

No. 86535-3

RECEIVED BY E-MAIL

IN THE SUPREME COURT OF THE STATE OF WASHINGTON

NATIONAL SURETY CORPORATION,

Plaintiff/Petitioner,

vs.

IMMUNEX CORPORATION,

Defendant/Respondent.

FILED W
SUPREME COURT
STATE OF WASHINGTON
2012 APR 16 A 10:17
BY RONALD R. CARPENTER
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BRIEF OF AMICUS CURIAE
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ORIGINAL

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I. IDENTITY AND INTEREST OF AMICUS CURIAE

The Washington State Association for Justice Foundation (WSAJ Foundation) is a not-for-profit corporation organized under Washington law, and a supporting organization to the Washington State Association for Justice (WSAJ). WSAJ Foundation is the new name of Washington State Trial Lawyers Association Foundation (WSTLA Foundation), a supporting organization to Washington State Trial Lawyers Association (WSTLA), now renamed WSAJ. WSAJ Foundation, which operates the amicus curiae program formerly operated by WSTLA Foundation, and has an interest in the rights of insureds under Washington law.

II. INTRODUCTION AND STATEMENT OF THE CASE

This review involves the question of the extent to which a liability insurer is responsible for defense costs when it defends under a reservation of rights and it is ultimately determined in a declaratory judgment action between insurer and insured that no duty to defend exists under the policy.

This case arises out of a declaratory judgment action brought by National Surety Corporation (National Surety) against Immunex Corporation (Immunex). In this action, National Surety sought a determination of its obligations under umbrella and excess liability insurance policies issued to Immunex. The underlying facts are drawn from the Court of Appeals opinion and the briefing of the parties. See Nat'l Sur. Corp. v. Immunex Corp., 162 Wn.App. 762, 256 P.3d 439 (2011), *review granted*, 173 Wn.2d 1006 (2012); Immunex Br. at 5-15;

National Surety Br. at 3-11; Immunex Reply & Cross-Respondent Br. at 4-5; National Surety Reply Br. as Cross-Appellant at 1-4; National Surety Pet. for Rev. at 2-7; Immunex Ans. to Pet. for Rev. & Cross-Pet. for Rev. at 1-3; National Surety Ans. to Cross-Pet. for Rev. at 1-4; National Surety Supp. Br. at 1; Immunex Supp. Br. at 1-4.

For purposes of this amicus curiae brief, which only addresses the issues before the Court in the abstract, the following facts are relevant: Immunex was sued by third parties and tendered the defense of these claims to National Surety, also seeking reimbursement for defense expenditures already incurred. National Surety notified Immunex by letter that it was defending under a “reservation of rights,” and “expressly stated in that letter that it reserved the right to recoup amounts paid in defense if a court ultimately determined that National Surety had no duty to defend.” Immunex, 162 Wn.App. at 774.¹ The National Surety policies do not contain any provision allowing it a right of recoupment. See id. at 777; Immunex Supp. Br. at 3, 6. While National Surety agreed to reimburse Immunex for certain defense costs it incurred, National Surety simultaneously initiated this declaratory judgment action against Immunex contending that it has no duty to defend, further asserting that Immunex’s tender of the defense was late and prejudicial to National Surety’s rights.

Throughout this course of events, Immunex continued to be represented by legal counsel it retained, both before and after tender.

¹ The reservation of rights letter is not set forth in the briefing, but the recoupment language of the letter is quoted in the National Surety Pet. for Rev. at 5 n.2.

On cross-motions for summary judgment, National Surety argued below that it has no duty to defend under the policy. Immunex contended the duty to defend applies and that it is entitled to reimbursement for legal costs incurred since the filing of the complaints in the underlying actions. National Surety countered that any reimbursement obligation only dates from Immunex's tender of the claims, and does not relate back to the commencement of the various actions. National Surety also argued that, in any event, tender of the claims was late and prejudiced National Surety's rights and that, as a consequence, it is relieved of any duty to reimburse defense costs. In turn, Immunex asserted that its tender was in fact timely, and that, even if late, National Surety suffered no prejudice.

