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NO. 88673-3
SUPREME COURT
OF THE STATE OF WASHINGTON

EXPEDIA, INC., a Washington Corporation; EXPEDIA, INC., a Delaware Corporation; HOTELS.COM, L.P., a Texas Limited Liability Partnership; HOTELS.COM, GP, LLC, a Texas Limited Liability Company; HOTWIRE, INC., a Delaware Corporation; TRAVELSCAPE, a Nevada Limited Liability Company,

Plaintiffs/Petitioners,

v.

STEADFAST INSURANCE COMPANY, a Delaware Corporation;
ZURICH AMERICAN INSURANCE COMPANY, a New York Corporation;
ROYAL & SUN ALLIANCE, a Foreign Corporation;
ARROWPOINT CAPITAL CORP., a Delaware Corporation;
ARROWOOD SURPLUS LINES INSURANCE COMPANY, a Delaware Corporation;
ARROWOOD INDEMNITY COMPANY, a Delaware Corporation,

Defendants/Respondents.

BRIEF OF PLAINTIFFS/PETITIONERS

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I. INTRODUCTION

This Court has recognized for decades the fundamental importance of the duty to defend to Washington policyholders insured under liability policies. The duty to defend ensures that policyholders are not left to bear the often prohibitive burdens of litigation on their own. Instead, so long as the underlying claim potentially is covered by the insurance policy, the insurer must fund its policyholder's defense from the time the underlying complaint is filed. In lawsuits between an insured and its insurer, courts must resolve the duty to defend early, so that the policyholder receives the benefit of a defense while the underlying lawsuit is ongoing. Otherwise, the duty to provide a "defense" becomes nothing more than an obligation to reimburse after the fact, thus defeating the critical benefit provided to those who obtain liability insurance—to receive protection from the ongoing burden of litigation—and leaving the policyholder with less than it bargained for when it bought its policy.

That prohibited result is exactly what happened here. Expedia asked Zurich to defend lawsuits seeking to hold Expedia liable for municipalities' alleged revenue shortfalls in connection with taxes imposed on hotel occupants. Rather than defend Expedia (either outright or under a reservation of rights), Zurich summarily refused, without any investigation. Expedia thus brought this action to obtain its bargained-for

defense. In response, Zurich moved for summary judgment, further seeking to avoid its duty to defend.

The trial court denied Zurich's motion for summary judgment, holding that because the underlying lawsuits potentially sought damages for negligent acts or omissions, coverage was not conclusively excluded by the policies. Faced with an adjudication that coverage was possible, Zurich should have immediately assumed its defense obligations. It did not. When Expedia asked the trial court to enter an order confirming that its denial of Zurich's summary judgment motion obligated Zurich to defend, the trial court refused to do so.

Expedia then sought summary judgment to establish Zurich's duty to defend. Zurich not only continued to refuse to defend, but sought discovery from Expedia that overlapped with, and potentially prejudiced Expedia in, matters at issue in the underlying lawsuits, arguing that the court should delay resolution of Expedia's duty to defend motion while Zurich explored potential factual issues relating to its ultimate obligation to indemnify Expedia. While recognizing that the discovery sought by Zurich could prejudice Expedia in the underlying lawsuits, the trial court nonetheless refused to consider Expedia's duty to defend motion until Zurich completed discovery, citing Zurich's unproven allegation that Expedia provided late notice of the claims and concluding that Expedia

would not be prejudiced because it is a large corporation with the financial wherewithal to defend itself in the underlying lawsuits. Zurich thus was able to avoid its defense obligation indefinitely, leaving Expedia to shoulder the burden of spending millions to defend lawsuits potentially covered by Zurich's policies.

This Court *requires* insurers to defend so long as any possibility of underlying indemnity coverage exists, and subjects insurers that take actions contrary to policyholders' interests to liability for breach of the duty of good faith. The trial court's decision turns both the language of the insurance contract and the public policy favoring the early resolution of the duty to defend on their heads. An insurer's duty to defend would be a hollow one if a policyholder must wait until trial in a coverage case before it can obtain its bargained-for defense. Washington law bars an insurer from forcing a policyholder to choose between forgoing a defense entirely—bearing the burden of its own defense costs out of pocket—or litigating matters that are at issue in the underlying lawsuits as a condition for obtaining its bargained-for defense.

This Court should reverse the orders below and direct the trial court to enter an order enforcing Zurich's duty to defend and staying discovery into matters that overlap with, or potentially prejudice Expedia in, the underlying lawsuits. In the alternative, this Court should direct the

trial court to adjudicate Expedia's duty to defend motion now, so that Expedia may have its defense coverage in place during the pendency of the underlying lawsuits without being forced to subject itself to overlapping discovery while those lawsuits remain ongoing.

II. ASSIGNMENTS OF ERROR

1. The trial court erred by refusing to enter Expedia's proposed order establishing Zurich's duty to defend following the trial court's denial of Zurich's summary judgment motion. CP 1883-1886; *see generally* CP 1704-1882.

2. The trial court erred by granting Zurich's CR 56(f) motion to continue Expedia's duty to defend motion. CP 4540-4542.

3. The trial court erred by refusing to adjudicate the duty to defend after Expedia requested that its summary judgment motion be heard. CP 4907-4909; *see also* June 15, 2012 RP 30:17-38:16.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Does the trial court's finding that the underlying lawsuits were potentially covered under Zurich's liability policies establish as a matter of law Zurich's duty to defend those lawsuits?

2. Does Washington law prohibit an insurer from avoiding its defense obligation based upon alleged late notice by the policyholder when the insurer has not yet established prejudice as a matter of law?

3. Does Washington law prohibit an insurer from relying upon the financial resources of the policyholder to deny its duty to defend or delay adjudication of the policyholder's duty to defend motion?

4. Does Washington law prohibit an insurer from delaying adjudication of a policyholder's duty to defend motion while it pursues potentially prejudicial discovery designed to develop questions of fact relating to its coverage defenses?

This Court should answer each of these questions in the affirmative.

