

No Breach of Contract Where Excess Insurer Timely Pays After Underlying Insurer Exhausts, But Fact Issue Exists on Bad Faith

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Applying Washington law, the United States District Court for the Western District of Washington denied an excess insurer's motion for summary judgment on its insured's bad faith claim, holding that, although the insurer did not breach its contract because it retracted its initial coverage denial, questions of fact existed as to whether insurer initially denied coverage in bad faith based on a prior knowledge exclusion. *Isilon Systems, Inc. v. Twin City Fire Ins. Co.*, No. 10-cv-01392 (W.D. Wash. April 10, 2012).

The insurer issued an excess policy to the insured company. In 2009, the SEC filed suit against the insured company's CFO alleging financial reporting fraud. The CFO subsequently entered into a settlement agreement without admitting or denying the SEC's allegations. The insured indemnified the CFO for his defense costs and sought reimbursement from its insurers. In July 2010, the insured sent a letter to the excess insurer advising that the underlying insurance was almost exhausted and seeking coverage for approximately \$5 million in defense costs. On July 26, 2010, the excess insurer denied coverage citing a prior knowledge exclusion in its policy. In August 2010, the insured sued the excess insurer. In January 2011, the excess insurer withdrew its denial, substituted a reservation of rights and stated that it would advance defense costs once the underlying insurer had exhausted its policy. After the underlying insurer exhausted, the excess insurer timely advanced \$5 million in defense costs.

The excess insurer then moved for partial summary on the insured's breach of contract, Washington Consumer Protection Act (CPA), breach of the implied covenant of good faith and fair dealing and Washington Insurance Fair Conduct Act claims. The court granted summary judgment on the CPA and breach of contract claims. The court held that the insured could not show any damages because the excess insurer performed under the contract. Specifically, under the excess policy, the excess insurer was not required to pay until the underlying insurer had exhausted its policy. Here, the excess insurer timely paid once the underlying insurer exhausted.

The court denied the excess insurer's motion for summary judgment on the insured's bad faith and IFCA claims, however. The court held that the excess insurer failed to demonstrate as a matter of law that the prior knowledge exclusion applied, *i.e.*, that the CFO had knowledge of facts and circumstances that might give rise to a claim at the time he signed the application for the excess policy. The court accordingly found that a

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genuine issue of material fact existed as to whether the excess insurer initially denied coverage in good faith.