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No. 86535-3

SUPREME COURT  
OF THE STATE OF WASHINGTON

No. 64712-1-I

COURT OF APPEALS, DIVISION I  
OF THE STATE OF WASHINGTON

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NATIONAL SURETY CORPORATION,

Petitioner,

v.

IMMUNEX CORPORATION,  
Respondent.

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**SUPPLEMENTAL BRIEF OF RESPONDENT IMMUNEX CORP.**

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ORIGINAL

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## **I. ISSUES ACCEPTED FOR REVIEW**

1. According to the Court of Appeals: “The issue here is whether an insurer must reimburse an insured for defense costs paid by the insured when it is determined that the insurer owed no duty to defend or indemnify the insured and the insurance policy does not expressly provide for a right of recoupment.” *Nat’l Sur. Corp. v. Immunex Corp.*, 162 Wn. App. 762, 774 (2011).

2. Whether an insurer defending its insured under a reservation of rights must pay pre-tender defense costs unless and until it can prove “actual and substantial” prejudice from a purported late tender of a claim for coverage; if so, whether the Court of Appeals correctly determined that National Surety had not proved “actual and substantial” prejudice as a matter of law.

## **II. STATEMENT OF THE CASE**

### **A. The Underlying Litigation.**

Respondent Immunex Corporation is a manufacturer of various prescription drugs. Beginning in late 2001, consumers, third-party payors, government entities, and consumer-rights groups across the county began filing a series of complaints against Immunex — 23 in total — alleging that Immunex artificially inflated the “average wholesale price” (“AWP”) of certain prescription drugs (the “AWP litigation”).<sup>1</sup> CP 361–62; 947, ¶ 117.

The alleged scheme was relatively straightforward. Medicare and other third-party payors reimburse physicians and other drug providers based on the AWP of a drug, as opposed to reimbursing a health-care provider’s actual costs. CP 932, ¶ 5. To determine the AWP for a drug,

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<sup>1</sup> The AWP complaints alleged causes of action based on the Racketeer Influenced and Corrupt Organizations Act, state unfair trade and protection statutes, civil conspiracy, fraud, and breach of contract. CP 376, 492, 520–21.

payors rely on the periodic reports of drug manufacturers like Immunex. CP 932, ¶ 4–5. The AWP plaintiffs alleged that Immunex reported inflated AWP information. CP 932, ¶ 8; 947, ¶ 117. In turn, third-party payors allegedly gave drug providers significantly higher reimbursement payments than the providers were due. CP 933, ¶ 9; 947, ¶ 118. Realizing the favorable “spread,” health-care providers purportedly increased the rate at which they prescribed Immunex’s drugs and thus allowed Immunex to enhance its market share at the expense of third-party payors and consumers. CP 933, ¶ 9; CP 937–38, ¶ 155; CP 945, ¶ 5; CP 947, ¶ 118.

**B. Insurance Coverage History.**

Petitioner National Surety Corporation issued Immunex umbrella and excess liability insurance policies covering the period from September 1, 1998, to September 1, 2002. CP 620–23. Among other potential “notices,” on August 21, 2001, Immunex provided “notice of potential claims against the Insured” to National Surety regarding the government’s investigation of Immunex’s AWP practices. CP 1047–49. On February 14, 2003, Immunex sent a status report updating National Surety on the investigation. CP 1054–55.

National Surety claims that neither the August 2001 notice or February 2003 notice constituted timely “notice” under National Surety’s policies of the AWP litigation. Instead, according to National Surety, an October 3, 2006, letter from Immunex to National Surety regarding coverage for the AWP litigation constituted Immunex’s first trigger of coverage for the AWP litigation. Pet. at 3; *see also* CP 1059–60CP 1059–60. National Surety’s position regarding the “notice” issue is wrong. However, the question of the timing of Immunex’s “notice” of the AWP litigation need not be addressed at this time because it is not before the Court on this appeal. Following Immunex’s October 2006 correspondence, it took National Surety another year and a half to communicate its coverage position to Immunex. On March 31, 2008, National

Surety agreed to defend Immunex under a reservation of rights. CP 1067–84. National Surety’s reservation of rights, however, purported to give National Surety the right to seek “reimbursement” of any defense payments: “[National Surety] reserves the right to recoup the amounts paid in defense if it is determined by a court that there is no coverage or duty to defend and that [National Surety] is entitled to reimbursement.” CP 1075. National Surety’s policies did not give National Surety a reimbursement right. *See generally* CP 620–54. National Surety has never paid any defense fees even though it promised to do so in March 2008.

