest Pipe Co. v. RLI Ins. Co., 734 F. Supp. 2d 1122, 1128 (D. Or. 2010) (*emphasis added*). After distinguishing between different levels of insurance, the Northwest Pipe Co. Court held:

Whether other insurers also defend this action is not relevant to RLI's duty to defend under the terms of its policy because RLI has not established either that Wausau or any other underlying insurer must indemnify Plaintiff for

the alleged property damage during RLI's policy period or that the alleged damage did not occur within the period of RLI's policy.

Id at 1131. Thus, under *Northwest Pipe*, when an umbrella policy drops down to defend as a primary policy, the issue of whether other insurers also defend is not relevant to the umbrella insurer's duty to defend.

C. When an Umbrella Insurer is Relieved of its Duty to Defend

In 2011, the Washington Court of Appeals explained the extent to which an insurer which reserves rights is liable for defense costs. This was in the case of an umbrella policy issuer which won a declaratory action establishing that it had no duty to defend. The Court ruled that the insurer was not entitled to recoupment of the defense costs it paid from the time of accepting the tender under a reservation of rights to the time it prevailed in its declaratory action. The Court reasoned that without a contractual provision in the insurance policy for recoupment, an appellate court will not read such a provision into the policy. *Nat'l Sur. Corp. v. Immunex Corp.*, 162 Wn. App. 762, 778 (2011) (*petition for cert. filed*). This case establishes that in Washington, an insurer that properly reserves its rights, defends and files a declaratory action, is first relieved of its duty to defend, prospectively, at the time the court terminates its duty to defend in the declaratory action. Liberty failed to take these steps.

2. Liberty Had A Duty To Defend.

Under Washington law, Liberty clearly had a duty to defend the Wellingtons based on Liberty's clear and unequivocal policy language. An insurer's duty to defend in Washington is readily triggered and is broader than its duty to indemnify. The Washington Supreme Court recently summarized Washington's well established law on insurers' duties to defend as follows:

The duty to defend is different from and broader than the duty to indemnify. *Am. Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 404 (2010). In the insurance context, this court has recognized that the right to a defense may be "of greater benefit" than indemnity and has held that "if there is any reasonable interpretation of the facts or the law that could result in coverage, the insurer must defend." *Id.* at 405 (internal quotations omitted).

Edmonson v. Popchoi, 172 Wn.2d 272, 282 (2011).

In addition to explaining the broad scope of the duty to defend and that the mere potential for liability is the triggering mechanism for the duty to defend, the Washington Supreme Court has clearly defined the time at which an insurer's duty to defend arises.

The duty to defend arises at the time an action is first brought, and is based on the potential for liability. An insurer has a duty to defend when a complaint against the insured, **construed liberally, alleges facts which could**, if proven, impose liability upon the insured within the policy's coverage. . . . In contrast, the duty to indemnify hinges on the insured's actual liability to the claimant and actual coverage under the policy. In sum, the duty to defend is triggered if the insurance policy **conceivably covers the**

allegations in the complaint, whereas the duty to indemnify exists only if the policy actually covers the insured's liability.

Woo, 161 Wn.2d at 52-53, (*emphasis added, internal quotation marks and citations omitted*).

In 2010, in *Alea*, citing *Woo*, the Washington Supreme Court reiterated the distinction between an insurer's duty to defend and its duty to indemnify. The duty to indemnify exists only if the policy actually covers the insured's liability. The duty to defend is triggered if the insurance policy conceivably covers allegations in the complaint. *Woo* 161 Wn.2d at 53.

Similar to the distinction in Washington case law, Liberty's policy contains two distinctly separate sections for Coverage and Defense. Section I entitled Coverage outlines the grant of coverage under Liberty's umbrella policy. Section III entitled Defense outlines Liberty's defense obligation.

Section I of Liberty's policy describes Liberty's coverage as follows:

I. COVERAGE

We will pay on behalf of the "Insured: those sums in excess of the "retained Limit" that the "Insured" becomes legally obligated to pay by reason of liability imposed by law or assumed by the "Insured" under an "Insured contract" because of "bodily injury," "property damage," "personal injury," or "advertising injury" that takes place during the

Policy Period and is caused by an “occurrence” happening anywhere. The amount we will pay for damages is limited as described below in the Insuring Agreement Section II.

(CP 314) (*emphasis added*).

Section III A. of Liberty’s policy describes Liberty’s duty to defend as follows:

III DEFENSE

We will have the right and **duty** to investigate any “claim” and defend any “suit” seeking damages covered by the terms and conditions of this policy when:

1. the applicable Limits of Insurance of the underlying policies listed in the Schedule of Underlying Insurance and the Limits of Insurance of any other insurance providing coverage to the “Insured” have been exhausted by actual payment of “claims” for any “occurrence” to which this policy applies; or
2. 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 insurance providing coverage to the “Insured.”

(CP 316) (*emphasis added*). The explicit language of Liberty’s policy obligates Liberty to provide a defense to the Wellingtons when damages are sought for any occurrence that is not covered by either the underlying insurance (Lloyds) or any other insurance. *Id.* Lloyds issued its reservation of rights letter detailing exclusions that were not contained in Liberty’s policy. (CP 76-85.) These exclusions potentially applied to defeat coverage under Lloyds’ policy for the Complaint’s allegations

against the Wellingtons. National Fire also issued a reservation of rights detailing exclusions in its policy which also potentially applied to defeat coverage. (CP 292 – 98.)

If Liberty thought it had no duty to defend and that there was no potential coverage under its policy, it could have rejected the Wellingtons' tender and refused to defend. *Truck Ins. Exch. v. VanPort Homes, Inc.*, 147 Wn.2d 751, 761 (2002). This is not what Liberty did. Instead, Liberty issued a tender response letter in which it reserved its rights to contest coverage and was silent on its duty to defend. Liberty had a duty under Washington law to respond to the Wellingtons' tender of defense.

Liberty's determination of the conceivability of coverage under its policy necessarily includes an examination of the Lloyds policy because the Liberty policy incorporated the underlying Lloyds policy by reference. (CP 335.) In addition, because Liberty argues coverage under the National Fire policy also defeated its duty to defend, Liberty's determination must include review of the National Fire policy. A review of the Liberty, Lloyds and National Fire policies shows there were potential gaps in coverage which triggered Liberty's duty to defend. The Lloyds policy contained exclusions which Liberty's policy did not contain. (CP126 - 74) and (CP 314 - 52.) These Lloyds' exclusions potentially applied to defeat coverage. Lloyds detailed several exclusions in its

reservation of rights letters which Liberty's policy lacked. (CP 76 - 85) and (CP 915 - 24.) Therefore, there was potentially coverage for damages under Liberty's umbrella policy for which there was no coverage under Lloyds' policy.

Clear examples of exclusions in Lloyds' underlying policy but not in Liberty's policy for the Wellingtons' potential liability from the Complaint are: the product exclusion, the fiduciary exclusion and the premises alienated exclusion.