IV. STATEMENT OF THE CASE

A. Expedia Operates a Merchant Model Business to Assist Consumers with Reserving Rooms from Hotels

Under its merchant model, Expedia simplifies travel reservations by placing all relevant information about hotels at a traveler's fingertips through Expedia's website. CP 1889-90. Expedia does not provide this valuable service for free. Instead, Expedia charges consumers a total price that includes: (1) the rate charged by the hotel for occupancy of the room (the rent); (2) an amount retained by Expedia as compensation for providing online services to the customer (the facilitation fee); and (3) an amount for "tax recovery charges and other service fees," which consists of an amount estimated to be the equivalent of any applicable local

occupancy tax imposed on the guest for renting the room plus an additional fee for Expedia's services. CP 1891-92.

An occupancy tax obligates hotel guests to pay a percentage of the rent charged by the hotel as a tax for the privilege of occupancy. *See, e.g.*, CP 2007-13. Although the tax falls on the guest, municipalities do not collect the tax directly from individual travelers. Instead, hotels include it on the guest's bill and collect it along with the rent for the room.

Expedia does not operate hotels or rent rooms. CP 1892. Nonetheless, because its customers pay for their hotel room reservations at the time of booking, Expedia's policy is to charge customers an amount estimated to be sufficient to cover the total that hotels are responsible for remitting to municipal taxing authorities. *Id.* In calculating these estimated amounts, Expedia applies the tax rates supplied by hotels to the discounted rate it negotiated with the hotel (i.e., the "rent" charged by the hotel), rather than the total retail price the customer pays to Expedia (rent plus fees). *Id.*

B. Cash-Strapped Municipalities Sue Expedia to Pursue Additional Revenue

Though Expedia's practices comport with the relevant ordinances and have long been the industry standard, cash-strapped municipalities have claimed that Expedia should have been collecting from travelers

amounts sufficient to cover the travelers' taxes if they were based on the full retail price of the room. CP 1893. Local governments filed lawsuits seeking, among other things, damages due to the alleged shortfall in revenue received from hotel stays booked through Expedia, whatever the reason for the shortfall. CP 1923; *see also, e.g.*, CP 2610, CP 3279, CP 3546. Most cases remain pending, but among those that have been fully adjudicated, Expedia has prevailed in all but a few. CP 1893; *see also* CP 2021-85.

The suits generally allege that Expedia breached a duty, whether innocently, negligently, or by some other error or mistake. *See, e.g.*, CP 2405. Each states a primary claim for violation of the relevant local or municipal ordinance, and most contain various other state common law claims. *See, e.g.* CP 2410-18. The lawsuits generally seek "damages," "compensatory damages," or other monetary relief. CP 1923; *see also, e.g.*, CP 2610, CP 3279, CP 3546. Some lawsuits also seek punitive damages or other penalties, alleging that Expedia acted "willfully, wantonly, and with conscious disregard for the rights of the [plaintiff]," and thus the plaintiff is entitled to "additional damages in an amount sufficient to punish Defendants." *See, e.g.*, CP 2787. No court has found that Expedia has intentionally or willfully violated the law. CP 1893; *see also* CP 2021-85.

C. **Expedia Tendered Coverage to Its Liability Insurers, Who Denied Any Duty to Defend or Indemnify**

Expedia procured liability insurance from three insurers over nine policy periods. The policies provide Expedia with broad coverage for any liability for damages “arising out of a negligent act or negligent omission . . . in the conduct of [Expedia’s] Travel Agency Operations.” CP 2104. The policies require the insurers to “defend any Suit against [Expedia] seeking” such damages. *Id.* That obligation requires the insurers to provide a defense on an ongoing basis while a potentially covered lawsuit is pending; it is not merely an obligation to reimburse defense expenses after the lawsuit concludes. *Id.*

After being served with the complaint in the first lawsuit, Expedia tendered the action to its insurers on June 10, 2005. CP 2147-48. Less than three weeks later, the insurers denied coverage without investigation and refused to provide Expedia with a defense. CP 2150-52. In 2010 and 2011, Expedia tendered 62 additional lawsuits to its insurers, who again summarily refused Expedia’s tender, offering essentially the same reasons as in the original denial. CP 2170-84; CP 2186-93. As a result, Expedia has been defending the underlying lawsuits at its own expense, incurring tens of millions of dollars of attorneys’ fees.

Expedia filed this action in November 2010, seeking declaratory relief and asserting claims for breach of contract and bad faith against each of its insurers. CP 1-17, 398-416, 1435-37.

D. The Trial Court Ruled That Zurich Cannot Meet Its Burden to Prove No Possibility For Coverage With Respect to Two Zurich Policies.

The insurers moved for summary judgment as to both their duty to defend and duty to indemnify. CP 18-44, 105-28. The insurers attempted to prove, as a matter of law, that the underlying lawsuits did not seek damages on account of negligent acts or omissions within the meaning of the policies. *Id.* As the trial court described in ruling on this motion, Zurich bore the burden of proving that there was no possibility that the underlying lawsuits against Expedia may be covered by the policies. Jan. 13, 2012 RP 80:6-81:2 With respect to two of the policies, the trial court denied Zurich's motion for summary judgment, holding that Zurich had not proven that there was no potential coverage for the underlying claims under those policies. CP 1883-87; Jan. 13, 2012 RP 77:14-85:16. In particular, the trial court found that at least one of the potential theories of liability set forth in the underlying complaints could result in the imposition of damages against Expedia for negligent conduct. Jan. 13, 2012 RP 81:22-24 ("one of those theories, at least, would put this more in the category of damages"); *Id.* 82:25-83:3 ("there is under at least one

conceivable theory a situation where Expedia could be found to be liable under the underlying complaints, yet not have engaged in willful misconduct”).

Following the trial court’s oral ruling denying Zurich’s summary judgment motion, Expedia filed a motion for an order providing that Zurich “has a duty to defend” under the two remaining Zurich policies because the underlying lawsuits “contain one or more claims that are potentially covered,” consistent with the trial court’s ruling. CP 1717; *see generally* CP 1704-24. The trial court declined to enter Expedia’s proposed order, instead entering an order simply denying Zurich’s motion for summary judgment with respect to those two policies. CP 1883-87. Zurich continued to refuse to provide Expedia with a defense.

E. The Trial Court Twice Refused to Hear Expedia’s Motion for Summary Judgment as to the Duty to Defend Until Prejudicial Discovery is Completed.