**C. Procedural Posture.**

National Surety filed its declaratory-relief action with the Superior Court on March 31, 2008 (the same date of its reservation of rights letter), seeking declarations that it does not owe defense or indemnity to Immunex. CP 3–9. Shortly thereafter, on June 13, 2008, the Court stayed the coverage action. CP 1025. The Court later lifted the stay so that National Surety and Immunex could file competing motions for partial summary judgment to determine whether National Surety had a duty to defend, which the parties filed in February 2009. CP 10–28, 341–60, 1028. On April 15, 2009, the Superior Court concluded that National Surety did not owe Immunex a duty to defend, thereby granting National Surety’s motion and denying Immunex’s motion. CP 1022–24.

In July 2009, Immunex moved for partial summary judgment on National Surety’s duty to pay Immunex for defense expenses incurred through the date of the Superior Court’s April 15, 2009, ruling, and National Surety asked the trial court to rule National Surety’s coverage obligations were limited because Immunex’s notice of the AWP litigation allegedly was not timely. CP 1366–87. On August 25, 2009, the Superior Court granted Immunex’s motion and ordered National Surety to pay Immunex’s defense costs incurred through April 15, 2009. CP

1362. The trial court denied National Surety's motion regarding notice, holding ruled that National Surety had not proved "actual and substantial" prejudice from Immunex's allegedly late notice, (although the Court gave National Surety an opportunity to do so at trial.) CP 1362.

Both parties appealed to the Court of Appeals the trial court's rulings regarding National Surety's defense obligations. The Court of Appeals affirmed the trial court's rulings on July 25, 2011. *Nat'l Sur. Corp. v. Immunex Corp.*, 162 Wn. App. 762, 782 (2011), *reconsideration denied* (Aug. 24, 2011).

Both parties then petitioned this Court for review. The Court granted National Surety's petition for review and denied Immunex's cross-petition for review on January 4, 2012.

**III. THE COURT OF APPEALS PROPERLY DETERMINED THAT NATIONAL SURETY COULD NOT UNILATERALLY RESERVE THE RIGHT TO REIMBURSEMENT IN THE ABSENCE AN EXPLICIT INSURANCE POLICY-BASED RIGHT TO DO SO.**

National Surety asks this Court to reverse the Court of Appeals' holding that National Surety had a duty to pay Immunex's defense fees through the date the Superior Court determined that the AWP litigation was not covered. *See Immunex Corp.*, 162 Wn. App. at 779. National Surety's position is not supported by its policies or under Washington law.

**A. National Surety's Policies Do Not Give It The Right To Seek Reimbursement.**

Throughout this litigation, National Surety has attempted to brush aside its policy language by arguing that its policies do not delineate all of its rights, including its "right to reimbursement."<sup>2</sup> That view is severely misguided. The beginning and ending inquiry for this

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<sup>2</sup> Technically, this matter does not involve a true right of "reimbursement." This is so because despite its promise to do so, National Surety never in fact paid Immunex with respect to the AWP litigation. Thus, this matter instead involves the question of whether National Surety must pay the defense fees incurred by Immunex before April 15, 2009 (the date the trial terminated the potential for coverage for the AWP litigation by ruling against the duty to

Court is whether the policies allow for “reimbursement” of defense fees that are incurred before a court decides the question of coverage. National Surety did not contract in its policies to obtain that protection that it now seeks.

In Washington, courts liberally construe insurance policies to provide maximum coverage for insureds whenever possible. *See Am. Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 404–05 (2010); *Truck Ins. Exch. v. VanPort Homes, Inc.*, 147 Wn.2d 751, 760 (2002). To effectuate this policy, courts give insurance contracts a “fair, reasonable, and sensible construction as would be given to the contract by the average person purchasing insurance.” *Weyerhaeuser Co. v. Commercial Union Ins. Co.*, 142 Wn.2d 654, 666 (2000) (citation omitted).

“[A]ny doubts, ambiguities and uncertainties arising out of the language used in the policy must be resolved in [the insured’s] favor.” *Phil Schroeder, Inc. v. Royal Globe Ins. Co.*, 99 Wn.2d 65, 69 (1983), *modified on other grounds*, 101 Wn.2d 830 (1984). Even if “a policy is fairly susceptible of two different interpretations, that interpretation most favorable to the insured must be applied, even though a different meaning may have been intended by the insurer.” *Ames v. Baker*, 68 Wn.2d 713, 717 (1966). The reasoning behind these strict pro-insured rules is simple: because of the nature of “take it or leave it” insurance policies, it is the insurer’s burden to draft “clear and unmistakable [policy] language.” *See Diaryland Ins. Co. v. Ward*, 83 Wn.2d 353, 359 (1974). To this end, the Court has found that “[t]he [insurance] industry knows how to protect itself and it knows how to write exclusions and conditions.” *Boeing Co. v. Aetna Cas. & Sur. Co.*, 113 Wn.2d 869, 887 (1990).