A. Lloyds Product Exclusion

Lloyds stated in its initial tender response letter that "the entire Cheswick Lane Condominium project can be considered Wellingtons' product * * *." Lloyds further stated that its policy's defective product exclusion applied to preclude coverage. (CP 83.) Lloyds cited to paragraphs 6(f)(1) and 6(f)(2) of its policy for these exclusions. (CP 154.) Lloyds' product exclusion did not include an exception for real estate. Therefore, there was a potential that Lloyds product exclusion applied to preclude any coverage under Lloyds policy for the Wellington builder and developer, which were the primary targets of the lawsuit. By contrast, Liberty's broader umbrella policy had a narrower product exclusion because real estate was excepted from its definition of "your product". Liberty's definition of "your product" means "any goods or products, other

than real property. (CP 326) (*emphasis added*). However, the Complaint alleges: “The defects or deficiencies described above have resulted in physical damage to the Project, ****” (CP 831.) The Complaint defines the condominium, which is real property, as the “Project.” (CP 829.) Lloyds’ policy contained a defective product exclusion which Liberty’s broader umbrella policy did not contain. Thus, it is conceivable that there existed a gap in Lloyds’ policy which required Liberty’s policy to drop down and act as a primary policy to cover this potential liability which Lloyds’ underlying policy excluded from coverage. This triggered Liberty’s duty to defend.

B. Lloyds Fiduciary Exclusion

This insurance does not apply to "bodily injury, "property damage, "personal injury", or "advertising injury" arising out of the ownership, maintenance or use including all related operations) of property which the Assured" is acting in a fiduciary or representative capacity.

(CP 158) (*emphasis added*). The fourth claim in the Complaint is entitled “Against the Developer Defendants for Breach of Fiduciary Duty.” Because Lloyd’s policy had a fiduciary exclusion and Liberty’s broader umbrella policy does not contain any exclusion for breach of fiduciary duty claims, the insured had a gap in its underlying insurance coverage. This gap triggered Liberty’s duty to drop down and act as a primary insurer. As a primary insurer, whose insurance policy conceivably

covered the allegations in the Complaint, Washington law imposed a duty on Liberty to defend.

C. Lloyds Premises Alienated Exclusion

If there is any doubt as to Liberty's duty to defend arising from the gap in coverage created by the underlying Lloyds' policy's exclusions already mentioned, the underlying Lloyds' policy's exclusion for premises alienated (condo units sold) separately triggered Liberty's duty to defend. Specifically, the Lloyds policy excludes "property damage" to premises alienated by the "Assured" arising out of such premises or any part thereof." (CP 141.) Paragraph 4 of the first amended Complaint alleged "* * * the association is instituting this action * * * on behalf of itself and all of the unit owners with respect to matters affecting the condominium."

The Lloyds policy contains a gap in coverage with its exclusion for premises alienated (sold). In direct contrast to the Lloyds policy, the Liberty policy contains no such "premises alienated" exclusion. A cursory review of the amended Complaint would have revealed that the insured had sold at least some of the premises. Because the Lloyds' policy contained the premises alienated policy exclusion and the broader Liberty policy did not contain a policy exclusion for "premises alienated, the Liberty umbrella policy drops down to fill the gap. Consequently, Liberty's policy coverage was invoked as primary insurance under section

III A. 2 of its policy. (CP 316.) Accordingly, Liberty was obligated to provide a defense.

D. National Fire's Damages Commencing Prior Exclusion

Liberty claims that the National Fire policy provided coverage for the occurrence and therefore Liberty's duty to defend was not triggered. Liberty is incorrect. National Fire's policy contained an explicit policy exclusion for damages commencing prior to the inception of National Fire's policy. (CP 259.) Any damages commencing in year-two, would be excluded under National Fire's policy, which incepted on day one of year three. (CP 187.) Liberty cannot, with a straight face, argue that this exclusion could not potentially apply to defeat coverage under National Fire's policy for damages commencing in Liberty's policy period because Liberty cited a similar exclusion in its policy to explain to the Wellington insureds why coverage under Liberty's policy may not apply. (CP 866.) Certainly if the exclusion potentially applied to defeat coverage under Liberty's policy, it potentially applied to defeat coverage under National Fire's policy. Liberty aptly explains the applicability of such exclusions, when it wrote in its September 19 , 2005 tender response: "According to the Pre-Existing Damages Exclusion, cited above, no coverage exists to the extent 'property damage' began prior to the inception date of this policy, 2/1/2001, and allegedly continued into the policy period." (CP

871.) Likewise, under the National Fire policy, no coverage exists to the extent property damage began prior to the inception date of the National Fire policy. To the extent that Liberty denies its duty to defend by claiming that National Fire was the “other insurance” that fulfilled Liberty’s policy’s paragraph III.A.2 language: “or any other insurance providing coverage to the ‘Insured’,” (CP 316.) (*emphasis added*), Liberty is incorrect. National Fire’s policy incepted at the conclusion of Liberty’s policy (Liberty Brief, pg. 1), and National Fire’s policy excluded coverage for damages commencing prior. (CP 259.) Therefore, it is conceivable that there were gaps in coverage which precluded Liberty from relying on National Fire as “any other insurance providing coverage to the ‘Insured.’” This conceivability of coverage triggered Liberty’s duty to defend. *Nat’l Sur. Corp. v. Immunex Corp.*, 162 Wn. App. 762, 775 (2011) (*petition for cert. filed*).

3. Why Liberty’s Arguments Fail

A major reason that Liberty’s appellate arguments fail is because, among other incorrect legal standards, Liberty bases its arguments on duty to indemnify case law and analysis, instead of a duty to defend case law and analysis. For example, on page 14 of its brief, Liberty argues, “The purpose of an umbrella policy is to protect the insured in the event of a catastrophic loss in which liability damages exceed available primary

coverage." *Safeco Ins. Co. of Illinois v. Automobile Club Ins. Co.*, 108 Wn. App. 468, 479 (2001). Here, Liberty only tells half the story – in this case, the half of the story that is irrelevant to this appeal. The excess vertical coverage attributes of Liberty’s umbrella policy are irrelevant to this appeal. At issue in this appeal instead, is Liberty’s umbrella policy’s broad horizontal coverage, which triggered its duty to defend because policy exclusions in the Wellingtons’ underlying Lloyds’ year-two policy, which potentially left allegations in the Complaint uncovered. In this example, Liberty cites an indemnity case in which an underlying insurance policy’s limits were exhausted and where only the vertical (excess) coverage, but not the horizontal (drop down to fill the gap created by the underlying policy’s exclusion) coverage, of the umbrella policy was at issue.

A. Liberty Misconstrues Its Policy Language To Deny Its Duty To Defend

Liberty’s analysis is particularly irrelevant because Liberty’s policy clearly treats coverage and defense distinctly. For instance, Liberty’s policy contains its indemnity provisions at: “COVERAGE” (CP 1052) and its defense provisions at “DEFENSE” (CP 1054.)

The flaw in Liberty’s position becomes readily apparent upon a review of its major arguments.

Despite its holding that Lloyd's had a duty to defend Wellington against all claims against it in the underlying lawsuit pursuant to Lloyd's primary policy, the trial court went on to find that Liberty also had a duty to defend under its umbrella policy and was therefore liable to contribute to the very same defense costs for which the underlying primary insurer Lloyd's was indisputably liable.

(Liberty Brief, pg. 2.)