The superior court determined that National Surety does not owe Immunex a duty to defend, but is responsible for reimbursement of Immunex's defense costs from the time of the filing of the various actions up until the court determination that no duty to defend exists.² The court denied National Surety's claim of prejudice as a matter of law, and determined that the issues of whether Immunex's tender was timely and whether National Surety suffered any prejudice as a result of an untimely tender were matters for trial.

The Court of Appeals affirmed on all bases. It concluded National Surety owes no duty to defend, but that it is liable for defense costs

² Based on the superior court's determination regarding the duty to defend, the parties apparently agreed to a stipulated order that National Surety has no duty to indemnify under the policy (subject to revocation if the partial summary judgment regarding the duty to defend is reversed). See Immunex Br. at 14-15.

incurred from the time of filing of the various actions up to the superior court determination that National Surety does not owe a duty to defend. The court held that the issues of late tender and prejudice required trial.

Both parties sought review before this Court. Immunex's petition seeking review of the duty to defend determination was denied, and the Court of Appeals' resolution of this issue is now the law of the case. National Surety's petition challenging the Court of Appeals' determination regarding reimbursement of defense costs and the late tender/prejudice issues was granted.

III. ISSUES PRESENTED

- 1.) Under Washington law, is the nature and scope of a liability insurer's duty to defend altered when the insurer defends the insured under a "reservation of rights?"
- 2.) Under Washington law, may a liability insurer that defends the insured under a reservation of rights seek to recoup the costs of the defense once a court determines in a declaratory judgment action that no duty to defend is owed by the insurer? In resolving this issue, does it matter that the insurer's reservation of rights specifies that the insurer will seek recoupment from the insured for defense costs following a court determination that the insurer owes no duty to defend?

IV. SUMMARY OF ARGUMENT

When a liability insurer defends its insured under a reservation of rights it acknowledges the duty to defend applies pending a final determination by a court. The reservation of rights notifies the insured the insurer may or will challenge whether the duty to defend applies under the circumstances. If it is later determined in a declaratory judgment action between insurer and insured that the insurer does not owe a duty to defend,

this determination applies prospectively only, and the insurer cannot seek to recover prior defense costs because the duty to defend was in effect at that time.

An insurer cannot avoid this result by conditioning its defense under a reservation of rights on a right to reimbursement for the costs of defense provided under the reservation because there is no consideration for the reservation of rights. The reservation of rights simply avoids a later claim by the insured that the insurer waived or is estopped to deny a duty to defend by providing a defense. The insured's contractual duty to defend is unaltered. Moreover, such a reimbursement provision is unenforceable as violative of the "equal consideration" rule adopted by this Court in Tank v. State Farm, 105 Wn.2d 381, 386, 715 P.2d 1133 (1986), because the provision exalts the insurer's financial interest over that of the insured, while at the same time potentially causing the insured undue concern and uncertainty about ultimate responsibility for the costs of defense that may adversely impact resolution of the underlying claim.

V. ARGUMENT

Introduction

This argument addresses the issue of the responsibility of a liability insurer (or insurer) that defends under a reservation of rights for the costs of defense up to the point a court determines that the duty does not apply. Although the issue arises here in the context of an insured's request for reimbursement, the Court of Appeals below correctly notes:

[T]he fact that National Surety had not, at the time of the trial court ruling, actually paid the costs of Immunex's defense cannot support a different result here than in a case where the insurer had already provided a defense. It would be unfair to refuse recoupment to an insurer who actually provided a defense while excusing an insurer from reimbursing an insured who undertook its own defense.

Immunex, 162 Wn.App. at 777; see also Immunex Supp. Br. at 13-14 & n.8. Based on this premise, and for the sake of simplicity, the argument below addresses the overarching legal issues presented here as if the insurer were seeking recoupment of defense costs incurred up until the point of the court determination that no duty to defend exists.³

V. ARGUMENT

A. Overview Of Washington Law Regarding A Liability Insurer's Duty To Defend, And The Nature Of A Reservation Of Rights Defense.

