

**Washington Court of Appeals holds that
“Washington law does not, in fact, force
insurers to pay for losses that they have not
contracted to insure”**

**Breaking Developments In London Market Law
04/18/08**

SYNOPSIS

On 7 April 2008, the Washington Court of Appeals issued its decision in *Polygon Northwest Co. v. American National Fire Ins. Co. et al.*, concerning trigger-of-coverage, contribution, and allocation of damages between multiple primary and excess insurers on the risk in a construction defects case.* Three of these holdings are most noteworthy. First, the *Polygon* Court held that an excess policy triggered when the insured’s liability exceeds the primary’s limits, notwithstanding non-payment due to insolvency. However, the excess insurer is not liable for the share of its insolvent underlying primary. Finally, the Court held that a statutory award of attorney’s fees against the insured is not a “supplemental payment” under the primary policies’ definition thereof.

THE FACTS

This case arose out of a construction defect claim against the general contractor, Polygon Northwest Co. (“Polygon”), by the homeowners of a condominium project that Polygon had built. The claims against Polygon implicated four policy years. Each year had a \$1 million CGL primary policy underlying an excess, but the primary insurer in years 3-4 was insolvent. The remaining primary insurers provided a defense, and Polygon settled the claims against it for \$7.8 million.

The excess insurer in years 3-4 refused to participate in the settlement, maintaining that the insolvent underlying insurer’s failure to pay its policy limit resulted in no trigger of coverage for its excess policies. The other insurers funded the settlement under Washington’s “all sums” rule and demanded contribution. After the trial court’s decision, the insurers appealed this and other issues.

THE HOLDINGS

1. Excess Policies with Insolvent Underlying Policies are Triggered When Liability Exceeds the Underlying Limits.

Great American, the excess insurer for years 3-4, argued that its policy was not triggered because the insolvent underlying primary, United Capitol, did not actually pay its policy limit. The *Polygon* Court disagreed, noting that an excess insurer's obligations do not "vanish" simply because the underlying primary is insolvent. Moreover, the Court noted that "[n]othing in Great American's policies stated that Great American's liability was contingent on the actual payment of the limits of its underlying insurance."

2. Excess Insurers are Not Liable for the Coverage of Insolvent Underlying Primary Policies.

After concluding that Great American's policy was triggered, the trial court turned to allocating the settlement amount between all solvent insurers. It concluded that Washington's "all sums" rule required it to allocate United Capitol's insolvent share among the other insurers, including Great American, to provide full coverage. The Court of Appeals disagreed, noting that Great American's "other insurance" and insolvency clauses specified how liability was to be allocated in the event of an underlying insolvency. Specifically, the *Polygon* Court noted that "Washington law does not, in fact, force insurers to pay for losses that they have not contracted to insure." Great American was therefore not liable for United Capitol's policy limits.

3. Statutory Awards of Attorney's Fees are Not "Supplemental Payments."

Under the Washington Condominium Act ("CA") and Consumer Protection Act ("CPA") (under which most construction defect claims are brought), prevailing plaintiffs are awarded attorney's fees and litigation expenses. Thus, the \$7.8 million settlement between the homeowners' association and the insured (Polygon) included \$6.3 million in compensatory damages and \$1.5 million for the plaintiffs' "litigation costs." If the "litigation costs" portion fell under the "supplemental payments" provision, the two solvent primary insurers would each be liable for \$750,000 in addition to their policy limits. If not, the excess insurers would be responsible for them because the primary policies were exhausted by "compensatory" portion of the settlement.

The relevant "supplemental payments" clauses covered "[a]ll costs taxed against the insured in the 'suit.'" The *Polygon* Court held that this term was intended "to have its legal meaning" under Washington law. The Court then concluded that attorney's fees are not included in the definition of "taxable costs" under Washington statutes and case law, and were therefore not "supplemental payments." Accordingly, the excess insurers were liable for the litigation costs.

What This Means for London Market Insurers

In holding that Great American's excess policies were triggered where the underlying primary did not pay due to insolvency, the Court was careful to distinguish excess trigger-of-coverage issues where the underlying primary insurer is solvent, but settles for less than its policy limits.

The *Polygon* Court's holding that "litigation costs" imposed against the insured under the CA and the CPA may have substantial effects on London Market Insurers providing excess coverage to builders in Washington. First, this characterization may cause excess policies to incept more frequently, with greater liability. Second, the amount of such statutory attorney's fee awards may

be substantially influenced by the conduct of the defense provided by primary insurers. Excess insurers, though generally without a duty to defend, may wish to consider monitoring suits involving CA and CPA claims more closely. Primary insurers, who are likely to benefit from this ruling, might consider reporting CA and CPA suits to excess insurers early in cases where compensatory damages plus “litigation costs” may exceed policy limits, which will allow these parties to protect their interests. Primary insurers should also consider the effect of this characterization of “litigation costs” on any good faith duty to settle a specific case within policy limits.

* If you wish to discuss coverage or defense of construction defect cases or any other aspect of Washington insurance law, please contact our attorneys via e-mail or telephone, 011-503-778-2100, to arrange a mutually convenient time. Our attorneys are experienced in handling construction and insurance issues, including the defense of Condominium Act and Consumer Protection Act claims, coverage opinions, and declaratory judgment and bad faith actions.

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