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Washington Insurance Law Update

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The Supreme Court of Washington issued three notable opinions this year regarding insurance coverage. The cases involved the following: A property insurance policy provided no coverage for lost business income due to COVID-19 restrictions; an all-risk builder's policy did not cover design defects or damages resulting from loss of use; and the terms of a contractor's commercial general liability (CGL) insurance policy that required both loss and claim to occur in the same policy year violated public policy and was unenforceable.

Lost Business Income From COVID-19

In *Hill and Stout, PLLC v. Mutual of Enumclaw Insurance Company*,[1] the court determined whether there was coverage under a property insurance policy for lost business income resulting from the governor's proclamation that limited the scope of a medical practice. Hill and Stout (HS), a dentistry practice, had property insurance that covered lost income from a direct physical loss to property.

In March 2020, the governor issued a proclamation limiting dentistry to emergency procedures only, and HS ceased all routine procedures. It filed a declaratory judgment action to establish that its business losses were covered.

The court held there was no coverage. Its analysis included whether there was a "direct physical loss" and whether the policy's "virus exclusion" applied.

No Direct Physical Loss

The court held that the proclamation did not physically keep HS from using its property, even though HS was not able to use the property as *intended*. The court discussed the "loss of functionality" test, which is asserted in coverage cases involving asbestos, gasoline fumes and methamphetamines, where there was no physical "alteration" to the property but there was a "direct physical loss" nonetheless. The court distinguished those cases, noting that nothing physically caused a loss of functionality in the present case.[2]

The Virus Exclusion Applied

Despite the first issue being dispositive, the court also addressed the virus exclusion and, specifically, the efficient proximate cause rule. This rule mandates coverage when an initial covered peril sets a causal chain in motion—even when that causal chain leads to excluded perils. A policy cannot contract around the efficient proximate cause rule by excluding coverage for losses caused by a covered matter. The court held COVID-19, an excluded peril, initiated the causal chain. Therefore, the virus exclusion applied, resulting in no coverage for the policyholder.[3]

Builder's All-Risk Insurance Policy

Seattle's major construction project replacing the Alaskan Way Viaduct and the breakdown of the tunnel boring machine (aka Bertha or TBM) resulted in another state Supreme Court case, *Seattle Tunnel Partners v. Great Lakes Reinsurance (UK) PLC*.[4]

Seattle Tunnel Partners (STP) contracted with the Washington State Department of Transportation (WSDOT) to construct a tunnel to replace the viaduct. STP obtained a builder's all-risk insurance policy from Great Lakes Reinsurance (Great Lakes) and other underwriters. The policy insured against damage to the "tunneling works" (the tunnel and property being used or intended for use in the construction of the tunnel). After the TBM stopped working, STP and WSDOT made claims under the policy, and Great Lakes denied coverage. Three issues were presented:

1. Whether a design defect is excluded from coverage under the machinery breakdown exclusion (MBE)
2. Whether the policy's indemnity provision covers project delay losses
3. Whether physical loss or damage includes loss of use or functionality[5]

Machinery Breakdown Exclusion

In a builder's all-risk policy, any peril that is not specifically excluded in the policy is an insured peril.[6] If an insured shows the loss falls within the scope of the policy's coverage, the burden shifts to the insurer to show the loss is excluded. At issue in this case was whether loss from design defect allegations (among others) was excluded under the MBE.[7]

The MBE provided that "any item by its own explosion mechanical or electrical breakdown, failure breakage or derangement" [sic] was excluded from coverage. After analyzing the "by its own" language, the court, agreeing with out-of-state cases, held that a design defect is internal to the insured property.[8] Therefore, the court held the MBE applied and excluded coverage for machinery breakdowns resulting from an internal cause, which includes a defective design.[9]

Project Delay Losses Not Covered Under Indemnity Provision

The court held that the policy covers direct physical losses but does not provide coverage for nonphysical losses, such as delay costs.[10] The court also held

that the indemnity provision in the policy, which determines what is recoverable after coverage under the policy is triggered, also did not provide coverage.[11]

Loss of Use/Functionality Not Covered If No Physical Impact to Insured Property

WSDOT claimed there was coverage under the policy for loss of use of the "tunneling works" because there was "direct physical loss, damage or destruction" to this insured property.[12]

The court noted that "direct physical loss or damage" refers to the deprivation or dispossession of or injury to the insured property.[13] It also held there must be some physical condition that impacted the tunneling works. The court did not rule out the possibility that "direct physical loss or damage" could include "loss of use." However, here the TBM blocked the tunnel while the TBM was inoperable and undergoing repairs. Accordingly, the court held, even if it interpreted direct physical loss or damage to include "loss of use," no coverage under the policy was triggered because the loss of use was not caused by a physical condition impacting the tunneling works.