Insurance contracts are unique in that they are affected by the public interest and abound with public policy considerations. See RCW 48.01.030; Oregon Auto Ins. Co. v. Salzberg, 85 Wn.2d 372, 376-77, 535 P.2d 816 (1975).⁴ These public policy considerations significantly impact policy interpretation. Governing statutes are read into and become part of the contract of insurance, see Mid-Century Ins. Co. v. Henault, 128

³ National Surety argues that Immunex's tender of the claim was late and that it was actually and substantially prejudiced by the late tender. This is a separate defense available to insurers that relieves them from the otherwise applicable duty to defend. See Mut. of Enumclaw v. USF Ins. Co., 164 Wn.2d 411, 417-26, 191 P.3d 866 (2008); Griffin v. Allstate Ins. Co., 108 Wn.App. 133, 139-41, 29 P.3d 777 (2001), *review denied*, 146 Wn.2d 1005 (2002); Unigard Ins. Co. v. Leven, 97 Wn.App. 417, 427, 983 P.2d 1155 (1999), *review denied*, 140 Wn.2d 1009 (2000). The issues of whether the tender by Immunex was late and whether any late tender prejudiced National Surety's rights arise only if the Court first determines National Surety is liable for pre-tender defense costs under its policy, and appears to involve application of settled law to these facts. WSAJ Foundation does not address the late tender/prejudice issues in this brief.

⁴ The current version of RCW 48.01.030 is reproduced in the Appendix to this brief.

Wn.2d 207, 212, 905 P.2d 379 (1995) (involving UIM statute, RCW 48.22.030); and ambiguous insurance policy provisions are interpreted in a light most favorable to the insured, see Moeller v. Farmers Ins. Co., 173 Wn.2d 264, 270, 267 P.3d 998 (2011).

With respect to a liability insurer's duty to defend its insured, a series of interpretive rules protect the insured's interest in this context. The duty to defend is recognized as one of the main benefits of the insurance policy, and the rights thereunder are broader than those related to the duty to indemnify (or pay). See Woo v. Fireman's Fund Ins. Co., 161 Wn.2d 43, 52-54, 164 P.3d 454 (2007). The duties to defend and indemnify are separate obligations of the insurer under the insurance policy. Thus, the duty to defend may be, and often is, triggered in instances where it is ultimately determined there is no duty to indemnify. See Kirk v. Mount Airy Ins. Co., 134 Wn.2d 558, 564, 951 P.2d 1124 (1998); Truck Ins. Exch. v. VanPort Homes, 147 Wn.2d 751, 760, 765, 58 P.3d 276 (2002).

The duty to defend arises when a formal claim is made against the insured, typically when a complaint is filed in the underlying action. See Kirk, 134 Wn.2d at 561; Mut. of Enumclaw v. USF Ins. Co., 164 Wn.2d 411, 420-21, 191 P.3d 866 (2008). Under Washington's complaint allegation rule, the liability insurer has a duty to defend if there is a *conceivable* basis for coverage based on the allegations in the complaint in the underlying action. See Woo, 161 Wn.2d at 53-60. The allegations of

the complaint are liberally construed in determining whether a duty to defend exists. See American Best Food, Inc. v. Alea London, Ltd., 168 Wn.2d 398, 404-05, 229 P.3d 693 (2010). If it is not clear from the face of the complaint that there could be coverage, then “the insurer *must* investigate and give the insured the benefit of the doubt that the insurer has a duty to defend.” Woo at 53 (emphasis in original). The insurer may rely on facts extrinsic to the complaint to trigger the duty to defend, but it may not rely on such facts to deny a defense. See id. at 54.

The duty to defend applies until a court determines that the underlying claim is clearly not covered. See Alea, 168 Wn.2d at 405. When any reasonable interpretation of the facts alleged in the complaint or the applicable law support coverage, the insurer must provide a defense. See id. These rules stem from the insurer’s obligation not to put its own interests ahead of its insured’s. See id.