In light of these principles, the Court will not rewrite a policy to reflect the language an insurer “wishes it had drafted.” *Pub. Emps. Mut. Ins. Co. v. Mucklestone*, 111 Wn.2d 442, 444

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defend). Because Nation Surety framed the issue as a “right of reimbursement” in its March 31, 2008, reservation of rights letter, Immunex uses that terminology here.

(1988). Indeed, “the court cannot . . . create a contract for the parties which they did not make themselves, nor can the court impose obligations which never before existed.” *Farmers Ins. Co. of Wash. v. Miller*, 87 Wn.2d 70, 73 (1976). As bluntly stated by the Court, “no public policy clearly expressed in Washington statutes or case law . . . would justify overriding the policy’s explicit [language].” *Fluke Corp. v. Hartford Acc. & Indem. Co.*, 145 Wn.2d 137, 145 (2001).

In this case, there is no dispute that National Surety’s policies do not contain any provision permitting it to recoup defense fees, or not to pay fees in the first instance, in the event that a court determines that a claim is not covered. That should end this Court’s query. Tellingly, this is not a case where National Surety merely failed to draft “clear and unmistakable [policy] language.” *Dairyland*, 83 Wn.2d at 359. Instead, National Surety wholly failed to draft any policy language regarding its supposed desire for “reimbursement” with respect to defense fees incurred in lawsuits that a court ultimately determined are not covered.

If National Surety wanted a reimbursement right, it knew how to draft it. *Boeing*, 113 Wn.2d at 887. Indeed, during the same period that National Surety issued the Immunex policies, National Surety’s parent company, Fireman’s Fund Insurance Company, issued standard policies expressly giving it the reimbursement right that National Surety now seeks through litigation. CP 1421–33. The Fireman’s Fund provision explicitly stated:

In the event the Insurer shall advance Defense Expense . . . prior to the final disposition of the Claim(s), such advance payments by the Insurer shall be repaid to the Insurer by the Insured(s) . . . in the event and to the extent that the Insured(s) shall not be entitled thereto under the terms and conditions of this Policy.

CP 1429. By affirmatively deviating from the standard language of its parent company, the “average person purchasing insurance” would reasonably conclude that National Surety did not

intend to provide for itself any “reimbursement” rights. *See Weyerhaeuser Co.*, 142 Wn.2d at 666 (citation omitted).

**B. National Surety Cannot Unilaterally Give Itself The Right To Reimbursement In A Reservation-Of-Rights Letter.**

National Surety argues that, although its policies do not contain a reimbursement right, it had that right, in any event, to reimbursement because it “reserved” this right when agreeing to defend Immunex. *See* Pet. at 8–10. National Union misunderstands Washington law, which expressly prohibits insurers from modifying the insurance contract unilaterally, post-policy issuance and post-claim.

Washington Revised Code section 48.18.190 prohibits insurers from “modifying, or extending any contract of insurance . . . unless in writing and made a part of the policy.” This Court has determined that the statute means exactly what it says: insurers cannot impose one-sided restrictions on insureds that are not *expressly* part of the policy. *See Safeco Ins. Co. v. Dairyland Mut. Ins. Co.*, 74 Wn.2d 669, 672 (1968). Likewise, the Court of Appeals has repeatedly refused to allow insurers to change the insurance contract through reservation-of-rights letters. *E.g.*, *Alaska Nat’l Ins. Co. v. Bryan*, 125 Wn. App. 24, 38–39 (2004) (concluding that “[t]he purpose of a reservation of rights letter is not to change the contractual relationship of the parties”); *Van Noy v. State Farm Mut. Auto. Ins. Co.*, 98 Wn. App. 487, 493 (1999) (“An insurer may not restrict coverage or otherwise alter terms of an insurance contract with subsequent letters and notices.”).

In this case, National Surety attempts to give itself reimbursement rights through its March 31, 2008, reservation-of-rights letter. It cannot do so. As correctly noted by the Court of Appeals, “the policy at issue did not expressly authorize National Surety to offer a defense under a reservation of rights subject to recoupment. This court cannot rewrite the policy to so allow.”

*Immunex Corp.*, 162 Wn. App. at 777. Similarly, the leading treatise on insurance law in Washington has explained why the precise argument advanced by National Surety is faulty:

The mere service of a unilateral reservation-of-rights letter . . . is inadequate to create [ ] a right to reimbursement. Even if an insurer, in [its] reservation letter, sets forth language reserving the right to reimbursement, the court should not allow such reimbursement unless the insured has signed a non-waiver agreement expressly stipulating that the insurer may seek reimbursement if it is later determined that the insurer never had the duty to defend.

Thomas V. Harris, *Washington Insurance Law* § 17.01, at 17-2 (3d ed. 2010) (the “Harris Treatise”).<sup>3</sup> Stated another way, “[a] reservation of rights will never allow an insurer to seek retroactive reimbursement for attorney fees and defense costs already incurred by the insurer.”