It is undisputed that National Fire actually paid all defense costs throughout the Underlying Lawsuit without any segregation between covered and allegedly "non-covered" claims. This undisputed fact forecloses Liberty's duty to defend as a matter of law.

(Liberty Brief, pg. 15.) Liberty's analysis is fundamentally flawed because Liberty's policy language does not limit Liberty's duty to defend if another insurer is defending. An examination of section III of Liberty's policy demonstrates that Liberty's policy indeed has no such provision.

(CP 1054.)

In Section III.A.2 of its policy, Liberty agreed to defend under the following terms:

III. DEFENSE

A. We will have the right and **duty to** investigate any "claim" and **defend any "suit"** seeking damages covered by the terms and conditions of this policy when:

2. 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 insurance providing **coverage** to the "Insured."

(CP 316) (*emphasis added*). Thus, the question under Liberty's policy is not whether Lloyds or National Fire were providing a defense; it is rather whether Lloyds or National Fire provided coverage. As explained *supra*, Lloyds and National Fire's policies each had exclusions which left the Wellingtons without coverage for allegations in the Complaint. If Liberty desired to limit its duty to defend, it readily could have done so when it wrote its policy by stating that it had no duty to defend if any other insurer provided a defense.⁵ Liberty's policy conceivably covered the damages alleged in the Complaint, which triggered Liberty's duty to defend.

B. To Excuse Its Duty To Defend, Liberty Impermissibly Relies On Lloyds' Duty to Defend and National Fire's Defense.

Liberty argues that Lloyds' and National Fire had duties to defend, so Liberty had no duty to defend. Liberty's argument fails upon analysis of Liberty's policy and Washington law on the duty to defend. Liberty relies on the trial court's determination that National Fire and Lloyds had duties to defend the Wellingtons, to argue that it had no duty to defend.

⁵ For example, commercial general liability policies customarily contain "Other Insurance" provisions which limit an insurer's duty to defend. *See e.g. Bethlehem Constr., Inc. v. Transp. Ins. Co.*, 2007 U.S. Dist. LEXIS 4303, 6-7 (E.D. Wash. 2007) ("St. Paul will have no duty under this policy to defend [insured] against any "suit" if any other insurer has a duty to defend the insured against that "suit". If no other insurer defends, St. Paul will undertake to do so, but St. Paul will be entitled to the insured's rights against all those other insurers.")

The trial court never determined whether or not National Fire had a duty to defend.⁶ (CP 1258.)

Nothing in Liberty's policy excuses Liberty's duty to defend when another insurer is also defending. (CP 1054.) The defense that National Fire provided and the equitable contribution trial court's determination of Lloyds' duty to defend are irrelevant to analyzing Liberty's duty to defend. This is because Liberty's policy includes coverage for claims which are not covered in Lloyds' listed underlying policy or any other insurance.

In arguing against its duty to defend, Liberty disregards the proper legal analysis which requires applying Washington's simple analysis on the duty to defend when an umbrella policy drops down to fill a gap in underlying coverage and acts as a primary policy, as set out in *Woo. Australia Unlimited, Inc.* 147 Wn. App. at 767 – 768. Liberty's policy bound Liberty to defend when damages were sought – not proven – for any occurrence which was covered by Liberty's policy, but not other policies. Under *Woo*, Liberty's aforementioned Section III A. 2 policy

⁶ The trial court made no ruling on National Fire duty to defend because National Fire accepted the tender and agreed to defend. National Fire acceptance of the tender was under a reservation of rights on indemnity. Because indemnity settled, no determination has been or will be made as to whether National Fire or Lloyds actually owed a duty to provide coverage on any claim

language is supplemented in Washington by the addition of the word “conceivably” as follows: “any damages are sought for any occurrence which is conceivably covered.” *Woo*, 161 Wn.2d at 53. Applying Washington law to the clear and unambiguous language of Liberty’s policy, Lloyds’ policy and National Fire’s policy, it is clear that Liberty had the duty to defend.

The *Northwest Pipe* court rejected an argument similar to Liberty’s. In *Northwest Pipe*, the District Court held that whether other insurers also defended was not relevant to the umbrella insurer’s duty to defend under its policy, because the umbrella insurer did not establish that the named underlying insurer, or any other underlying insurer, must indemnify the plaintiff for the alleged property damage during the subject policy period, or that the alleged damage occurred outside of the policy period. *Northwest Pipe Co.* 734 F. Supp. 2d at 1131. While not binding precedent in Washington, this case is persuasive authority. The *Northwest Pipe Co.* court treated the umbrella insurer as a primary insurer when it dropped down to fill gaps in underlying coverage. *Id* at 1128. This is consistent with Washington law and apropos to Liberty’s III.A.2 policy language. (CP 316.)

C. Liberty's Interpretation Of "Coverage" In Par. III.A.2 Of Its Policy To Include National Fire's Defense Is Internally Inconsistent With Liberty's Policy.

In summary judgment, Liberty unsuccessfully argued that "National Fire provided coverage in the form of a defense." (CP 22.) Liberty now attempts to recast its "coverage in the form of a defense" argument on appeal. Liberty argues that National Fire's defense means National Fire undisputedly provided coverage. Liberty bases its arguments on its statement: "Here, it is now undisputed that two primary policies – Lloyd's and National Fire's – provided coverage to Wellington in the Underlying Lawsuit." (Liberty Brief, pg. 25.) Liberty is incorrect that Lloyds or National Fire indisputably provided coverage. Lloyds and National Fire each reserved rights in the construction defect lawsuit, where coverage was never resolved. (CP 84) and (CP 298.) Likewise, coverage was never at issue in the subsequent equitable contribution case, where National Fire sued for: "[a] declaration that determines the extent to which NFM's⁷ defense obligations to the Wellingtons overlap with those of Lloyds, Liberty and the subcontractor insurers and the amount of equitable shares of contribution between all parties." (CP 11.) The Equitable Contribution Complaint makes no mention of coverage or indemnity, other than to

⁷ National Fire referred to itself as "NFM" in the Equitable Contribution Complaint.

memorialize the parties' indemnity settlement. (CP 6 – 11.) Likewise, the trial court summary judgment order only made rulings relating to Lloyds and Liberty's – but not National Fire's - duty to defend. It did so without any specificity as to claims. The trial court only dealt with the issue of claims in its equitable allocation, where it found that it was: "impossible to distinguish fees between covered and uncovered claims. The attorneys' fee itemizations did not allocate between claims." (CP 1258.) Thus the trial court made no rulings on coverage and Liberty's statement that: "it is undisputed that National Fire and Lloyds provided coverage" is incorrect.⁸

The Court's finding of a defense obligation does not turn uncovered claims into covered claims. Lloyds and National Fire's policies had exclusions which Liberty's did not. The horizontal umbrella coverage provision that Liberty drafted at Section III.A.2 of its policy causes Liberty to drop down and function as a primary policy to fill underlying gaps in coverage. This triggered Liberty's duty to defend. *See Australia Unlimited, Inc.* 147 Wn. App. at 766 - 767 (*citing Woo*, 161 Wn.2d at 53-54). Therefore, under the clear language of Liberty's policy, Liberty had a duty to defend.