Expedia then filed its own motion for summary judgment seeking an adjudication that Zurich has a duty to defend Expedia in the underlying lawsuits. CP 1895-1921. Expedia argued, as the trial court had earlier ruled in denying Zurich’s motion, that the underlying complaints sought damages from Expedia based on potentially negligent acts, errors, or omissions, thus giving rise to a possibility of coverage. *Id.* Expedia filed

this summary judgment motion on March 30, 2012. *Id.* It has not yet been heard.

Zurich moved for a CR 56(f) continuance, arguing that it needed to develop evidence outside of the “eight corners” of the underlying complaints and the policies to raise “triable issues of fact concerning the coverage available under the insurance policies at issue in Expedia’s motion.” CP 3821. After the conclusion of substantive briefing on Expedia’s duty to defend motion and in a summary order, the trial court granted Zurich’s CR 56(f) motion and took Expedia’s motion off calendar, rejecting Expedia’s argument that extrinsic evidence offered by an insurer and questions of fact as to coverage defenses are irrelevant to the question of whether the duty to defend has arisen. CP 4540-42.

Zurich asserted it was entitled to discovery concerning Expedia’s knowledge and intent before Expedia’s duty to defend motion could be heard. Much of this discovery directly overlaps with issues being litigated in the underlying lawsuits, where the plaintiffs seek evidence concerning what Expedia knew about potential occupancy tax liability, and when, to try to prove that Expedia acted with intent. CP 4692, 4695-4712, 4587-4656. In an effort to expedite the trial court’s adjudication of Zurich’s duty to defend, and to protect itself from risk in the underlying lawsuits, Expedia asked the trial court to (a) set a hearing date for Expedia’s duty to

defend motion while (b) protecting Expedia from overlapping, and thus potentially prejudicial, discovery. CP 4557-80.

The trial court found that there is a “dangerous overlap” between the coverage case and the underlying cases concerning “the discovery seeking Expedia’s knowledge or intent regarding its liability for the payment of the certain occupancy tax amounts.” June 15, 2012 RP 31:10-13. It further found Zurich’s pursuit of discovery from Expedia “could be injurious to [Expedia’s] interests” in the underlying cases. June 15, 2012 RP 31:18-20. Conflating the duty to defend with the duty to indemnify, however, the trial court refused to hear Expedia’s duty to defend motion until that “dangerous” and “injurious” discovery was complete because it could not “conclude, as a matter of law, that this discovery is not relevant to the [insurance] company’s defenses.” June 15, 2012 RP 31:24-32:1.

The trial court offered two justifications for the deferral of Expedia’s motion. First, the trial court held that, by virtue of the timing of Expedia’s tender, Expedia, could not procure defense coverage from Zurich without allowing Zurich to “develop[] the evidence that they think they need to have.” June 15, 2012 RP 36:1-4. The trial court did not find that any late notice by Expedia prejudiced Zurich as a matter of law. *See id.* 35:3-38:16. Second, the trial court held that Expedia “has adequate funds, obviously, to hire counsel” and litigate the underlying lawsuits

itself. *Id.* 36:11-16. It concluded that Expedia thus would not be prejudiced by any delay in Zurich's obligation to defend because "when this all winds up," Expedia would "still have recourse against their insurance company for payment" of the years of litigation expenses Expedia incurred. *Id.* 36:25-37:4. The trial court entered an order denying Expedia's motion on August 22, 2012. CP 4907-09.

Expedia timely sought discretionary review of the trial court's August 22 order and all other orders related to that order, CP 4910, which this Court granted on July 10, 2013.

V. ARGUMENT

A. This Court Reviews the Orders Below De Novo.

Legal issues affecting the scope of insurance coverage are reviewed de novo. *See Fluke Corp. v. Hartford Accident & Indem. Co.*, 145 Wn.2d 137, 143, 34 P.3d 809 (2001); *accord Haskell v. Super. Ct.*, 33 Cal. App. 4th 963, 978, 39 Cal. Rptr. 2d 520 (1995). Similarly, language in an insurance policy is interpreted as a matter of law and construction of that language is reviewed de novo. *Moeller v. Farmers Ins. Co. of Wash.*, 173 Wn.2d 264, 271, 267 P.3d 998 (2011).

Orders regulating the timing and procedure of a case, such as orders related to a request for continuance under CR 56(f), generally are reviewed for abuse of discretion. *See Mannington Carpets, Inc. v.*

Hazelrigg, 94 Wn. App. 899, 902, 973 P.2d 1103 (1999). Here, however, the trial court erred on issues of law relating to the duty to defend, and “[a]n appellate court reviews issues of law de novo.” *Ino Ino, Inc. v. City of Bellevue*, 132 Wn.2d 103, 114, 937 P.2d 154 (1997). Even if the abuse of discretion standard applies, a trial court abuses its discretion when it misapplies the law because “[a]n errant interpretation of the law is an untenable reason for a ruling.” *Minehart v. Morning Star Boys Ranch, Inc.*, 156 Wn. App. 457, 463, 232 P.3d 591 (2010); *see State v. Tobin*, 161 Wn.2d 517, 523, 166 P.3d 1167 (2007) (abuse of discretion arises from “application of an incorrect legal analysis or other error of law”).

B. The Trial Court Failed to Correctly Apply the Law Governing the Duty to Defend as Articulated by This Court.

Under decades of this Court’s jurisprudence, the duty to defend contained in the policies Expedia bought from Zurich requires Zurich to provide a defense from the time a potentially covered claim is asserted throughout the pendency of the underlying litigation, so long as the potential for coverage exists. *Am. Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 405, 229 P.3d 693 (2010). This Court has adopted rules to ensure that insurers will not desert their policyholders while they attempt to develop the evidence necessary to justify their denial of coverage. *Id.*

Zurich flouted those rules. It refused to defend Expedia when Expedia requested coverage. Zurich then sought a ruling that it had no obligation to provide coverage, but was rejected. Instead, the trial court held that the claims against Expedia potentially were within the scope of Zurich's coverage because they potentially sought damages for negligent acts. This finding was sufficient to confirm Zurich's obligation to defend Expedia under Washington law, and the trial court should have ordered Zurich to defend immediately upon making that determination. Zurich, however, continued to refuse to defend, and the trial court improperly declined to order Zurich to comply with its defense obligation. The trial court compounded its error by twice refusing to adjudicate Zurich's duty to defend and hold Zurich to the promise it made. These orders contain four fundamental legal errors that warrant reversal.