*Id.*

National Surety has no basis to overcome Washington Revised Code section 48.18.190 or Washington precedent. Because Washington law prohibits insurers from giving themselves additional rights not contained in the insurance policies, National Surety’s attempt here to modify its policies to obtain a “reimbursement” right through its reservation of rights letter is ineffective.<sup>4</sup>

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<sup>3</sup> The Court has often referred to the Harris Treatise as support for its decisions. *E.g.*, *Woo v. Fireman’s Fund Ins. Co.*, 161 Wn.2d 43, 54 (2007); *Mut. of Enumclaw Ins. Co. v. Dan Paulson Constr., Inc.*, 161 Wn.2d 903, 914 n.8 (2007).

<sup>4</sup> In the proceedings below, National Surety also tried to frame the reimbursement issue as one of unjust enrichment. This theory does not work either because, by reserving its rights, National Surety received valuable benefits: it insulated itself from bad-faith damages and coverage by estoppel. *Am. Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 405 (2010); *Kirk v. Mount Airy Ins. Co.*, 134 Wn.2d 558, 562–64 (1998); *see also Am. & Foreign Ins. Co. v. Jerry’s Sport Ctr., Inc.*, 606 Pa. 584, 615–17 (2010) (expressly rejecting unjust-enrichment theory in reimbursement context).

**C. Washington Prohibits National Surety's "All Reward, No Risk" Coverage Position.**

Without a reimbursement right in its policies and in the face of explicit Washington statutory law and case law prohibiting it from changing the rules after policy issuance, National Surety nonetheless argues that this Court should, presumably solely as a policy matter, allow insurers to recoup defense fees for non-covered claims. *See* Pet. at 8–10. Not only does National Surety's position represent bad policy, but this Court first foreclosed National Surety's position almost 90 years ago.

**1. Washington does not allow an insurer to merely offer to defend under a reservation of rights while refusing to make any defense payments until the court determines that a duty to defend exists, all the while insulating itself from a bad-faith claim and coverage by estoppel.**

This Court long has consistently held that Washington insurers have two — and only two — choices when they are unsure about the existence of their duty to defend. Each option has its own costs and benefits, and it is up to individual insurers to decide whether the risks are worth the reward with any given claim.

Under the first option, when a claim for coverage is presented to an insurer, it can outright deny coverage. *See* Harris Treatise § 16.01, at 16-1 (“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.”). The risk to that approach: if a court later determines that the insurer had a duty to defend, the insurer has committed breach and possibly bad faith (including potentially coverage by estoppel) due to its wrongful denial.<sup>5</sup> *See Am. Best Food, Inc. v. Alea London, Ltd.*, 168

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<sup>5</sup> “Coverage by estoppel prevents an insurer who has acted in bad faith from denying coverage even if it turns out there was no coverage under the policy. Further, coverage by estoppel will require the insurer to pay all damages regardless of policy limits. Thus coverage by estoppel is the remedy for, and to some extent, the deterrence against, some acts of bad faith.”

Wn.2d 398, 405 (2010); *Kirk v. Mount Airy Ins. Co.*, 134 Wn.2d 558, 562–64 (1998). The reward to that approach: if the insurer is correct that no coverage exists, it will not have made any payments to the insured.

Under the second option, “[i]f 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.” *Truck Ins. Exch. v. VanPort Homes, Inc.*, 147 Wn.2d 751, 761 (2002); *see also Woo*, 161 Wn.2d at 54. The reward to this approach: an insurer insulates itself from breach and bad-faith damages. To obtain this benefit, the insurer, however, assumes risk: the insurer is required to “defend” until the court issues its ruling. *VanPort*, 147 Wn.2d at 761; *Woo*, 161 Wn.2d at 54.

With Washington’s two-option framework in mind, National Surety argues that in *Woo v. Fireman’s Fund Insurance Co.* and *Kirk v. Mount Airy Insurance Co* this Court left open a third “best of both worlds” option for insurers. Under this purported third option created by National Surety, “by offering to pay defense costs under a reservation of rights until the coverage dispute is resolved,” but never actually making payment, insurers can avoid breach and bad-faith claims.. *See Pet.* at 10 (emphasis added). Neither *Woo* nor *Kirk* (nor any other Washington authority for that matter) lends any credence to National Surety’s argument that insurers do not actually need to pay defense fees (they need only “offer” to pay them).<sup>6</sup>

In *Woo*, this Court reminded insurers that if they are unsure about whether coverage exists, they have only two choices, not National Surety’s crafted third approach – they may

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*Mut. of Enumclaw Ins. Co. v. T&G Constr., Inc.*, 165 Wn.2d 255, 267 n.4 (2008) (citations omitted).