⁸ Liberty's statement that: "Liberty was obligated to contribute up to 20 percent of the total defense costs (CP 1259.)" is also incorrect. (Liberty Brief, pg. 11). The trial court ruled that Liberty's share is 20%. (CP 1259.)

If Liberty wanted its umbrella policy to provide no defense in the event that any other insurer provides any defense to its insured, it could have explicitly drafted its policy to say so. Instead, Liberty asks the Court to accept a tortured interpretation of its policy and Washington law to excuse it from its contractual and legal duty to defend. Rather than rewriting Washington law to comport to Liberty's interpretation of its policy, Liberty could simply rewrite its policy to comport to its intentions and to Washington law.

D. Liberty Incorrectly Asserts: "Liberty Understood That Its Duty To Defend Was Not Triggered, And It Therefore Declined To Participate In The Defense."

Liberty's position is inconsistent with its historical facts and is inconsistent with its requirements under Washington law. As a matter of fact, Liberty never declined to accept its insureds' 2005 and 2006 tenders to participate in their defense. Instead, Liberty responded only to the first of its insureds' two tenders with its ten page discussion assessing its policy's indemnity exclusions and by asserting it "reserved any and all rights." (CP 863 – 872). Liberty failed to address its duty to defend in its tender response and failed to contribute for defense or to file a declaratory action to attempt to cut off its duty to defend. *See Am. Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 405 (2010). Liberty subsequently

settled its more limited duty to indemnify by contributing \$300,000. (Liberty Brief, pg. 8).

Liberty first expressly denied its duty to defend when it answered the Equitable Contribution Complaint.⁹ As for Liberty's statement that "Liberty understood that its duty to defend was not triggered, and it therefore declined to participate in the defense" (Liberty Brief, pg. 8, Par. 2), a more accurate statement is that Liberty actually responded to its insureds' tender by reserving its rights on indemnity and remaining totally silent on its duty to defend. (CP 863 – 872.) Granting Liberty the benefit of the doubt, and casting aside concerns raised by *Am. Best Food*, Washington law provided Liberty with three options to respond to the Wellingtons' tenders. (CP 358 – 63) and (CP 910 – 911.) They are: (1) accept the tender; (2) reject the tender, ("When an insured tenders the defense of a claim, one of the insurer's options is to decline the tender and refuse to defend the claim.") *Truck Ins. Exch.* 147 Wn. 2d at 761 or; (3) accept under a reservation of rights, file a declaratory action and defend until such coverage is resolved in the declaratory action. *Am. Best Food*, 168 Wn.2d at 405. Now, Liberty asks the Court of Appeals to sanction its

⁹ SUB 44, CP _.) Liberty's Answer to 3rd Amended Complaint, dated 10/2/09 (copy attached as Appendix B), See Supplemental Record.

fourth path. Liberty's fourth path was to: (1) reserve its rights to keep all options open; (2) provide no details on the rights it would later assert to defeat its duty to defend; (3) contribute nothing to defense costs, and; (4) file no declaratory action to spare itself the risk of an adverse ruling. Liberty's fourth path is impermissible. Washington law is clear that, "When the facts or the law affecting coverage is disputed, the insurer may defend under a reservation of rights until coverage is settled in a declaratory action. Once the duty to defend attaches, it is not cut off until it is clear that the claim is not covered." *Am. Best Food, Inc.* 168 Wn.2d at 405 (2010).

E. The Trial Court holding that "No Right Of Allocation Exists For The Defense Of Non-Covered Claims That Are 'Reasonably Related' To The Defense Of Covered Claims" is immaterial to Liberty's duty to defend.

In support of its quest to overturn the trial court's duty to defend determination, Liberty asserts that the trial court's holding that Lloyds had a duty to defend covered and uncovered claims because they were reasonably related meant there was no lack of "coverage" within the meaning of Section III.A.2 of Liberty's umbrella policy and thus Liberty had no duty to defend. Liberty's argument fails. As explained previously, Liberty's attempt to characterize the court's determination of a duty to

defend as a finding of “coverage” does not comport with Liberty’s policy language.

Liberty cites *Bordeaux* which quotes *Nordstrom*, a 9th Circuit case which holds that “an insurer has the right to allocate defense costs according to covered and uncovered claims in the underlying litigation.” *Nordstrom, Inc. v. Chubb & Son*, 820 F. Supp. 530, 532 (W.D. Wash. 1992). *Nordstrom* further holds that:

[A]n insurer is not entitled, however, to re-litigate an underlying action following a settlement. * * * Indeed, the *Nodaway* court stated: “It must be remembered, however, that the court is not required to resolve all fact and legal issues in the underlying case, but simply to determine what reasonable allocations should have been made, considering uncertainties in both fact and law known at the time of the settlement.” *Nodaway Valley Bank v. Continental Casualty Co.*, 715 F. Supp. 1458, 1465 (W.D. Mo. 1989).

Nordstrom, 820 F. Supp. at 535.

Had Liberty properly reserved its rights and defended its insured and filed a declaratory action in the underlying construction defect suit, then Liberty could have litigated the issue of whether the Lloyds and National Fire policies provided coverage for the allegations contained in the Wellington Complaint. Instead, Liberty waited over five years for NFM’s equitable contribution suit to deny its defense obligations. *See Am. Best Food, Inc.* 168 Wn.2d at 405. To the extent that Liberty is seeking to argue that the court’s allocation was improper this issue is not before the court. Liberty

has not appealed the trial court's equitable allocation for contribution, and National Fire has withdrawn its cross appeal.

F. The 6th Circuits Federal Mogul case does not follow Liberty's facts or Washington law.

Liberty relies on *Federal Mogul* to support its argument that it had no duty to defend the Complaint. The *Federal Mogul* case is not on point with the issue raised in this case. In the *Federal Mogul* case, the insured filed a complaint against its umbrella insurer alleging it had a duty to defend because the limits of its underlying insurer had been exhausted. The Sixth Circuit upheld the district court's judgment, which dismissed the complaint for failure to state a claim:

In its complaint, the Trust alleged that the Vellumoid claims "**fall within the scope of coverage,**"... of not only the Travelers Policy, but also the other two primary insurance policies held by the Trust. The complaint further alleged that "[t]hose primary insurers are defending the Trust with respect to Vellumoid asbestos-related bodily injury claims." These allegations are dispositive of the issue before us, for the plain language of the [Continental policy] provides that Continental must defend only where an occurrence is not covered by the underlying insurance listed in the schedule, "or any other underlying insurance collectible by the insured.". The Trust's claim that exhaustion of only the Travelers Policy triggers Continental's duty to defend under the DSSP is untenable because it ignores the words "or any other underlying insurance collectible by the insured."

Fed.-Mogul U.S. Asbestos Personal Injury Trust v. Continental Casualty Co., ___ F3d ___, (2011) LEXIS 13894, 9-10 (6th Cir. 2011)

(parentheticals omitted) (emphasis added). In the *Federal Mogul* case, the insured who was arguing that the umbrella insurer's duty to defend had been triggered, actually alleged in its complaint that the claims fell within the scope of coverage of each of its three primary policies. When Liberty invoked *Federal Mogul*, it stated that the court held "because the insured alleged that several primary insurers were defending, it could not state a claim for defense under the umbrella policy." (Liberty Brief, pg. 18.) However, Liberty only included the insured's allegations that the primary insurers were defending and omitted the allegations in which the insured alleged that the primary policies also provided coverage. What the court in fact found was that the umbrella insurer did not have a duty to defend because *Federal Mogul* alleged both that the claims "fall within the scope of coverage," as well as that the primary insurers were defending. *Id* (emphasis added).

