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Washington Supreme Court Strikes Down A "Claims-Made" Policy Issued To A Contractor On Public Policy Grounds

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Insights for Insurers

Preferred Contractors Insurance Company Risk Retention Group, LLC v. Baker and Son Construction, Inc., 2022 Wash. LEXIS 426 (Aug. 11, 2022)

Traditionally, general liability insurance contracts were "occurrence-based" contracts. Claims-made insurance contracts have been available for many years, most notably in the context of professional liability insurance. Beginning in the mid-1980s, claims-made contracts were introduced into the general liability insurance market in response to court rulings on the trigger of coverage issue under occurrence-based contracts as applied to long-tail bodily injury or property damage claims. Under occurrence-based contracts, the contract or contracts in effect at the time bodily injury or property damage takes place must respond to an otherwise covered loss.

Under "claims-made" contracts, it is the time that the claimant first makes a claim against the policyholder or when the claim is first made and reported that determines whether the insurance contract must respond to an otherwise covered loss, rather than the timing of bodily injury or property damage. Most claims-made contracts have retroactive dates, which often are the contract inception dates, but can be earlier. Coverage for bodily injury or property damage that took place prior to the retroactive date generally is excluded even where the claim is first made against the policyholder during the contract period. Thus, under most claims-made contracts, coverage is "triggered" by a claim first made on or after the retroactive date and before the contract expires. Many claims-made contracts have extended reporting periods or "tails" to provide coverage for claims made for a certain period of time after the expiration of the contract arising from events taking place during the contract period.

Some policies may incorporate elements of both "occurrence-based" and "claims-made" policies. The Washington Supreme Court was confronted with such a policy and struck it down on public policy grounds. More specifically, the Washington Supreme Court struck down an "occurrence-based" policy issued to a contractor that included a "claims-made" endorsement requiring the claim first be made during the policy period on August 11, 2022.

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In *Preferred Contractors Insurance Company Risk Retention Group, LLC v. Baker and Son Construction, Inc*. a unanimous Washington Supreme Court ruled that a commercial general liability policy violated Washington's public policy after accepting a certified question from the United States District Court for the Western District of Washington.

Succinctly stated:

> This case asks, via certified question, whether a contractor's commercial general liability (CGL) insurance policy that requires the loss to occur and be reported within the same policy year and provides neither prospective nor retroactive coverage violates Washington's public policy. In light of chapter 18.27RCW, which regulates the registration of contractors, and specifically RCW 18.27.050, which requires registered contractors to carry at least $100,000 in financial responsibility for bodily injuries, we answer the certified question in the affirmative.

The claim arose out of a wrongful death action resulting from the death of an individual on a construction project.

The court actually described the policies as "claims-made policies" with an insuring agreement that provided coverage with language more similar to an occurrence policy:

> b. This insurance applies to "bodily injury" and "property damage" only if: (1) The "bodily injury" or "property damage" is caused by an "occurrence" that first takes place or begins during the "policy period". An "occurrence" is deemed to first take place or begin on the date that the conduct, act or omission, process, condition(s) or circumstance(s) alleged to be the cause of the "bodily injury" or "property damage" first began, first existed, was first committed, or was first set in motion, even though the "occurrence" causing such "bodily injury" or "property damage" may be continuous or repeated exposure to substantially the same general harm; (2) The "bodily injury" or "property damage" resulting from the "occurrence" first takes place, begins, appears and is first identified during the "policy period". All "bodily injury" or "property damage" shall be deemed to first take place or begin on the date when the "bodily injury" or "property damage" is or is alleged to first become known to any person, in whole or in part, even though the location(s), nature and/or extent of such damage or injury may change and even though the damage or injury may be continuous, progressive, latent, cumulative, changing or evolving. Id. at 46-47, 109-110.