First, the trial court failed to adhere to Washington law holding that the duty to defend exists whenever, and for so long as, there is a potential for coverage and requiring that the determination be made based upon the policies and the complaint alone. Instead, the trial court improperly refused to order Zurich to defend after finding the claims against Expedia were potentially covered and then improperly deferred adjudication of Expedia's duty to defend motion to allow Zurich to take discovery into matters extrinsic to the policies and complaints for the

purpose of raising disputed issues of fact (which, even if they existed, would not defeat the duty to defend).

Second, the trial court wrongly relied on Zurich's mere assertion of a late notice defense—without any proof of actual and substantial prejudice to Zurich—to excuse it from providing ongoing defense coverage to Expedia, in derogation of the duty to defend.

Third, the trial court erroneously applied a needs-based test concerning when a policyholder is entitled to a duty to defend, contrary to Washington law that treats policyholders equally without regard to need.

Fourth, the trial court improperly ordered that Expedia could not obtain resolution of its duty to defend motion without completing discovery that overlaps with issues in the underlying cases, thus leaving Expedia in an irreconcilable dilemma—either forgo defense coverage until the underlying lawsuits are concluded or pursue that coverage and potentially prejudice its position in those lawsuits.

1. **The Trial Court Erroneously Refused to Order Zurich to Defend Expedia in Underlying Lawsuits Potentially Covered by Zurich's Policies.**

As the trial court recognized when it denied Zurich's motion for summary judgment, Washington has "extraordinarily vigorous protections for the insured with regards to the duty to defend." Jan. 13, 2012 RP 83:17-18. Chief among those protections are the standard for determining

whether the duty has been triggered and the evidence applicable to that determination.

The duty to defend is based upon the *potential* for coverage. *Woo v. Fireman's Fund Ins. Co.*, 161 Wn.2d 43, 52, 164 P.3d 454 (2007). It arises when "a complaint against the insured, construed liberally, alleges facts which could, if proven, impose liability upon the insured within the policy's coverage." *Woo*, 161 Wn.2d at 52-53 (quoting *Truck Ins. Exch. v. VanPort Homes, Inc.*, 147 Wn.2d 751, 760, 58 P.3d 276 (2002)). All ambiguities or questions of fact or law relating to the existence of coverage are construed "liberally in favor of 'triggering the insurer's duty to defend.'" *Id.* at 53 (quoting *VanPort Homes*, 147 Wn.2d at 760).

An insurer may not resolve a disputed issue of fact or law in its favor in order to deny the duty to defend. *Am. Best*, 168 Wn.2d at 405. To the contrary, as long as there is "any reasonable interpretation of the facts or the law that could result in coverage, the insurer must defend." *Id.*; see also 14 Lee R. Russ et al., *Couch on Insurance* § 200.11 (3d ed. 2007) (when the duty to defend "depends on an outstanding factual dispute, the disputes must be resolved in favor of coverage until the insurer conclusively establishes that there is no potential for coverage"). Disputed issues of fact relating to the insurer's defenses do not justify denial or delay of the policyholder's motion; instead, such factual disputes

confirm the existence of the duty to defend. *Am. Best*, 168 Wn.2d at 405; *see also Anthem Elecs., Inc. v. Pac. Emp'rs Ins. Co.*, 302 F.3d 1049, 1060 (9th Cir. 2002); *SmartReply, Inc. v. Hartford Cas. Ins. Co.*, No. 2:10-cv-01606, 2011 WL 338797, at *2 (W.D. Wash. Feb. 3, 2011); 1-17 Thomas V. Harris, *Washington Insurance Law*, § 17.01 at 17-3 (3d ed. 2010) (“An insurer is not justified in declining a tender of defense when there are such unresolved issues [of fact or law].”).

An insurer is obligated to decide whether an underlying lawsuit triggers the duty to defend based solely on the eight corners of the underlying complaint and the insurance policy. *Woo*, 161 Wn.2d at 53-54; *VanPort Homes*, 147 Wn.2d at 760; *see also Wellman & Zuck, Inc. v. Hartford Fire Ins. Co.*, 170 Wn. App. 666, 675, 285 P.3d 892 (2012) (“[T]he duty to defend must be determined from the complaint.”). Washington has made exceptions to this rule to allow policyholders to submit additional evidence establishing the existence of a defense obligation. *Woo*, 161 Wn.2d at 54. An insurer, however “*may not* rely on facts extrinsic to the complaint to deny the duty to defend.” *Id.* Because an insurer cannot rely on facts extrinsic to the complaint to deny the duty to defend, it also may not delay adjudication of the duty to defend to pursue discovery into those extrinsic facts. *See SmartReply*, 2011 WL 338797, at *2 (citing *VanPort Homes*, 147 Wn.2d at 760).

The duty to defend is thus different from and broader than the duty to indemnify. The latter ““hinges on the insured’s *actual liability* to the [underlying] claimant and *actual coverage* under the policy.” *Woo*, 161 Wn.2d at 53 (quoting *Hayden v. Mut. of Enumclaw Ins. Co.*, 14 Wn.2d 55, 64, 1 P.3d 1167 (2000) (emphasis in *Woo*)). The duty to indemnify does not arise, if at all, until the policyholder is found liable, and at that point the policyholder must prove that its liability is not just potentially covered—as is the case at the duty to defend stage—but actually covered under the policy. As a result, the duty to defend often arises in situations where the duty to indemnify ultimately is found not to exist.

The trial court confused these duties when it held that the discovery Zurich pursued was necessary to resolve Expedia’s motion to establish a duty to defend “on the merits.” June 15, 2012 RP 37:8. Zurich’s duty to defend Expedia turns solely on whether the relevant underlying complaints potentially give rise to coverage under Zurich’s policies, a question determined exclusively by the “eight corners” of those complaints and policies. *Woo*, 161 Wn.2d at 53-54. Whether Expedia is actually entitled to indemnity for any liabilities incurred in the underlying lawsuits is a different question, decided on different evidence, than the duty to defend issue raised by Expedia’s motion.