Liberty spends much time arguing that the National Fire policy qualifies as "any other insurance providing coverage to the Insured" and uses the *Federal Mogul* case to support its argument that any primary insurer providing a defense will defeat the umbrella insurer's defense obligation. Liberty's argument is unavailing. Whether or not the National Fire policy qualifies as "any other insurance" is simply irrelevant because Liberty cannot prove that National Fire undisputedly "provided coverage"

for the claims asserted in the Complaint. Under Washington's strict standard for the "duty to defend" Liberty must prove that there was no potential for coverage under its policy. In order to do this, Liberty must prove both the Lloyds policy and the National Fire policy provided indemnity for each of the Complaint's claims against each of the Wellington defendants with no gap in coverage. This Liberty cannot do. Liberty can only prove that the trial court held Lloyds had a duty to defend and that Lloyds sent multiple reservation of rights letters outlining coverage defenses. As to coverage under the National Fire policy, Liberty can only prove that National Fire defended its insureds under a reservation of rights while asserting its right to deny coverage. Under Washington duty to defend law, Sixth Circuit case law with distinguishable facts will not change Liberty's policy language or Washington's law, which required Liberty to defend. Recent case law from neighboring jurisdictions interpreting cases better aligned with the facts of this case explicitly hold that when an umbrella insurer drops down to fill gaps in coverage, it acts as a primary insurer. *See Legacy Vulcan Corp.* 185 Cal. App. 4th at 689 and *Northwest Pipe Co.* 734 F. Supp. 2d at 1128. *Supra.*

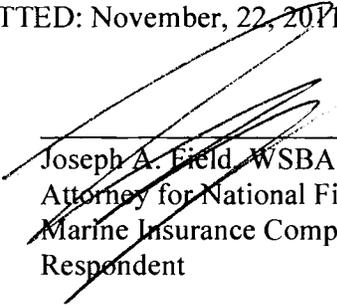
VI. CONCLUSION

Liberty's policy language obligates it to defend under Washington's well established law on an insurer's duty to defend. Liberty's umbrella

policy was operative in year-two and included coverage for acts excluded from Lloyds' underlying year-two policy. The Complaint alleged liability for these acts. National Fire's policy incepted in year three and excluded coverage for damages commencing prior to its inception. At the time the Complaint was filed, the potential existed for liability and the conceivability existed for coverage under Liberty's broad umbrella policy. When the Liberty policy dropped down to fill gaps in underlying coverage, Liberty's policy language obligated it to serve as a primary insurance policy. Thus, irrespective of whether or not other insurers defended, Liberty had a duty to defend.

The trial court correctly determined that Liberty had a duty to defend based on Liberty's policy language. If Liberty is unhappy with the burdens of its policy language under Washington law, it would be more appropriate for Liberty to amend its policy language than for this Court to amend Washington's well established case law. This Court should affirm the trial court's decision.

RESPECTFULLY SUBMITTED: November, 22, 2011



Joseph A. Field, WSBA No. 24705
Attorney for National Fire and
Marine Insurance Company,
Respondent

CERTIFICATE OF SERVICE

I, Joseph A. Field, am attorney for National Fire and Marine Insurance Company in this matter. I certify under penalty of perjury under the laws of the State of Washington, that on November 22, 2011, I served a true copy of the foregoing document on all counsel of record as indicated below.

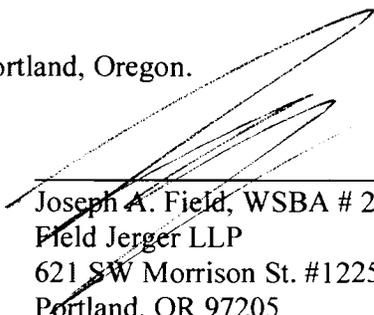
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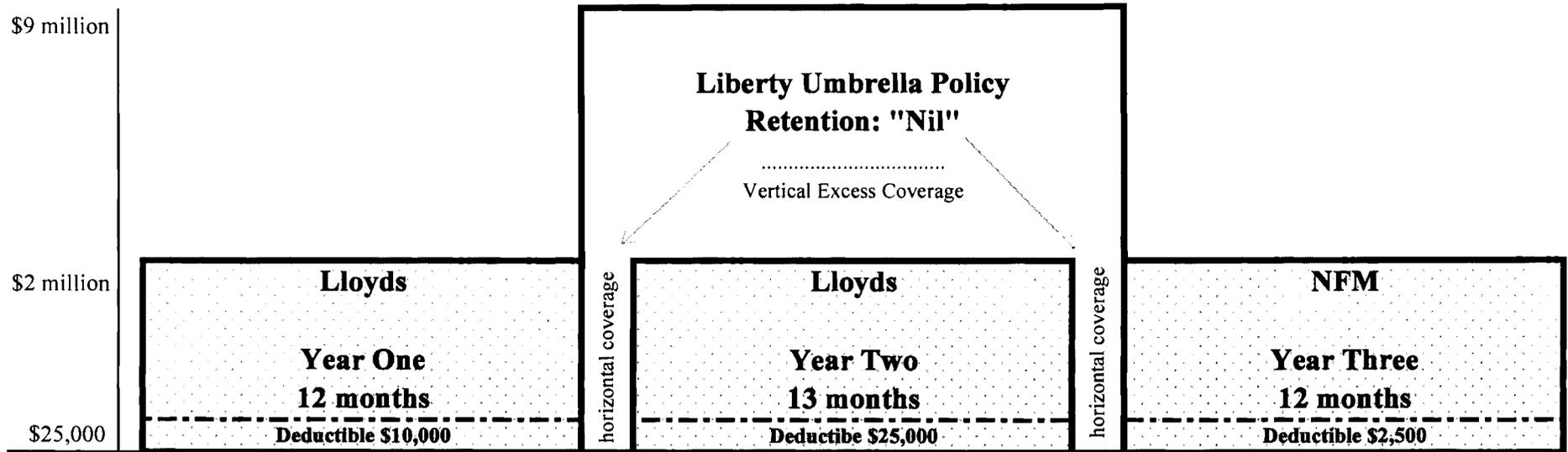
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APPENDIX ONE

NFM Appendix One: Wellington's Coverage Chart

Liberty Umbrella Policy provides:

- 1) Vertical excess coverage
- 2) Horizontal drop down coverage to fill gaps



APPENDIX TWO

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SUPERIOR COURT OF WASHINGTON
FOR KING COUNTY

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NATIONAL FIRE & MARINE)
INSURANCE COMPANY, a Nebraska)
corporation,)

NO. 08-2-27208-7 SEA

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Plaintiff,)

DEFENDANT LIBERTY MUTUAL)
INSURANCE COMPANY'S ANSWER)
TO THIRD AMENDED COMPLAINT)

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v.)

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CERTAIN UNDERWRITERS AT LLOYD'S)
LONDON, an English corporation which)
issued Policy No. A99BF021; LIBERTY)
MUTUAL INSURANCE COMPANY, a)
Massachusetts corporation; 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,)

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Defendants.)

