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Washington Supreme Court Clarifies Distinction between Contribution and Subrogation Claims between Insurers, and Refines Standard for Prejudice for Late Notice Defense

Breaking Developments In London Market Law 09/08/08

On 4 September 2008, the Washington Supreme Court issued its decision in *Mutual of Enumclaw Ins. Co. v. USF Ins. Co.*, concerning the distinction between contribution and subrogation claims between insurers and the rules of tender that apply to each, and clarifying the standard for demonstrating “actual prejudice” prong of the “late notice” defense.

The Facts

This case arose out of a 2000 claim for construction defects against builder and developer Dally Homes, Inc. Dally tendered the claim to Mutual of Enumclaw (“MOE”) and Commercial Underwriters Insurance Company (“CUIC”), but not to USF Insurance Company (“USF”). In 2002, MOE and CUIC settled the claims against Dally, and received an assignment of rights against any non-participating insurers from Dally. In 2004, MOE and CUIC first learned of USF’s coverage for the first time. The letter from MOE and CUIC demanding reimbursement of defense and indemnity costs was USF’s first notice of the claim. MOE and CUIC then filed suit for contribution and subrogation. The trial court granted summary judgment without distinguishing between the two claims. The Court of Appeals reversed, holding that Washington’s “late tender” rule was incompatible with the “selective tender” rule. MOE and CUIC appealed.

Tender Rules for Contribution and Subrogation Claims

The Washington Supreme Court noted that different tender rules apply to claims for subrogation – based on the assignment of an insured’s rights to an insurer and a contribution action by one insurer against a nonparticipating insurer whose policy covers the claim against the insured. The Court first addressed contribution, noting that “the insurer who seeks contribution does not sit in the place of the insured and cannot tender a claim to the other insurer,” and holding that “if the insured has not tendered a claim to an insurer prior to settlement or the end of trial, the other insurers cannot recover in equitable contribution against that insurer.” The Court held that this

result is consistent with the “selective tender” rule, under which an insurer to whom a claim has not been tendered is excused from its duty to contribute to the settlement of that claim.

The Court distinguished subrogation stating, “[a]n insurer entitled to subrogation ‘stands in the shoes’ of the insured and is entitled to the same rights and subject to the same defenses as the insured.” Because Dally assigned its rights to MOE and CUIC, the “selective tender” rule did not apply to their subrogation claim because the rationale that the insured has a right to control tender is no longer applicable, and application of the rule would destroy the value of an assignment of rights against insurers to whom tender had not been made. Because an insurer asserting subrogation claims is subject to the same defenses as its insured, however, the “late tender” or “late notice” rule applies.

Proving “Actual Prejudice”

Under Washington law, an insurer may only avoid coverage due to late tender if the late tender has caused “actual prejudice.” The Court therefore turned to the determination whether USF, which first received notice two years after the case was settled, suffered “actual prejudice” from the delay. Although the issue of prejudice is generally a question of fact, Washington courts had granted summary judgment in a number of situations. The Court identified two strands of decisions, one holding that the insurer must show a “specific detriment as a result of the prejudice” and one holding that the insurer must simply show that “it lost an opportunity to investigate or defend.” The Court resolved the duality by holding that “in order to show prejudice, the insurer must prove that an insured’s breach of a notice provision had an identifiable and material detrimental effect on its ability to defend its interests.” Thus, the insurer must show not only that it lost the opportunity to participate in the defense, but that “its participation would have materially affected the outcome,” or that “the kind of evidence lost would have been material” to its coverage investigation. The Court concluded that USF, which received notice four years after the complaint and two years after the settlement, was not entitled to summary judgment because it did not establish that it was deprived of the ability to investigate coverage or contest the value of damages.

What This Means for London Market Insurers

The application of the selective tender rule to contribution claims emphasizes the importance of obtaining a valid assignment of rights against all known and unknown insurers when settling coverage and liability claims. Failure to do so could leave an insurer without the ability to seek reimbursement from insurers to whom the insured did not tender.

The Court’s new requirement that an insurer demonstrate specific detriment arising from an insured’s late notice – even where notice was not provided for years after the claim was resolved – will likely make prevailing on a “late notice” defense more difficult, particularly on summary judgment. In another context, the Washington Supreme Court has remarked that it is impossible to determine whether a different result might have occurred had the parties taken different decision, noting that the burden of proving such a difference may be quite heavy. However,

several of the Court's prior decisions on "actual prejudice" in the "late notice" context suggest that insurers may prevail even under the Court's altered standard.

If you wish to discuss coverage or defense of construction defect cases, contribution and subrogation claims, 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 contribution and subrogation actions.

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