The duty to defend is “one of the main benefits of the insurance contract.” *VanPort Homes*, 147 Wn.2d at 760. Particularly in the modern world of litigation, the expenses incurred defending against potential liability can be just as burdensome as the ultimate liability itself, if not more so. Those expenses often place pressure on defendants to settle cases as to which they have meritorious defenses, simply to avoid the burdensome costs of litigation. Moreover, while the ultimate liability may be avoided, particularly where the allegations prove to be untrue, the defense costs must be borne regardless of the outcome.

If an insurer could refuse to defend its policyholders for so long as disputed issues concerning coverage remained, any incentive for an insurer to defend during the pendency of underlying litigation would disappear. Policyholders would be left without the promised security that their insurance was intended to provide. They would be forced to “double down” and fund two parallel lawsuits—one to avoid liability in the underlying case and one to compel the insurer to provide the bargained-for benefits of the insurance policy. If an insurer could also rely on disputed facts to avoid its defense obligation, it could erect a nearly insuperable barrier of defenses, each of which must be conclusively eliminated by the policyholder before the policyholder receives its promised defense.

This Court has never condoned such a perverse result; instead, it has proscribed rules designed to prevent it from happening. An insurer may not “desert policyholders and allow them to incur substantial legal costs while waiting for an indemnity determination.” *Am. Best*, 168 Wn.2d at 405 (quoting *VanPort Homes*, 147 Wn.2d at 761). The insurer has a duty to defend unless and until the insurer can prove that there is no possibility for coverage. *Id.* (an insurer “must defend until it is clear that the claim is not covered”); see also 1-7 Jeffrey E. Thomas, *New Appleman on Insurance Law* § 7.05[5][a] (Library ed. 2013) (“For the defense duty to meaningfully provide the benefit for which the policyholder bargained, it must be provided during the pendency of the underlying suit.”).¹

The trial court turned these standards on their heads. The trial court allowed Zurich to avoid its defense obligation even after failing to prove that there was no possibility for coverage. Once the trial court found that it was not clear that the claim is not covered (i.e., that it was potentially covered), it should have ordered Zurich to immediately provide

¹ An insurer may defend under a reservation of rights and file a declaratory judgment action to determine its duties to defend or indemnify. See *Am. Best*, 168 Wn.2d at 405. However, the insurer must continue to defend its policyholder until the absence of coverage has been established conclusively. See *Nat’l Sur. Corp. v. Immunex Corp.*, 176 Wn.2d 872, 879-880, 297 P.3d 688 (2013). The insurer also may not take positions in the declaratory judgment action, or engage in discovery, that exposes its policyholder to potential prejudice in the underlying lawsuits. See 1-17 Thomas V. Harris, *Washington Insurance Law* § 17.01 at 17-3 (3d ed. 2010).

Expedia the defense it bargained for. *Am. Best*, 168 Wn.2d at 405; Jan. 13, 2012 RP 77:14-85:16.

As California courts applying essentially the same duty to defend principles have recognized, once an insurer fails to meet its burden on summary judgment of demonstrating that coverage is not possible, coverage necessarily is possible. See *Am. Cyanamid Co. v. Am. Home Assurance Co.*, 30 Cal. App. 4th 969, 975, 35 Cal. Rptr. 920 (1994) (if the insurers' evidence "does not permit the court to eliminate either party's view . . . the duty to defend is then *established*, absent additional evidence bearing on the issue" (internal quotation marks omitted)).² When there remain disputed facts as to the ultimate existence of coverage, "presumably there continues to exist a potential for coverage and thus a duty to defend." *Montrose Chem. Corp. v. Super. Ct.*, 6 Cal. 4th 287, 301, 24 Cal. Rptr. 2d 467, 861 P.2d 1153 (1993); accord *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1084, 17 Cal. Rptr. 2d 210, 846 P.2d 792 (1993) (if the evidence permitted does not permit the court to "eliminate" the possibility of coverage, the duty to defend is established); *Amazon.com*

² California and Washington courts apply generally the same principles to the duty to defend. See *SmartReply*, 2011 WL 338797, at *2. Where they differ, Washington law provides more protection to policyholders. For example, California permits an insurer to consider extrinsic evidence known to it at the time of tender in denying its duty to defend, where Washington does not. Compare *Montrose Chem. Corp. v. Super. Ct.*, 6 Cal. 4th 287, 298-99, 24 Cal. Rptr. 2d 467, 861 P.2d 1153 (1993) (permitting insurer to deny coverage based upon extrinsic evidence that "conclusively eliminate[s] a potential for liability") with *Woo*, 161 Wn.2d at 54 ("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.").

Inc. v. Atl. Mut. Ins. Co., No. 05-719, 2005 WL 1711966, at *4 (W.D. Wash. July 21, 2005) (under Washington law, summary judgment is “required for insured unless insurer could conclusively negate coverage as a matter of law”). That reasoning is applicable here. The trial court erred in refusing to hold, as Expedia’s proposed order stated, CP 1717, that the failure of Zurich’s summary judgment motion necessarily established Zurich’s duty to defend.

The trial court then compounded its refusal to enforce Zurich’s duty to defend by twice refusing to hear Expedia’s subsequent duty to defend motion. By depriving Expedia of an adjudication of Zurich’s defense obligation, the trial court has enabled Zurich to desert Expedia while Expedia incurred substantial legal cost defending the underlying cases and undertaking discovery in the coverage case. Rather than ensuring that Zurich defends Expedia until any possibility for coverage is extinguished, the trial court relieved Zurich of its defense obligation while it pursued discovery into issues relating to Zurich’s coverage defenses. Moreover, the discovery that the trial court permitted Zurich to pursue was extrinsic to the policies and the underlying complaints and thus not relevant to the resolution of Expedia’s motion.³

³ The trial court claimed that it was not resolving the question of whether extrinsic evidence was relevant to a policyholder’s motion for adjudication of the duty to defend. June 15, 2012 RP 32:2-8. As an initial matter, this is not an open question for the trial

In *Haskel*, the California Court of Appeals addressed this precise issue—“To what extent, if at all, is an insurer entitled to delay a summary adjudication of the defense duty issue until discovery has been completed on disputed coverage questions?” The court held that the insurer *may not* “delay an adjudication of their defense obligation until they develop sufficient evidence to retroactively justify their refusal to provide that defense.” 33 Cal. App. 4th at 973, 977. The *Haskel* court held that such a delay was “directly contrary” to duty to defend principles. *Id.* The “immediate imposition” of the duty to defend is not a mere procedural nicety; it is substantively “necessary to provide to an insured the full benefits due under the policy.” *Id.* at 968.