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COMES NOW defendant Liberty Mutual Insurance Company and in answer to
plaintiff's Third Amended Complaint alleges as follows:

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LIBERTY MUTUAL'S ANSWER TO
THIRD AMENDED COMPLAINT - 1

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I. PARTIES

1. Answering paragraph 1, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

2. Answering paragraph 2, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

3. Answering paragraph 3, admits.

4. Answering paragraph 4, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

5. Answering paragraph 5, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

6. Answering paragraph 6, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

7. Answering paragraph 7, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

8. Answering paragraph 8, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

9. Answering paragraph 9, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

10. Answering paragraph 10, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

11. Answering paragraph 11, states it lacks sufficient information to admit or deny the allegations therein and therefore denies the same.

12. Answering paragraph 12, admits.

13. Answering paragraph 13, admits.

14. Answering paragraph 14, admits.

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CERTIFICATE OF SERVICE

I hereby certify that on October 2, 2009, I caused to be served a copy of the foregoing on the following person(s) in the manner indicated below:

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LIBERTY MUTUAL'S ANSWER TO
THIRD AMENDED COMPLAINT - 5

118923.0087/1743941.1

**Appendix Two
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LIBERTY MUTUAL'S ANSWER TO
THIRD AMENDED COMPLAINT - 6

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**Appendix Two
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DATED this 2nd day of October, 2009.

Heidi Carchano
Heidi Carchano

LIBERTY MUTUAL'S ANSWER TO
THIRD AMENDED COMPLAINT - 7

118923.0087/1743941.1

**Appendix Two
to National Fire
Response Brief**

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APPENDIX THREE

JAN 19 2010

THE HONORABLE REGINA CAHAN
Hearing Date: February 19, 2010
Hearing Time: 10:00 am

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SUPERIOR COURT OF WASHINGTON FOR KING COUNTY

NATIONAL FIRE & MARINE
INSURANCE COMPANY, a Nebraska
corporation,

Plaintiff,

v.

CERTAIN UNDERWRITERS AT LLOYD'S
LONDON, an English corporation which
issued Policy No. A99BF021; LIBERTY
MUTUAL INSURANCE COMPANY, a
Massachusetts corporation; MUTUAL OF
ENUMCLAW INSURANCE COMPANY, a
Washington corporation; THE OHIO
CASUALTY INSURANCE CO., an Ohio
corporation; and ZURICH AMERICAN
INSURANCE COMPANY, an Illinois
corporation,

Defendants.

NO. 08-2-27208-7 SEA

DEFENDANT LIBERTY MUTUAL'S
MOTION FOR SUMMARY JUDGMENT

I. INTRODUCTION AND RELIEF REQUESTED

COMES NOW Defendant Liberty Mutual Insurance Co. ("Liberty") and moves the Court for summary judgment dismissing National Fire & Marine Ins. Co.'s ("NFM") claim for equitable contribution. Both Liberty and NFM are insurers of Wellington Cheswick, LLC ("Wellington"). NFM is the primary insurer, while Liberty an excess insurer. In this action, NFM sues Liberty and others, and asserts that Liberty must contribute to the payment of

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1 certain defense costs which NFM paid in defense of Wellington. However, the terms of
2 Liberty's policy with Wellington required that Liberty indemnify and defend Wellington for
3 the amounts above the primary policy limits. Underlying Liberty's excess policy are primary
4 policies that had not been exhausted. Thus, under the express terms of its policy, Liberty's
5 duty to defend Wellington never triggered. Under Washington law, an insurer cannot be
6 compelled to equitably contribute to another insurer where the terms of its own policy would
7 not require it to indemnify or defend a mutual insured. Liberty, therefore, is entitled to
8 summary judgment, finding that it is not required to equitably contribute to the defense costs
9 incurred by NFM, and dismissing NFM's claim for equitable contribution.
10

11 **II. STATEMENT OF FACTS.**

12 **A. The Cheswick Lane Construction Defect Suit.**

13 From 2000 through 2002, Wellington Cheswick LLC ("Wellington"), a Washington-
14 based residential builder, built a multi-family condominium project in King County, called the
15 Cheswick Lane condominium community. See *NFM's Third Amended Compl.*, attached as
16 Exhibit B to the Declaration of Mark Beard ("Beard Dec.") at 4. In 2004, the Cheswick Lane
17 Condominium Owners' Association sued Wellington for alleged construction defects in the
18 design and construction of the condominium complex. *Id.* Upon commencement of the suit,
19 Wellington tendered its defense to its insurers. NFM and Liberty were two of several insurers
20 who had issued insurance policies to Wellington. *Id.*
21

22 **B. Primary Insurers: Lloyds of London and National Fire & Marine Ins. Co.**

23 Plaintiff NFM was one of Wellington's primary insurers and provided coverage to
24 Wellington during the years Wellington constructed the condominium community. *Beard*
25
26

1 Dec., Ex. B, at 4. As one of Wellington's primary insurers, NFM defended Wellington in the
2 Cheswick Lane suit and allegedly incurred \$1,457,188.17 in defense costs. *Id.* at 6.

3 Lloyds of London also issued to Wellington a commercial general liability primary
4 policy, Policy No. A01BF118. *See Beard Dec.*, Ex. B, at 4; *see also* "Schedule of Underlying
5 Insurance," attached as Exhibit A to Beard Dec. The Lloyds primary policy contained limits
6 of \$1 million per occurrence, and a \$2 million general aggregate limit per job/project. *Beard*
7 *Dec.*, Ex A at 22.

9 **C. The Excess Insurer — Liberty Mutual Ins. Co.**

10 Defendant Liberty insured Wellington as an excess insurer under a commercial
11 umbrella excess policy, Policy No. LQ1-B71-077026-011. *See generally Beard Dec.*, Ex A.
12 Liberty's policy with Wellington required Liberty to pay "those sums in excess of the
13 'Retained Limited' that [Wellington] becomes legally obligated to pay by reason of liability
14 imposed by law or assumed by [Wellington]" during the policy period. *Id.*, at 1. Thus,
15 Liberty's policy with Wellington provided that Liberty would be liable for only the excess of
16 the retained limit, or sums above and outside of the underlying policies:
17

18 We will be liable only for that portion of damages ... in excess of the "retained
19 limit," which is the greater of:

- 20 1. the total amounts stated as the applicable limits of the underlying
21 policies listed in the Schedule of Underlying Insurance and the
22 applicable limits of any other insurance providing coverage to the
23 "Insured" during the Policy Period; or
24 2. the amount stated in the Declarations as Self-Insured Retention as a
25 result of any one "occurrence" not covered by the underlying policies
26 listed in the Schedule of Underlying Insurance nor by any other
insurance providing coverage to the "Insured" during the Policy Period;

Beard Dec., Ex. A, at 2-3. The Schedule of Underlying Insurance referenced the commercial
general liability policy issued by Underwriters at Lloyds, with limits of \$1 million per

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1 occurrence and \$2 million general aggregate per job/project. *See Id.*, "Schedule of
2 Underlying Insurance."