<sup>6</sup> Under National Surety’s view of the law, no rationale insurer would ever make defense payments until they were ordered to do so by a court. That is clearly contrary to Washington law, as “[t]he insurer’s duty to defend the insured is one of the main benefits of the insurance contract.” *Safeco Ins. Co. of Am. v. Butler*, 118 Wn.2d 383, 392 (1992).

either deny coverage or defend under a reservation of rights while seeking declaratory relief. 161 Wn.2d 43, 54 (2007). The Court explicitly re-affirmed that if an insurer accepts the defense, “the insurer *must bear the expense of defending* the insured.” *Id.* (emphasis added). While National Surety is correct that *Woo* concerned a covered claim, that does not make *Woo* distinguishable. *Woo* unambiguously concludes that if an insurer does not want to “bear the expense” while awaiting the court’s coverage determination, it should deny coverage altogether and roll the dice with respect to breach and bad faith. *See id.* As such, *Woo* expressly prohibits insurers from merely offering a defense while not making any payments unless the court orders them to do so. As explained by the Harris Treatise, *Woo* “implicitly recognized that a reservation letter cannot be the basis for retroactive reimbursement of fees when it held that, in reservation-of-rights cases, the insurer ‘must bear the expense of defending the insured’ even if the insurer litigates a concurrent declaratory judgment action.” Harris Treatise § 17.01, at 17-2.

*Kirk* also undermines National Surety’s position. There, after concluding that the remedy for an insurer’s bad-faith refusal to defend is a presumption of harm and coverage by estoppel, the Court stated: “The insurer can easily avoid all of these issues by defending with a reservation of rights. 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.” 134 Wn.2d at 563 n.3 (emphasis added). Relying on the Court’s statement that “the insurer will not be obligated to pay,” National Surety argues that *Kirk* gives insurers the ability to “offer” to defend while withholding defense payments until a court determines the existence of coverage . Not only is that view contrary to every other Washington case on this topic, but it reads *Kirk* out of context. When viewed in context, the *Kirk* Court simply reiterated the recognized principle that an insurer’s defense obligation ceases once a court determines that coverage does not exist — “the

insurer will not be obligated to pay” after that point in time. *See id.* Contrary to National Surety’s argument, *Kirk* did not overturn established caselaw in such a vague manner. *See, e.g., VanPort*, 147 Wn.2d at 761 (“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.”).<sup>7</sup>

**2. *Minnesota Mutual* bars National Surety’s attempt to give itself a reimbursement right not contained in the insurance contract.**

National Surety cannot sidestep the import of *Minnesota Mutual Life Insurance Co. v. Fraser*, 128 Wn. 171 (1924). In *Minnesota Mutual*, the Court addressed the factually analogous issue of whether, in the absence of a contractual right to reimbursement, a company could recoup monetary advancements given to an agent to pay for expenses. *Id.* at 171–72. The Court concluded that, “in the absence of some provision in the contract from which such intent can be clearly inferred,” the company could not unilaterally give itself a reimbursement right. *Id.* at 175.

The Court pointed out multiple ways the company could have made its reimbursement intent clear. For example, the company could have drafted an agreement stating that the “advance shall create an indebtedness on [the agent’s] part.” *Id.* at 174. It could have “signif[ied] that [the agent] is to be a borrower” or that the company “will lend” to the agent. *Id.* The company could have stated “directly that [the agent] assumed a personal liability.” *Id.* “It would have been a simple matter to have said that [the agent] would repay the money, if that was the agreement.” *Id.* Because the agreement did not demonstrate the company’s claimed reimbursement right, the Court concluded “that the parties never intended to enter into such an agreement.” *Id.*

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<sup>7</sup> Because *Kirk* actually supports *Immunex*, National Surety alternatively attempts to distinguish it because, like *Woo*, it concerned a covered claim. That argument fails here as well: because insurers do not know whether a claim is covered when they accept defense under a reservation of rights, they must make contemporaneous defense-cost payments until a court concludes that the claim is not covered. *See VanPort*, 147 Wn.2d at 761.

Just like in *Minnesota Mutual*, National Surety could have inserted language into its policies giving it a reimbursement right in the event a court ultimately determined Immunex's claim was not covered. Indeed, National Surety's parent company used this exact language. CP 1429. The language that National Surety chose to include in its policies controls the parties' relationship, not National Surety's backward-looking desire to have used different language.

National Surety attempts to distinguish *Minnesota Mutual* on two equally unavailing grounds, both of which simply reformulate its "all reward, no risk" position. First, National Surety argues that the *Minnesota Mutual* company actually paid the advances to the agent and then later sought recoupment, whereas in this case National Surety promised to make payments to Immunex but it did not actually do so. In other words, National Surety asks this Court to reward it for its breach of contract and bad faith. As astutely noted by the Court of Appeals:

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. Such a holding would encourage insurers to avoid payments and would interfere with the policy goal of defending the insured.