An insurer that fails or refuses to defend is subject to a claim for insurance bad faith and coverage by estoppel if it is subsequently determined that the duty to defend applies, even though the insurer may not have a duty to indemnify under the policy. See Truck Ins., 147 Wn.2d at 759. Consequently, a liability insurer’s failure or refusal to defend can have drastic consequences. However, the insurer is not without a safe harbor. If there is uncertainty regarding the duty to defend, the insurer may choose to defend under a “reservation of rights,” and initiate a declaratory judgment action seeking a determination that the duty to

defend does not apply. An insurer invoking the reservation of rights device thereby avoids potential liability for insurance bad faith in failing to defend the insured. As explained in Truck Ins.:

Once the duty to defend attaches, insurers may not desert policyholders and allow them to incur substantial legal costs while waiting for an indemnity determination. *Kirk*, 134 Wn.2d at 563, 951 P.2d 1124. If the insurer is unsure of its obligation to defend in a given instance, it may defend under a reservation of rights while seeking a declaratory judgment that it has no duty to defend. *Grange Ins. Co. v. Brosseau*, 113 Wn.2d 91, 93-94, 776 P.2d 123 (1989). A reservation of rights is a means by which the insurer avoids breaching its duty to defend while seeking to avoid waiver and estoppel. "When that course of action is taken, the insured receives the defense promised and, if coverage is found not to exist, the insurer will not be obligated to pay." *Kirk*, 134 Wn.2d at 563 n. 3, 951 P.2d 1124.

147 Wn.2d at 761; accord Alea at 405.

An insurer's reservation of rights is usually accomplished by a letter from the insurer to the insured, the purpose of which is to notify the insured that although the insurer is presently honoring its duty to defend, it may or will seek a determination that the duty to defend does not apply. See Thomas V. Harris, Washington Insurance Law §17.03 at 17-9 & 17-10 (3rd ed. 2010) (recognizing reservation of rights usually achieved by a letter and does not require the consent or agreement of the insured).

The issuance of a reservation of rights letter does not alter the liability insurer's obligation to the insured during the time that it provides the defense. As explained in Tank, an insurer defending under a reservation of rights:

owes the same duty of good faith to its insured, regardless of the type of defense it has undertaken. The Court of Appeals in [*Weber v. Biddle*, 4 Wn.App. 519, 524, 483 P.2d 155 (1971)], specifically found no distinction between the two type of defenses:

‘A reservation of rights agreement is not a license for an insurer to conduct the defense of an action in a manner other than [the manner in which] it would normally be required to defend. The basic obligations of the insured remain in effect.’

The ‘basic obligations’ referred to in *Weber* amount to a duty of good faith. We have seen that the duty of good faith of an insurer requires fair dealing and equal consideration for the insured’s interests. Thus, under *Weber*, the same standard of fair dealing and equal consideration is unquestionably applicable in a reservation of rights defense.

105 Wn.2d at 387 (first bracket added); see also Truck Ins. at 761.

B. Because The Insurer Defending A Claim Under A Reservation Of Rights Is Fulfilling Its Duty To Defend Under The Policy, A Court Determination That The Duty Does Not Exist Only Applies Prospectively.

National Surety argues that under Washington law an insurer’s duty to defend under the reservation of rights does not emanate from the insurance policy, but instead is some form of provisional “good faith” duty to defend imposed by this Court’s opinions in Woo and Alea, supra. See National Surety Pet. for Rev. at 8-11; National Surety Supp. Br. at 2-8. At the same time, National Surety makes the related argument that a court determination that no duty to defend exists relates back to the inception of the claim, as though the duty to defend never existed under the policy. See National Surety Pet. for Rev. at 8-9. In making these arguments,

National Surety misapprehends the nature of the duty to defend, as explained by this Court.

Under the principles governing the duty to defend explained in §A, a defense under a reservation of rights is based on the insurance policy itself. The duty to defend is broader than the duty to indemnify, based on *conceivable*, not *actual*, coverage, and it applies until it is determined that the claim is clearly not covered. See Alea, 168 Wn.2d at 404; Woo, 161 Wn.2d at 52-53. Providing a defense under a reservation of rights allows the insurer to “avoid[] breaching its duty to defend,” while at the same time reserving its right to contest coverage. See Truck Ins., 147 Wn.2d at 761; accord Woo at 54 (citing Truck Ins.); Alea at 405 (quoting Truck Ins.). Otherwise, the insurer’s selection of defense counsel, negotiation of the terms of engagement, and management and control of the defense, among other things, would give rise to “waiver and estoppel” of the right to challenge its obligation to defend. See Truck Ins. at 761.