3 Liberty's policy with Wellington policy provided that Liberty was not obligated to pay
4 defense costs unless and until its duty to indemnify came into effect. *Beard Dec.*, Ex. A at 3.
5 However, Liberty had the right to participate in settlement at its own expense to help defray
6 potential risks of continuing litigation.
7

8 We will, however, have the right and will be given the opportunity to
9 participate in the settlement, defense and trial of any "claim" or "suit" relative
10 to any "occurrence" which, in our opinion, may create liability on our part
under the terms of this policy. If we exercise such right, we will do so at our
own expense.

11 *Beard Dec.*, Ex. A, at 4.

12 **D. Settlement of the Cheswick Lane Lawsuit.**

13 The *Cheswick Lane* lawsuit proceeded to trial, and ultimately settled in August of
14 2006. *Beard Dec.* at ¶ 4 and Ex. B. at 5. Two of the primary insurers — NFM and Lloyds of
15 London — contributed *approximately* \$600,000 each toward the settlement. *Id.*, at ¶ 6.
16 Liberty contributed \$300,000 toward the global settlement of \$1,375,000. In its defense of
17 Wellington, NFM allegedly incurred \$1,457,188.17 in defense costs. These defense costs are
18 now the subject of NFM's equitable contribution action. NFM alleges that Liberty, among
19 others, is required to contribute a certain share of the \$1,457,188.17 in defense costs that
20 NFM paid. *Beard Dec.*, Ex. B at 6. NFM thus seeks a declaratory judgment finding that
21 Liberty has a defense obligation to Wellington, and that Liberty must therefore pay a share in
22 the total defense costs, even though neither of the primary insurance policies underlying
23 Liberty's policy have been exhausted.
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1 exhausted. Therefore, Liberty is not required to equitably contribute to NFM, because only
2 \$600,000 of the \$1 million per occurrence and the \$2 million per job/project general
3 aggregate available in the underlying Lloyd's policy was spent.

4 **A. Summary Judgment Standard.**

5 The fundamental purpose of summary judgment is to avoid a useless trial. *Davis v.*
6 *West One Automotive Group*, 140 Wn. App. 449, 456, 166 P.3d 807 (2007). A defendant is
7 entitled to summary judgment if the pleadings, affidavits, depositions, and admissions on file
8 demonstrate that there is no genuine issue of material fact and that the moving party is entitled
9 to summary judgment as a matter of law. CR 56(c); *Hutchins v. 1001 Fourth Ave. Assocs.*,
10 116 Wn.2d 217, 220, 802 P.2d 1360 (1991). All facts and reasonable inferences are viewed in
11 the light most favorable to the nonmoving party. *Atherton Condo. Apartment-Owners Ass'n*
12 *Bd. of Directors v. Blume Dev. Co.*, 115 Wn.2d 506, 516, 799 P.2d 250 (1990).

13 Once the moving party meets its burden of showing that there is no issue of material
14 fact, the burden shifts to the nonmoving party to come forward with admissible evidence
15 demonstrating that a genuine issue of material fact exists. *See Young v. Key Pharmaceuticals,*
16 *Inc.*, 112 Wn.2d 216, 225, 770 P.2d 182 (1989); *see also Landberg v. Carlson*, 108 Wn. App.
17 749, 753, 33 P.3d 406 (2001) (stating that summary judgment is a procedure to test the
18 existence of a party's evidence). If after viewing all the evidence reasonable minds could
19 reach but one conclusion, the court should grant summary judgment. *See Korslund v.*
20 *Dyncorp Tri-Cities Services, Inc.*, 156 Wn.2d 168, 177, 125 P.3d 119 (2005); *see also*
21 *Holiday Resort Community Ass'n v. Echo Lake Associates, LLC*, 134 Wn. App. 210, 219, 135
22 P.3d 499 (2006).

23 There is no issue of fact here. Underlying Liberty's excess policy is a commercial
24 general liability primary policy issued by Underwriters at Lloyds, providing limits of
25 \$1 million per occurrence and \$2 million per job/project general aggregate. Liberty and
26 Wellington contracted for an excess insurance policy, which would be triggered once the

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1 primary policy was expended. Lloyd's paid only \$600,000 in indemnifying Wellington, \$1.4
2 million less than the maximum policy level which would have triggered Liberty's duty to
3 defend.

4 Viewing this evidence in a light most favorable to NFM, reasonable minds can come
5 to but one conclusion: An excess insurer need not contribute to a primary insurer's defense
6 costs or indemnification costs where any underlying, primary insurer has not exhausted the
7 limits provided for within its policy. Liberty is an excess insurer who is being asked to
8 contribute to a primary insurer's defense costs, where another primary insurer did not exhaust
9 its funds. Liberty cannot be compelled to pay in contravention of its own policy. Liberty
10 should thus be granted summary judgment in its favor, dismissing plaintiff's claim for
11 equitable contribution.

12 **B. The Plain Terms of the Policies Here show that Liberty was an Excess**
13 **Insurer whose Duty to Defend had not been Triggered.**

14 The interpretation of an insurance policy is a question of law for the Court to decide.
15 *Weyerhaeuser Co. v. Aetna Cas. & Sur. Co.*, 123 Wn.2d 891, 897, 874 P.2d 142 (1994). If
16 possible, insurance policies are interpreted as a whole, with all parts of the insurance policy
17 harmonized and given effect. *U.S. Fire Ins. Co. v. Roberts & Schaefer Co.*, 37 Wn. App. 683,
18 686-87, 683 P.2d 600 (1984). If the language of the policy is clear and unambiguous, courts
19 enforce it as written, giving it a fair, reasonable and sensible construction. *Tuttle v. Allstate*
20 *Ins. Co.*, 134 Wn. App. 120, 126-27, 138 P.3d 1107 (2006).

21 The excess policy issued between Liberty and Wellington is sufficiently clear for the
22 Court to interpret it according to its plain meaning and to conclude that Liberty is not required
23 to defend Wellington. First, Liberty and Wellington undoubtedly had an excess policy, as it is
24 clearly stated on its cover page. By its express, written terms, Liberty was required to
25 indemnify and defend Wellington for only "those sums in excess of the 'Retained Limit'" of
26 the underlying policies. Second, the policy clearly identifies the underlying insurance

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1 policies, the exhaustion of which is a condition precedent to the triggering of Liberty's duty to
2 defend. The Lloyd's policy, which was not extinguished in the Wellington construction
3 defect suit, is the first commercial general liability policy listed, with a \$1 million per
4 occurrence and \$2 million per job/project aggregate limit. Thus, there is no question when
5 viewing this policy that Liberty's excess policy was intended by both Liberty and Wellington
6 to be in effect only after the underlying, primary Lloyd's policy had been exhausted.

7 **C. An Excess Insurer is not Liable to Pay the Insured's Defense Costs Where**
8 **its Policy Mandates that it Pay Only After Primary Insurer's have**
9 **Exhausted their Policies.**

10 An insurer's duty to defend its insured arises when the complaint is filed and if the
11 allegations, if proven, would fall within the coverage of the policy. *E-Z Loader Boat Trailers,*
12 *Inc. v. Traveler's Indemnity Co.*, 106 Wn.2d 901, 908, 726 P.2d 439 (1986) (en banc). An
13 excess insurer's obligation to defend the insured "is generally defined by the [terms of the]
14 excess policy." *Weyerhaeuser Co. v. Commercial Union Ins. Co.*, 142 Wn.2d 654, 690, 15
15 P.3d 115 (2001). In accordance with the policy, an excess insurer's duty to defend will
16 typically "arise when: (1) the claim is covered under the language of the excess policy; (2) the
17 excess policy does not expressly eliminate a defense obligation; and (3) the coverage and
18 obligations of the underlying insurer's have been validly exhausted." *Id.* (internal citations
19 omitted).