CGL Policy Time Limits Unenforceable

Finally, in *Preferred Contractors Insurance Company v. Baker and Son Construction Inc.*, the court determined that a contractor's CGL insurance policy violates Washington's public policy and is unenforceable.[14]

Baker was a subcontractor on a commercial construction project. In October 2019, a two-by-four fell and struck a person on the head, who died later that night. In September 2020, Baker received a notice from an attorney representing the widow stating that she was asserting a wrongful death claim against Baker. Baker immediately notified its insurer, Preferred Contractors Insurance Company (PCIC).[15]

Baker had two CGL policies with the PCIC. One covered 2019; the other, 2020. These were claims-made policies, but the insuring agreement also had language similar to an occurrence policy. Endorsements provided no continuous coverage between policies that were renewed, limiting each policy period to one year.[16] Because the death occurred in October 2019 and the widow did not notify Baker of her intent to sue until September 2020, the occurrence and reporting dates did not occur in the same policy period.

The court noted that insurance policies are private contracts and that parties are ordinarily free to exercise their freedom of contract to limit the liability covered in the policy. However, the court will, rarely, refuse to enforce a provision in a policy that violates public policy.[17]

To establish public policy, the widow and Baker relied upon RCW 18.27.050, which requires contractors to have insurance or financial responsibility to cover "injury or damage including death" to register with the state. This chapter also provides that its explicit purpose is to "afford protection to the public," among others, from "unreliable, fraudulent, financially irresponsible, or incompetent contractors" (RCW 18.27.140).[18]

The court agreed that the legislature created a public policy wherein contractors must be financially responsible for the injuries they negligently inflict on the public. Given that public policy, the court held that terms of a CGL policy that require the loss to occur and be reported to the insurer in the same policy year and fails to provide prospective or retroactive coverage is unenforceable.[19] ■

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[1] *Hill and Stout, PLLC v. Mutual of Enumclaw Insurance Company*, 515 P.3d 525 (2022).

[2] *Id.*, 515. P.3d 525, 534-35 (2022).

[3] *Id.*, 515 P.3d 525, 537 (2022).

[4] *Seattle Tunnel Partners v. Great Lakes Reinsurance (UK) PLC*, 516 P.3d 796 (2022).

[5] *Id.*, 516 P.3d 796, 800 (2022).

[6] *Id.*, 516 P.3d 796, 800 (2022).

[7] *Id.*, 516 P.3d 796, 801 (2022).

[8] *Id.*, 516 P.3d 796, 804 (2022).

[9] *Id.*, 516 P.3d 796, 805–06 (2022).

[10] *Id.*, 516 P.3d 796, 807 (2022).

[11] *Id.*, 516 P.3d 796, 808 (2022).

[12] *Id.*, 516 P.3d 796, 808 (2022).

[13] *Id.*, 516 P.3d 796, 809 (2022).

[14] *Preferred Contractors Insurance Company v. Baker and Son Construction Inc.*, 514 P.3d 1230, 1231, 200 Wash.2d 128, 130–31 (2022).

[15] *Id.*, 514 P.3d 1230, 1232, 200 Wash.2d 128, 131 (2022).

[16] *Id.*, 514 P.3d 1230, 1232, 200 Wash.2d 128, 132 (2022).

[17] *Id.*, 514 P.3d 1230, 1234, 200 Wash.2d 128, 136 (2022).

[18] *Id.*, 514 P.3d 1230, 1234, 200 Wash.2d 128, 137 (2022).

[19] *Id.*, 514 P.3d 1230, 1237–38, 200 Wash.2d 128, 143–44 (2022).