The duty to defend principles that animated the *Haskel* decision are the same ones that provide the framework for Washington’s vigorous public policy enforcing an insurer’s duty to defend. *See id.* at 976-77 (insurers must defend “unless and until they . . . *conclusively* establish[] that there is no potential for coverage”); *id.* at 976 (duty to defend arises on tender and lasts “until it has been shown that there is *no* potential for

court to resolve. This Court conclusively has held that such evidence may not be considered. *See Woo*, 161 Wn.2d at 53-54; *VanPort Homes*, 147 Wn.2d at 760. Moreover, there could have been no reason for the trial court to defer ruling on Expedia’s motion unless it determined that the evidence Zurich was pursuing through its CR 56(f) motion was relevant to Expedia’s motion. Had the trial court correctly ruled that such extrinsic evidence was irrelevant to Expedia’s motion, it would not have delayed adjudication of that motion.

coverage” (internal quotation marks omitted)). This Court should reaffirm its holdings that an insurer has a duty to defend as a matter of law for so long as coverage remains possible.

2. **An Insurer’s Late Notice Defense Cannot Negate the Duty to Defend Without Conclusive Proof of Prejudice to the Insurer—Until Then, the Insurer Must Defend.**

In holding that the timing of Expedia’s tender to Zurich rendered the absence of a defense “a problem of Expedia’s own making,” June 15, 2012 RP 36:17-18, the trial court erroneously held that a policyholder’s late tender may excuse an insurer’s refusal to defend, even in the absence of prejudice. Under the trial court’s reasoning, an insurer’s mere allegation of late tender, without any showing of prejudice, would justify excusing the insurer from its ongoing duty to defend and delaying adjudication of the duty to defend, so long as the policyholder may potentially seek reimbursement of its defense costs after the fact. This standard lacks support in Washington law, for three reasons.

First, the defense of late tender does not allow an insurer to shirk its duty to defend until that defense is resolved. *See Nat’l Sur. Co. v. Immunex Corp.*, 176 Wn.2d 872, 889, 297 P.3d 688 (2013) (“[A]n insured’s late tender in violation of the insurance contract does not relieve the insurer of its duty to defend unless it proves *actual and substantial prejudice* from late notice.”). To the contrary, when there has been a late

tender, “the insurer must demonstrate actual prejudice before it will be relieved from its duties to its insured.” *Mut. of Enumclaw Ins. Co. v. USF Ins. Co.*, 137 Wn. App. 352, 360-61, 153 P.3d 877 (2007). The “duty to defend remains unless [the insurer] proves actual and substantial prejudice.” *Id.* Indeed, this Court recently rejected the argument that a policyholder “selectively delay[ing] tender of a claim for years in order to control the defense and settlement of the claims” constitutes prejudice to the insurer as a matter of law. *Immunex*, 176 Wn.2d at 890. Instead, the Court recognized that facts relating to the insurer’s prejudice must be determined before its late notice defense was established and that, until such time, the duty to defend remains in place. *Id.* Contrary to binding precedent, the trial court wrongly excused Zurich from its duty to defend while questions of fact concerning prejudice remained unresolved.

Second, there is nothing unique about a late notice defense. Notice provisions are a common feature in liability policies and, when coverage disputes arise, insurers frequently assert that their policyholders failed to comply with the notice provisions. *See* 24 Tim Butler and Matthew King, *Wash. Practice, Envtl. Law & Practice* § 24.12 (2d ed. 2013). If insurers could avoid their duty to defend merely by asserting a late notice defense, policyholders would be denied the benefits of prompt defense coverage that Washington law requires.

Third, an insurer “cannot assert prejudice with regard to its ability to conduct an investigation that it never even tried to conduct.” *In re Feature Realty Litig.*, 634 F. Supp. 2d 1163, 1180 (E.D. Wash. 2007). Here, the initial tender was made in 2005 shortly after the first underlying lawsuit was filed. CP 2147-48. It was summarily denied, without investigation, and without any reservation of rights. CP 2150-52. Several of the underlying lawsuits similarly were tendered shortly after they were filed. The majority of the underlying lawsuits at issue in the case were filed in 2008 or later, within two years of Expedia’s 2010 tender. CP 2170-84. Not surprisingly, Zurich’s response to that tender was identical to the first—coverage denied.

The timing of Expedia’s tender is irrelevant—even to the duty to indemnify—if Zurich did not suffer prejudice. Given that Zurich summarily denied each of Expedia’s tenders, it will be hard pressed to establish that it would have acted differently—let alone suffered actual and substantial prejudice—had Expedia tendered any of the cases sooner. *See Cannon, Inc. v. Fed. Ins. Co.*, 82 Wn. App. 480, 486, 918 P.2d 937 (1996) (no prejudice as a matter of law in the absence of evidence that the insurer’s analysis or investigation of coverage would have been different had the policyholder tendered earlier). In any event, the circumstances of Expedia’s tender at most give rise to issues of fact concerning whether late

notice is a defense to Zurich's duty to indemnify. Such issues of fact cannot excuse Zurich from its defense obligation, particularly in light of its inability to prove, or even allege, actual and substantial prejudice.

A late notice defense not yet proven by the insurer is thus no different than any other coverage defense not yet proven by the insurer. For so long as the defense remains unresolved, or there are disputed issues of fact related to the defense, the insurer must defend. *Time Oil Co. v. Cigna Property & Casualty Insurance Co.*, 743 F. Supp. 1400 (W.D. Wash. 1990), which applied Washington law, illustrates the proper sequencing for resolving a duty to defend motion in the face of late notice and other defenses. One of Time Oil's insurers asserted a late notice defense that could not be resolved at the summary judgment stage due to factual disputes relating to whether the insurer suffered actual and substantial prejudice. *Id.* at 1416. Notwithstanding that unresolved defense, Judge Rothstein held that Time Oil "has established the existence of a duty [to defend]" because the allegations of the underlying complaint raised a claim potentially covered by the policies and thus granted Time Oil's motion for summary judgment as to the duty to defend. *Id.* at 1420, 1422.