*Immunex Corp.*, 162 Wn. App. at 777.

Second, National Surety claims that *Minnesota Mutual* benefited from advancing money to its agent, whereas National Surety would not have received any benefit by paying Immunex's defense fees. As this Court has explained, even if a court later determines that a claim is not covered, insurers who defend under a reservation of rights nevertheless do, in fact, receive a benefit: the insurers avoid exposure to breach and bad-faith damages and coverage by estoppel in the event that the court instead determined that the claim was covered. *Kirk*, 134 Wn.2d at 562–64.

**D. Numerous Out-Of-State Courts Hold That Insurers Cannot Unilaterally Give Themselves Reimbursement Rights Through A Reservation Of Rights Letter.**

On essentially identical fact patterns to that in this case, a significant number of courts across the nation agree that insurers cannot inject a recoupment right into an insurance policy through a unilateral reservation-of-rights letter.<sup>8</sup> Critically, the majority of state supreme courts to address this issue have sided with Immunex, as have the majority of federal appellate courts.

For example, in *General Agents Insurance Co. of America, Inc. v. Midwest Sporting Goods Co.*, 215 Ill. 2d 146, 148 (2005), the insurer agreed to defend the insured under a reservation of rights subject to the “right to recoup any defense costs paid.” The policy, however, did not provide such a right. *Id.* at 154. After the court ruled against coverage under the policy, the insurer sought reimbursement of its defense payments. *Id.* at 149. The insurer argued that its defense obligation extended only to potentially covered claims, and that, because of the court’s ruling, the insured’s claims never were potentially covered. As a result, according to the insurer, it never had an obligation, contractual or otherwise, to pay defense costs. *Id.* at 155–56.

Disagreeing, the Illinois Supreme Court explained: “As a matter of public policy, we cannot condone an arrangement where an insurer can unilaterally modify its contract, through a reservation of rights, to allow for reimbursement of defense costs in the event a court later finds that the insurer owes no duty to defend.” *Id.* at 162–63. The court rejected the insurer’s argument that this result was unfair:

Certainly, if an insurer wishes to retain its right to seek reimbursement of defense costs in the event it later is determined that the underlying claim is not covered by the policy, the insurer is free to include such a term in its insurance contract. Absent such a provision in the policy, however, an

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<sup>8</sup> The only difference between the out-of-state authorities and the present case is that, unlike the other insurers, National Surety did not actually pay Immunex any defense fees even though it promised to do so. As shown above, this is a distinction without a difference.

insurer cannot later attempt to amend the policy by including the right to reimbursement in its reservation of rights letter.

*Id.* at 164.

More recently, the Pennsylvania Supreme Court addressed this issue in *American and Foreign Insurance Co. v. Jerry's Sport Center, Inc.*, 606 Pa. 584 (2010). Summarizing the facts and its rationale, the court succinctly explained:

[The insurer] cannot employ a reservation of rights letter to reserve a right it does not have pursuant to the contract. As noted above, the policy here did not provide for a right of reimbursement of defense costs for non-covered claims. . . . We are persuaded that permitting reimbursement by reservation of rights, absent an insurance policy provision authorizing the right in the first place, is tantamount to allowing the insurer to extract a unilateral amendment to the insurance contract.

*Id.* at 614–15.

Four federal courts of appeal have also adopted the position advanced by Immunex here,<sup>9</sup> including the carefully reasoned decision of the U.S. Court of Appeals for the Eighth Circuit in *Westchester Fire Insurance Co. v. Wallerich*, 563 F.3d 707 (8th Cir. 2009). In that case, the insurer defended the insured subject to a reservation of rights, including a claimed right to “reimbursement.” *Id.* at 710. The policy, however, accorded no such right. *Id.* at 719. The district court ultimately concluded that no duty to defend existed, and the insurer thereafter sought recoupment of its defense payments. *Id.* at 711. The Eighth Circuit rejected the insurer’s recoupment argument because the insurer “could have included in the policy an express provision for such reimbursement. [The insurer] cannot now unilaterally amend the policy by including the right to reimbursement in its reservation-of-rights letter.” *Id.* at 719.

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<sup>9</sup> See *Emp’rs Mut. Cas. Co. v. Bartile Roofs, Inc.*, 618 F.3d 1153, 1175–76 (10th Cir. 2010) (applying Wyoming law); *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 448 F.3d 252, 259 (4th Cir. 2006); *Terra Nova Ins. Co., Ltd. v. 900 Bar, Inc.*, 887 F.2d 1213, 1220 (3d Cir. 1989); but see *Valley Forge Ins. Co. v. Health Care Mgmt. Partners, Ltd.*, 616 F.3d 1086, 1094 (10th Cir. 2010) (applying Colorado law).