20 Thus, after reviewing the policy, the general rule in Washington is that the excess
21 insurer's obligation does not arise until the primary policy is spent. *Millers Casualty Ins. Co.*
22 *of Texas v. Briggs*, 100 Wn.2d 9, 13, 665 P.2d 887 (1983) (en banc) ("It is equally well
23 established that the liability of the excess insurer does not arise until after the limits of the
24 coverage under the primary policy have been exceeded."); *see also Rees v. Viking Ins. Co.*, 77
25 Wn. App. 716, 719, 892 P.2d 1128 (1995) ("An excess carrier's obligation to pay and defend
26 begins when, and only when, the limits of the primary insurance policy are exhausted."); *U.S.*

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1 *Fire Ins. Co. v. Roberts & Schaefer Co.*, 37 Wn. App. 683, 689, 683 P.2d 600 (1984) (“The
2 general rule, followed by the trial courts in this state, is that the excess insurer’s duty to
3 defend does not arise until the primary insurer has exhausted its obligation.”).

4 The policy purposes underlying this rule rest on basic notions of fairness: “If an
5 excess insurer were required to defend before exhaustion of an underlying carrier’s duty, the
6 ‘primary carrier would profit from its wrongful failure to defend.’” *Weyerhaeuser Co.*, 142
7 Wn.2d at 690 (quoting *Truck Ins. Exch. of Farmers Ins. Group v. Century Indem. Co.*, 76 Wn.
8 App. 527, 531, 887 P.2d 455 (1955)). It would be wrongful because “a mere tendering of
9 policy limits does not abrogate an underlying insurer’s duty to defend.” *Id.* at 691. A primary
10 insurer has a duty, after all, to defend its insured up to its policy limits, and only after “the
11 underlying insurer has paid its limits in *settlements or judgments*, the supplemental insurer’s
12 obligation to defend arises.” *Id.* at 690. *See also Cadet Mfg. Co. v. American Ins. Co.*, 391 F.
13 Supp. 2d 884, 891 (W.D. Wash. 2005) (“Once the underlying insurer has paid its limits in
14 settlements or judgments, the excess insurer’s obligation to defend arises.”).

15 Liberty was not required to defend Wellington. Under the three conditions under
16 *Weyerhaeuser*, the third factor — namely the coverage and obligations of the underlying
17 insurers — had not been validly exhausted. So, while Wellington’s claim may have been
18 within the scope of the policy, Liberty’s obligation simply had not arisen, given that the
19 primary insurers had not exhausted their policy limits.

20 **D. Even if one Primary Insurer Exhausts its Policy Limits, an Excess Insurer**
21 **Need Not Equitably Contribute to the Other Primary Insurer Until the**
22 **Remaining Primary Insurers have Exhausted their Own Policy Limits.**

23 Even though one of the underlying insurers has paid its policy limits, an excess insurer
24 is not obligated to equitably contribute to that insurer’s costs so long as there are other
25 primary insurer’s policies underlying the excess insurer’s policy, and the other primary
26 insurers have not exhausted their policies. In *Polygon Nw. Co. v. American National Fire Ins.*

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1 Co., 143 Wn. App. 753, 189 P.3d 777 (2008), the primary insurer brought an action for
2 equitable apportionment of defense costs among the primary and excess insurers arising out of
3 a settlement in a construction defect case. *Id.* at 761. Polygon Northwest was a home-builder
4 with a \$4 million primary insurance policy, and with excess policies triggering for liability
5 above the \$4 million threshold. *Id.* One of Polygon's primary insurers became insolvent,
6 leaving it with only \$2 million in actual coverage and a \$2 million gap before excess coverage
7 was triggered. *Id.* at 763. Given the \$2 million gap between primary and excess coverage,
8 the other primary insurer sought to have the trial court cover that \$2 million gap by
9 apportioning defense costs among the excess insurers. *Id.* at 763-64. The trial court
10 apportioned the \$2 million gap among the excess insurers. *Id.* at 766.

11 The Court of Appeals reversed, stating: "The trial court's task in crafting its
12 contribution award was not to distribute among the various excess insurers the 'gap' in
13 coverage created by [the primary insurer's] insolvency but, rather, was to *define each*
14 *insurer's liability* for the covered loss according to the terms of its policy or policies." *Id.* at
15 778 (emphasis in original). The appellate court described the contours of Washington's rule:

16 Washington law does not, in fact, force insurers to pay for losses that they have not
17 contracted to insure. Rather, the contours on an insurer's coverage obligations are
18 defined by the specific language of the insurance contract interacting with the type of
19 loss suffered by the insured.

20 *Id.* at 775. The Court recognized the inherent inequity in making an insurer pay for that
21 which it did not contract to insure: "An insurer sued for contribution by another insurer cannot
22 be held liable for a sum greater than it would have had to pay its insured." *Id.* at 80.

23 Washington law does not mandate that Liberty pay defense costs or losses which it did
24 not contract to insure. NFM was contractually obligated, as Wellington's primary insurer, to
25 pay its defense costs. Other primary insurers were also contractually obligated to pay
26 Wellington's defense costs. As an excess insurer, Liberty was contractually required to
indemnify and defend only when the primary coverage had been exhausted. Not all the

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1 primary policies reached their limits. The Lloyds of London policy is \$1.4 million shy of
2 general aggregate limit. Therefore, Liberty cannot be compelled to indemnify Wellington.
3 Any ruling to the contrary would be unfair to Liberty, because it would require Liberty to
4 defend and indemnify where (a) it had not contractually agreed to do so, and (b) another
5 primary insurer had not fulfilled its obligation to defend Wellington.

6 **VI. CONCLUSION.**

7 Liberty is an insurer that contracted with Wellington to provide an excess layer of
8 insurance after the underlying policies had been exhausted. In the *Cheswick Lane* suit, at least
9 one underlying policy — a commercial general liability policy issued by the Underwriters at
10 Lloyds — had not been entirely spent. Of the \$1 million per occurrence and \$2 million
11 general aggregate per job/project available, Lloyds expended only \$600,000. So, even if
12 NFM has exceeded its policy limits, this equitable contribution action casts too wide of a net
13 by seeking to require Liberty to contribute to defense costs. An excess insurer need not
14 contribute to defense costs for an insured where it would be contrary to the terms of its policy.
15 Liberty's policy with Wellington required Wellington to pay once the primary policies have
16 been exhausted. Not all the primary policies have been exhausted. Therefore, Liberty is not
17 required to contribute to NFM's defense claims. This Court should accordingly grant
18 Liberty's motion for summary judgment, finding that Liberty is not required to equitably
19 contribute to any amounts expended by NFM.
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DATED: January __, 2010

LANE POWELL PC

By 
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