The duty to defend arises from the insurance policy itself, not some free-floating duty of good faith. See Woo at 54 (describing the duty to defend as “a valuable service paid for by the insured and one of the principal benefits of the liability insurance policy”). Woo and Alea both make clear that the duty to defend arises from the insurance policy. See also Tank, 105 Wn.2d at 387 (confirming that under a reservation of rights defense “[t]he basic obligations of the insurer remain in effect,” quoting

Weber v. Biddle, 4 Wn.App. at 524); Truck Ins. at 761; Harris, *supra* §17.01 at 17-1 & n.1.

The very nature of the insurer's reservation of rights letter reflects this understanding. The insurer acknowledges an existing duty to defend but reserves the right to challenge application of the duty under the particular facts and circumstances. Although it has its doubts, which may be voiced in a declaratory judgment action seeking to extricate it from the duty to defend, the insurer chooses to honor the duty rather than taking the risk involved in not defending and being liable for insurance bad faith and coverage by estoppel, if it is proven to be wrong in its assessment of the circumstances.

Nor does Washington case law support the notion that a court determination that the duty to defend does not apply relates back to the inception of the claim, rendering the duty inapplicable *ab initio*. As Woo makes clear, an insurer defending under a reservation of rights "must bear the expense of defending the insured." 161 Wn.2d at 54. The duty, and expenses associated with it, end when the court determines there is no conceivable basis for coverage, and not before. Otherwise, the duty to defend would be coextensive with the duty to indemnify, and the insured would lose what may well be the most valuable benefit of the insurance policy.

National Surety argues that this view of the insurer's duty to defend is unsupportable because the insured is receiving a policy benefit

(an interim defense) that the insurer did not contract to provide and for which the insured paid no premium. See National Surety Supp. Br. at 6-7. This argument fails for several reasons. Initially, there is nothing in the briefing that suggests National Surety did not factor into its premium structure instances such as this, where it must provide a defense on a claim it considers doubtful pending court determination whether the duty to defend does or does not apply. However, even if National Surety failed to take this type of situation into account in calculating premiums because it misapprehended its duty to defend under the policy, this would not excuse it from being required to fulfill its obligation. See Ames v. Baker, 68 Wn.2d 713, 717, 415 P.2d 74 (1966) (holding insurer cannot escape policy obligation based on what it intended to provide insured). In any event, the situation involved in this case hardly presents an unforeseeable course of events. Insurers are frequently faced with choosing whether to defend under a reservation of rights and seek relief from the court regarding the obligations to defend and indemnify, with the prospect that they will be responsible for costs incurred in defending their insureds while the duty remains in effect.

Under Washington law, a court declaration that the duty to defend does not apply is prospective only. Up to the point where a court determines the duty to defend does not apply, it remains in full force and effect.

C. A Provision In An Insurer's Reservation Of Rights Letter Specifying The Insurer May Recoup Defense Costs Incurred If It Is Ultimately Determined No Duty To Defend Exists Is Without Legal Effect, And Otherwise Violates The "Equal Consideration" Rule Adopted In *Tank*.

Under the analysis in §B, if correct, a court determination that the duty to defend does not apply only operates prospectively. The defense provided before that determination, pursuant to a reservation of rights, fulfills the insurer's obligation under the policy. Consequently, there is no basis for seeking reimbursement for providing this policy benefit. See Harris, supra §17.01 at 17-1 & 17-2.⁵

Nonetheless, National Surety argues that, although its policy does not contain a reimbursement provision, an insurer may seek reimbursement when it includes a statement of its intent to do so in its reservation of rights letter.⁶ This argument should be rejected. Under Washington law, the reservation of rights letter is a mere *notice* by the insurer forewarning the insured that the insurer may or will challenge the