A final notable case is the U.S. District Court for the Eastern District of Virginia's decision in *Zurich American Insurance Co. v. Public Storage*, 743 F. Supp. 2d 548 (E.D. Va. 2010). In that case, the court decided the reimbursement issue under *Washington law*. *Id.* at 551. The court concluded that Washington would not allow insurers to recoup defense payments for noncovered claims based on a unilateral reservation-of-rights letter.<sup>10</sup> *Id.* at 550–51.

**IV. THE COURT OF APPEALS CORRECTLY CONCLUDED THAT NATIONAL SURETY MUST PAY PRE-TENDER DEFENSE COSTS UNLESS NATIONAL SURETY CAN ESTABLISH “ACTUAL AND SUBSTANTIAL” PREJUDICE AT TRIAL.**

The second issue this Court accepted for review is whether National Surety has a duty to pay Immunex's defense fees incurred prior to the date of Immunex's allegedly first proper notice of the AWP litigation to National Surety.

**A. Contrary To National Surety's Argument, It Must Pay Pre-Tender Defense Costs Unless It Can Establish “Actual And Substantial” Prejudice.**

National Surety first argues that the Court's well-established “actual and substantial” prejudice test does not apply to this case. This Court has held that an insurer's duty to defend arises at the time a third-party claimant files a complaint against the insured alleging facts that could impose liability upon the insured covered by the insurance policy. *Mut. of Enumclaw Ins. Co. v. USF Ins. Co.*, 164 Wn.2d 411, 420–21 (2008); *Truck Ins. Exch. v. VanPort Homes, Inc.*,

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<sup>10</sup> Numerous other courts from around the country have similarly concluded that insurers cannot grant themselves unilateral recoupment rights. Indeed, confined to merely the last five years, this has been the overwhelming trend. *E.g.*, *Welch Foods Inc. v. Nat'l Union Fire Ins. Co.*, No. 09-12087, 2011 WL 576600, at \*3 (D. Mass. Feb. 9, 2011); *Zurich Specialties London Ltd. v. Vill. of Bellwood, Ill.*, No. 07-2171, 2011 WL 248444, at \*15 (N.D. Ill. Jan. 26, 2011); *Axis Specialty Ins. Co. v. Brickman Grp. Ltd., LLC*, 756 F. Supp. 2d 644, 655–57 (E.D. Pa. 2010); *Blue Cross of Idaho Health Serv., Inc. v. Atl. Mut. Ins. Co.*, 734 F. Supp. 2d 1107, 1114–16 (D. Idaho 2010); *Hous. Cas. Co. v. Sprint Nextel Corp.*, No. 09-1387, 2010 WL 4852649, at \*7–8 (E.D. Va. Nov. 22, 2010); *Nationwide Mut. Ins. Co. v. Mortensen*, No. 00-1180, 2009 WL 2710264, at \*5 (D. Conn. Aug. 24, 2009); *Gen. Star Indem. Co. v. V.I. Port Auth.*, 564 F. Supp. 2d 473, 479–80 (D. V.I. 2008); *St. Paul Fire & Marine Ins. Co. v. Holland Realty, Inc.*, No. 07-390, 2008 WL 3255645, at \*8 (D. Idaho Aug. 6, 2008).

147 Wn.2d 751, 760 (2002). As the Court has repeated time and again, “even where an insured breaches a ‘prompt notice’ provision of an insurance policy, the insurer is not relieved of its duties under the insurance contract unless it can show that the late notice caused it actual and substantial prejudice.” *USF Ins. Co.*, 164 Wn.2d at 426 (citations and footnote omitted).

In this case, National Surety challenges the Court of Appeals’ conclusion that the “actual and substantial” prejudice test applies to non-covered claims. See *Immunex Corp.*, 162 Wn. App. at 780. National Surety cites to *VanPort* to argue that this Court did away with the “actual and substantial” prejudice test for non-covered claims. Specifically, National Surety points to the Court’s conclusion that an insurer can “defend under a reservation of rights while seeking a declaratory judgment that it had no duty to defend.” See Pet. at 16 (quoting *VanPort*, 147 Wn.2d at 761). National Surety also points to *VanPort*’s statement that where “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.” Pet. at 16–17 (quoting *VanPort*, 147 Wn.2d at 761). Taking these statements from *VanPort* together, National Surety argues that the “actual and substantial” test applies only to covered claims, whereas an insurer does not need to establish any prejudice to avoid paying pre-tender costs for a noncovered claim.