Here, in contrast, the trial court misapplied Washington law by excusing Zurich from its duty to defend until Zurich's coverage defenses

could be fully adjudicated. This Court should require Zurich to defend unless and until it establishes as a matter of law that it has suffered prejudice from Expedia's alleged late tender.

3. **The Insurer's Duty to Defend Does Not Depend Upon the Financial Needs of the Policyholder.**

This Court has never allowed the duty to defend to hinge on the relative financial stability of a policyholder. Nonetheless, the trial court declined to adjudicate Expedia's motion in part because Expedia "has adequate funds . . . to hire counsel" and had "driven the bus" of its own defense for a certain period of time. June 15, 2012 RP 35:14-15, 36:11-13. This holding was wrong. Washington courts do not treat large corporate insureds (or wealthy individuals) differently from smaller companies or individuals, nor do they apply different standards depending upon how capable a policyholder is of funding its own defense when the insurer wrongly refuses to do so. Insurance policies are contracts—often standard form contracts—and issues related to the scope of coverage provided by those contracts apply equally to large and small policyholders. *See Boeing Co. v. Aetna Cas. & Sur. Co.*, 113 Wn.2d 869, 883, 784 P.2d 507 (1990).

The trial court's order effectively rewrote the plain language of the policy by converting the duty to provide an ongoing defense into a mere

duty to reimburse after the fact. Zurich's promise was expansive and straightforward—it agreed to “defend any Suit” seeking damages on account of any “negligent act or negligent omission” in the conduct of Expedia's travel agency operations. CP 2104. Zurich did not limit its obligation to defend only to those cases in which Expedia was financially unable to defend itself, or in which failing to defend would materially prejudice Expedia. Nor did Zurich state that it will not defend Expedia while underlying suits are ongoing, but only reimburse Expedia after the fact. Washington courts construe policies as written, “in accord with the understanding of the average purchaser.” *Queen City Farms, Inc. v. Cent. Nat'l Ins. Co. of Omaha*, 126 Wn.2d 50, 65-66, 882 P.2d 703 (1994). No purchaser would read Zurich's policy language and conclude that its right to an immediate and ongoing defense turned on the policyholder's own financial wherewithal. *See id.* at 67 (rejecting introduction of extra-contractual limitation into insurance policy because “if the insurers wanted [a different] standard to apply, they could easily have drafted language to that effect.”).

Moreover, the needs-based test applied by the trial court would be unworkable. Before a duty to defend motion could be resolved, the policyholder would need to make an evidentiary showing demonstrating the burden it suffers as a result of paying its own defense costs. The

insurer necessarily would be permitted to probe into its policyholder's financial condition in attempting to oppose the motion. Rather than the simple approach that presently governs the duty to defend—looking to the underlying complaint and the policy—courts would need to engage in a nuanced analysis of need and burden. How much income, relative to defense costs, is sufficient to render those costs non-burdensome? How should projections of future financial performance and future litigation expense be weighed? What happens if the financial circumstances of the policyholder change? Should the court revisit the question any time a new stage of litigation is reached, or a new lawsuit is filed? These are just a few of the questions that arise under the trial court's approach. That approach would complicate insurance coverage cases and deprive policyholders of the certainty and clarity of expectations that the rules governing the duty to defend provide.

Not only did the trial court apply an unworkable double standard to a corporate policyholder, it drew its conclusion that Expedia would not be prejudiced by losing its right to an ongoing defense without any foundation in the record. Neither Expedia nor Zurich presented evidence of Expedia's financial condition, the ongoing costs of Expedia's defense, or the burden those costs place on Expedia.

As the past several years have made clear, no corporation is safe from the vicissitudes of the financial markets—a company that is healthy and stable in one moment may suffer a rapid downturn as economic conditions change, making the burdens of litigation expense impossible to bear. Even in healthy times, funding dozens of lawsuits across the country causes harm by depriving corporate resources from their intended corporate, charitable, or other designated uses. Moreover, even if Expedia suffered no material impact by undertaking the burden of funding litigation expenses, converting Zurich’s obligation from one of ongoing defense to reimbursement after the fact leaves Expedia vulnerable to the risk that Zurich may be adversely affected by market conditions and unable to pay Expedia’s legal bills when the time comes to seek reimbursement. Liability insurance is designed to protect policyholders against these vulnerabilities. *See Immunex*, 176 Wn.2d at 878 (“[S]ecurity and peace of mind are principal benefits of insurance . . .”).

This Court should hold that insurers may not rely on the financial condition of the policyholder in deciding whether and when to defend.

4. **Washington Law Does Not Permit an Insurer to Conduct Overlapping and Potentially Prejudicial Discovery Prior to the Adjudication of Its Defense Obligation.**

Insurers violate their duty of good faith when they take positions in coverage litigation that expose their policyholders to the risk of prejudice in the underlying lawsuits. *Mut. of Enumclaw Ins. Co. v. Dan Paulson Constr. Inc.*, 161 Wn.2d 903, 918, 169 P.3d 1 (2007) (insurer acts in bad faith if it litigates coverage issues that “*might* prejudice its insured’s tort defense” (emphasis added, internal quotation marks omitted)); *W. Nat’l Assurance Co. v. Hecker*, 43 Wn. App. 816, 821 n.1, 719 P.2d 954 (1986) (insurer may not litigate “facts upon which [underlying] liability is based”). Facts that overlap with or are logically related to the issues in the underlying lawsuits are off limits in coverage cases while the underlying lawsuits are ongoing. *See* 1-14 Thomas V. Harris, *Washington Insurance Law* § 14.02 (3d ed. 2010). The overlapping facts “can only be decided in the damage action”; it is the job of the underlying court, and not the coverage court, to determine those facts in the first instance. *Holland Am. Ins. Co. v. Nat’l Indem. Co.*, 75 Wn.2d 909, 912, 454 P.2d 383 (1969); *see* 2 Allan D. Windt, *Insurance Claims and Disputes: Representation of Insurance Companies and Insureds* § 8.4 at 8-15 to 8-16 (6th ed. 2013) (endorsing rule and noting that it prevents an insured from being forced

into a “dress rehearsal” of the underlying litigation); 1-7 Jeffrey E. Thomas, *New Appleman on Insurance Law* § 7.05[4][c] (Library ed. 2013) (same). These rules derive from the principle that insurers must refrain from conduct that elevates their own interests above those of their policyholders. *Tank v. State Farm Fire & Cas. Co.*, 105 Wn.2d 381, 391, 715 P.2d 1133 (1986).