⁵ In Holly Mtn. Resources, Ltd. v. Westport Ins. Corp., 130 Wn.App. 635, 104 P.3d 725 (2005), *disapproved on other grounds*, Am. Best Food, Inc. v. Alea London, 168 Wn.2d 398, 229 P.3d 693 (2010), the court stated "[a] reservation of rights is a means by which the insurer conditionally defends its insured, *subject to potential reimbursement by the insured upon later discovery that there was no duty to defend.*" (Emphasis added.) The highlighted language would appear to support recoupment of defense costs by the insurer from the insured. Holly Mtn. does not provide any authority for this proposition, but in context it appears to be relying on Truck Ins. See Holly Mtn., 130 Wn.App. at 652 n.8. Truck Ins. does not address recoupment, but it quotes language from Kirk stating "[w]hen that course of action is taken [i.e., defense under a reservation of rights], *the insured receives the defense promised and, if coverage is found not to exist, the insurer will not be obligated to pay.*" Truck Ins., 147 Wn.2d at 761 (quoting Kirk, 134 Wn.2d at 563 n.3; brackets & emphasis added). This language from Kirk seems to refer to the duty to indemnify rather than the duty to defend, and, in light of the language referring to the "promised" defense, it does not support a right to recoup defense costs. See Kirk at 565 n.3.

⁶ Whether a policy provision providing the insurer with a right of reimbursement is enforceable in an adhesion contract setting is unclear, and resolution of this question must await the proper case.

duty to defend, thereby avoiding a claim of waiver or estoppel of the right to contest the duties to defend and indemnify. The reservation of rights letter is not supported by consideration and it cannot alter the terms of the insurance policy. See Stauffer v. Northwestern Mut. Life Ins. Co., 184 Wash. 431, 436-38, 51 P.2d 390 (1935) (holding attempted modification of life insurance contract unenforceable in absence of consideration); Grand Lodge of Scandinavian Fraternity v. United States Fid. & Guar. Co., 2 Wn.2d 561, 572, 98 P.2d 971 (1940) (holding attempted modification of fidelity bond unenforceable in absence of consideration).

More importantly, in asserting an entitlement to recoup defense costs, an insurer violates the “equal consideration” rule adopted in Tank, 105 Wn.2d at 486-88, by exalting its financial interests over those of the insured, while also violating its duty of good faith by causing the insured undue concern and uncertainty about ultimate responsibility for the costs of defense. The insurer’s financial interests are favored because it is asserting a right of reimbursement otherwise unavailable under its policy. At the same time, it undermines the insured’s interests because concern and uncertainty about defense costs may well adversely impact resolution of the underlying claim. For example, when the defense is being provided under a reservation of rights, the insured carries the primary responsibility for attempting to settle the underlying claim. See Harris, supra §17.07 at 17-20 to 17-21. In this instance, the insured’s perception of the amount of

monies available to both settle the claim and reimburse the insurer for defense costs could influence settlement negotiations.

A reimbursement provision in an insurer's reservation of rights letter is unenforceable under Washington law.

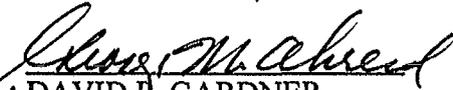
VI. CONCLUSION

The Court should consider the arguments advanced in this brief in resolving the issues on review.

DATED this 9th day of April, 2012.


FOR BRYAN P. HARNETIAUX,
WITH AUTHORITY


GEORGE M. AHREND


FOR DAVID B. GARDNER,
WITH AUTHORITY

On Behalf of
WSAJ Foundation

Appendix

APPENDIX

RCW 48.01.030. Public interest

The business of insurance is one affected by the public interest, requiring that all persons be actuated by good faith, abstain from deception, and practice honesty and equity in all insurance matters. Upon the insurer, the insured, their providers, and their representatives rests the duty of preserving inviolate the integrity of insurance.

[1995 c 285 § 16; 1947 c 79 § .01.03; Rem. Supp. 1947 § 45.01.03.]

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Subject: Nat'l Surety v. Immunex Corp. (S.C. #86535-3)

Dear Mr. Carpenter:

On behalf of the Washington State Association for Justice Foundation, a proposed amicus curiae brief in the above referenced case is attached to this email. A letter request to appear as amicus curiae was previously emailed on April 6, 2012. Counsel for the parties are being served simultaneously by copy of this email, by prior agreement.

--

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