National Surety’s position is based almost entirely on a portion of a sentence in *VanPort* that National Surety takes out of context. Based on the *VanPort*’s statement that “the insurer will not be obligated to pay,” National Surety argues that the Court actually meant “the insurer will not be obligated to pay defense fees *already owed*” if a court determines that the claim is not covered. *VanPort* does not stand for this proposition. When the sentence upon which National Surety relies on is read as a whole, it stands for the simple proposition that a defending insurer can stop making defense payments once a court concludes that coverage does not exist, but “the

insured [must] receive[] the defense promised” while the parties await the court’s determination. *See VanPort*, 147 Wn.2d at 761. As the Court unequivocally states: “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.” In other words, *VanPort* expressly concludes that insurers must pay all defense costs incurred until a court determines that no duty to defend exists.

Accordingly, National Surety has failed to show that the “actual and substantial” prejudice test does not continue to apply to both covered and noncovered claims.

**B. National Surety Fails To Prove “Actual And Substantial” Prejudice As A Matter Of Law.**

National Surety argues that even if it has to show “actual and substantial” prejudice, the Court of Appeals erred in concluding that National Surety has not done so as a matter of law. *See Immunex Corp.*, 162 Wn. App. at 782. National Surety’s contention is based on its allegation that Immunex took over six years to provide proper notice of the AWP claim.

The Court has explained that “[w]hether or not late notice prejudiced an insurer is a question of fact, and it will seldom be decided as a matter of law.” *USF Ins. Co.*, 164 Wn.2d at 427; *see also Tran v. State Farm Fire & Cas. Co.*, 136 Wn.2d 214, 228 (1998). The reason for this rule is straightforward: because prejudice analysis often involves conflicting evidence, courts are simply in no position to decide this issue as a matter of law, especially given that “any doubts, ambiguities and uncertainties” must be resolved in the insured’s favor. *See Phil Schroeder, Inc. v. Royal Globe Ins. Co.*, 99 Wn.2d 65, 69 (1983), *modified on other grounds*, 101 Wn.2d 830 (1984) (citation omitted).

To make the requisite showing of prejudice, this Court has concluded that “many factors may determine whether an insurer was actually prejudiced.” *USF Ins. Co.*, 164 Wn.2d at 430. In

a nonexhaustive list, the Court has given various examples of what factors courts should consider:

Were damages concrete or nebulous? Was there a settlement or did a neutral decision maker calculate damages; what were the circumstances surrounding the settlement? Did a reliable entity do a thorough investigation of the incident? Could the insurer have eliminated liability if given timely notice? Could the insurer have proceeded differently in the litigation?

*Id.* at 429–30 (citations omitted).

In this case, National Surety did not make any showing of prejudice, much less the showing necessary for summary judgment. As a threshold matter and as appropriately noted by the Court of Appeals, “a question of material fact remains regarding whether Immunex’s tender of the lawsuit was in fact late. These are issues for trial.” *Immunex Corp.*, 162 Wn. App. at 780. While National Surety *alleges* that Immunex did not provide notice for six years, Immunex actually provided sufficient notice much sooner, on August 21, 2001 and then again on February 14, 2003. CP 1047–49, 1054–55. On top of that, the parties never had a chance to litigate this issue or even take discovery on it. CP 1025–26, 1209. Try as it might, National Surety cannot for the first time litigate before this court the question of when Immunex first properly provided notice of the AWP litigation.

Even if Immunex did not provide proper notice until October 2006, which Immunex disputes, National Surety has not identified any evidence whatsoever that it suffered prejudice, let alone enough evidence to establish actual and substantial prejudice *as a matter of law*. By not setting forth any evidence regarding the factors the Court identified in *USF Insurance Co.*, neither the lower courts nor this Court can say — as a matter of law — whether National Surety was prejudiced by Immunex’s alleged October 2006 tender.

Moreover, National Surety waited at least a year and a half — from October 3, 2006 (the date National Surety alleges it first received proper notice) to March 31, 2008 — to file its declaratory-relief complaint. CP 3–9, 1059–60. Because a significant chunk of National Surety’s claimed prejudice is directly attributable to its own delay, it has no reasonable basis to argue that Immunex should be penalized for the entire six-year delay. Whether National Surety can establish actual and substantial prejudice is a fact-intensive issue, and the Court of Appeals correctly determined that it must be decided at trial.

## V. CONCLUSION

The Court should affirm the Court of Appeals with respect to both the “reimbursement” issue and the pre-tender issue. National Surety cannot seek recoupment of defense fees in the absence of a policy-based right to do so, and it assuredly cannot give itself a reimbursement right through a unilateral reservation-of-rights letter. National Surety’s argument that this Court somehow abrogated the “actual and substantial” prejudice test is unfounded, as is its assertion that it has established actual and substantial prejudice as a matter of law.

Dated: March 12, 2012

By: \_\_\_\_\_  
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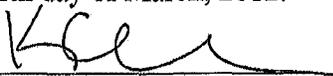
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The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on March 12, 2012, I arranged for service of the foregoing Supplemental Brief of Respondent Immunex Corp., to the court and to the parties to this action as follows:

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