The discovery Zurich sought—and that the trial court held *must* be completed before Expedia’s duty to defend motion could be heard—and the arguments Zurich seeks to advance result in precisely the overlap that Washington courts prohibit. The focus of much of Zurich’s discovery has been on establishing what Expedia knew and when in order to further Zurich’s claims that Expedia acted intentionally or that Expedia’s losses were known in advance. Zurich has sought documents concerning Expedia’s communications with the underlying taxing authorities and other taxing authorities beyond those at issue in the underlying lawsuits. These are precisely the topics that the underlying plaintiffs are pursuing. CP 4692, 4695-4712, 4587-4656. Zurich’s discovery also extends beyond the complaint and the policies and thus is not relevant to whether the duty to defend has arisen. *See Woo*, 161 Wn.2d at 53-54.

Forcing Expedia to complete this discovery exposes it to the risk that questions concerning its knowledge and intent could be resolved in

the coverage case before they are finally adjudicated in the underlying lawsuits. The potential prejudice caused by litigation of such overlapping issues is “obvious.” *Montrose*, 6 Cal. 4th at 302. Indeed, a “classic situation” where such prejudice arises is when “the [underlying claimant] seeks damages on account of the insured’s negligence, and the insurer seeks to avoid providing a defense by arguing that its insured harmed the [underlying claimant] by intentional conduct.” *Montrose Chem. Corp. v. Super. Ct.*, 25 Cal. App. 4th 902, 907, 31 Cal. Rptr. 2d 38 (1994). This “classic situation” is present here.

Expedia is further prejudiced by the prospect that it could be forced to take contradictory positions in this case and in the underlying lawsuits. Through discovery, Zurich seeks to compel Expedia to identify potentially negligent acts that caused the damages the underlying plaintiffs are pursuing. CP 4626, 4630. Proving the occurrence of such negligent acts could result in Expedia proving its own liability in the underlying cases, contrary to Washington law. *See Dan Paulson*, 161 Wn.2d at 918. Instead of standing beside Expedia, this discovery aligns Zurich with the underlying claimants who seek to establish Expedia’s liability. As the California appellate courts have recognized, the proper course in such cases is to adjudicate the duty to defend and then stay overlapping

discovery while the underlying litigation is ongoing. *Montrose*, 6 Cal. 4th at 302; *Haskel*, 33 Cal. App. 4th at 980-81.

The supposed “alternatives” offered by the trial court provide no meaningful protection to Expedia because they fundamentally deny one of the substantive protections Washington insurance law provides to policyholders. The trial court refused to hear Expedia’s duty to defend motion until the conclusion of discovery, including discovery into matters overlapping with the underlying lawsuits. While it invited Expedia to raise *other* unspecified motions that might be resolved without the need to resort to such discovery (i.e., the “alternative”), it offered no alternative by which Expedia’s duty to defend motion could be heard without the discovery that the trial court itself found to be “dangerous” and “injurious.” June 15, 2012 RP 31:10-20, 38:6-16. Expedia must either forgo the duty to defend while the underlying cases are ongoing—transforming its right to a prompt defense into a mere right to reimbursement many years after the fact—or expose itself to potential prejudice in those cases. This result is contrary to Washington law.

Expedia has two fundamental rights that are adversely impacted by the decisions below. First, Expedia is entitled to prompt and ongoing defense coverage for so long as there is any possibility that the underlying claims are covered. Second, Expedia is entitled to protection from

litigation into issues that overlap with the underlying lawsuits. *See Dan Paulson*, 161 Wn.2d at 918. Expedia is entitled to both of these rights; Washington law does not condone the forced deprivation of one as a consequence of pursuing the other. Indeed, this is exactly what *Haskel* holds. The court there ruled both that the trial court was “required to consider Haskel’s motion for summary adjudication” on the duty to defend *and* that Haskel was “entitled to a stay of discovery on issues which prejudice its defense of the underlying action.” 33 Cal. App. 4th at 975, 978. Only by enforcing both rights now, at this stage of the litigation, can this Court provide Expedia with the protection that Washington law provides.

VI. CONCLUSION

Expedia has an “unrestricted right to prosecute a concurrent [coverage] action” and is “not required to await the resolution of the [underlying] claim,” particularly when its insurer has refused to provide a defense. *Harris, supra*, § 14.02. The orders below deny Expedia that right and impose restrictions that Washington law does not permit. This Court should reaffirm the longstanding protections for policyholders inherent in the duty to defend and order that Zurich has an immediate obligation to defend Expedia, based on the trial court’s conclusion that coverage was possible under the policies. At the very least, this Court should order the

trial court to adjudicate Expedia's duty to defend motion immediately, based solely upon the relevant policies and underlying complaints. It should further order the trial court to stay discovery into matters overlapping with, or potentially prejudicial to Expedia in, the underlying lawsuits until such lawsuits are concluded.

DATED this 24th day of September, 2013.

Respectfully submitted,

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DECLARATION OF SERVICE

I, Heather Bond, declare under penalty of perjury that I am over the age of 18 and competent to testify and that the parties listed below were served in the manner listed below:

On September 24, 2013, I caused a copy of Brief of Plaintiffs/Petitioners and this Declaration of Service to be delivered on this date via Legal Messenger to:

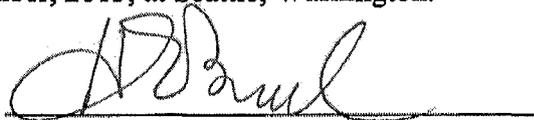
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On September 24, 2013, I further served via UPS copies of the above-referenced documents to Defendants/Respondents' out-of-state co-counsel:

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I hereby declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 24th day of September, 2013, at Seattle, Washington.



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Expedia, Inc., et al. v. Steadfast Insurance Company, et al.
Case No. 88673-3 (Court of Appeals Case No. 69341-7-1)

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