The "claims-made" features of the policies were added in a "claims-made and reported limitation" endorsement. It provided:

> [T]his policy shall apply only to claims first made against the insured and reported to us in writing during the policy period. Coverage under this policy will only apply to claims made against the insured and reported to us on or after the policy inception date and prior to the policy expiration date as shown on the Declarations page(s), subject to the extended reporting period provided below. If prior to the effective date of this policy, any insured had a reasonable basis to believe a claim may arise, then this policy shall not apply to such claim or any related claim. As a condition precedent to any coverage (defense or indemnity) under this Policy, You must give written notice to the Company of any claim as soon as practicable, but in all events no later than: (a) the end of the Policy Period; or (b) 60 days after the end of the Policy Period so long as such "Claim" is made within the last 60 days of such Policy Period. Id. at 86, 149. By endorsements, the successive policies also provided there was no continuous coverage between policies that were renewed, limiting each policy period to one year.

In this case, because the individual's death occurred in October 2019 and his widow did not notify the policyholder of her intent to sue until September 2020:

> …the occurrence and reporting dates did not occur in the same policy period. In other words, the 2019 policy did not cover the claim because it was not reported within the policy period and the 2020 policy did not provide coverage because the occurrence the claim arose from happened before the policy period began on January 5, 2020.

The Washington Supreme Court noted, it would be an oversimplification to say all claims-made or all occurrence policies are the same. Most claims-made policies are effective from a set "retroactive date," which:

> …can be set for before the policy period to prevent a gap in coverage when the insured switches between insurers or from an occurrence policy to a claims-made policy. The court further noted that it is more common to set the retroactive date as the first day of the claims-made policy period and retain that retroactive date across policy

> renewals to prevent gaps in coverage.

According to the court "claims-made policies, while fundamentally different from traditional occurrence policies, generally do not violate public policy."

> However, the policies in this case are not pure claims-made policies because they do not provide retroactive coverage, not even for losses that occur during one policy period and are reported during a subsequent policy period. No court in this state has decided the enforceability of nonretroactive claims-made policies, and few other courts across the country have addressed the issue.

The court pointed out that the New Jersey Supreme Court refused to enforce such a nonretroactive claims-made policy in *Sparks v. St. Paul Insurance Co,* 100 N.J. 325, 339, 495 A.2d 406 (N.J. 1985). The New Jersey Supreme Court based its decision on some contract interpretation doctrines that Washington does not follow, as well as on public policy. *Id*. at 339. The Washington Supreme Court distinguish the policy at issue in the present case from the policy as issue in *MSO Wash., Inc. v. RSUI Group., Inc*., No. C12-6090 RJB, 2013 WL 1914482 (W.D. Wash., May 8, 2013) (unpublished) on the grounds that the policy involved in that case contained a retroactive date that was the inception date of the earliest policy, thereby providing continuous coverage on the policy's renewal and some form of retroactive coverage as to the second policy.

According to the Washington Supreme Court:

> [w]e are mindful that parties to insurance contracts generally should have the freedom to contract. But when the legislature orders contractors to bear financial responsibility for the injuries their negligence may cause and dictates insurance is the preferable method to comply with this mandate, we cannot enforce insurance provisions that render coverage so narrow it is illusory. While RCW 18.27.050 does not require insurers to issue occurrence policies or provide retroactive coverage to contractors switching from an occurrence to a claims-made policy, *see HB Dev., LLC v. W. Pac. Mut. Ins*., 86 F. Supp. 3d 1164, 1181-82 (E.D. Wash. 2015), insurers should not issue policies that essentially cause contractors to default on their statutorily mandated financial responsibility. The insurance policies PCIC issued to [the contractor] fail to provide prospective or retroactive coverage and create limited one-year windows for claims to occur and be reported to qualify for coverage. Such restrictive coverage violates Washington's public policy. Therefore, we answer the certified question in the affirmative. Through RCW 18.27.050 and RCW 18.27.140, the legislature has created a public policy wherein contractors must be financially responsible for the injuries they negligently inflict on the public. With such a public policy established, a contractor's CGL policy that requires 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.

The decision suggests that, with the inclusion of a retroactive date, such a policy would be enforceable. An unanswered question is whether such a policy would be enforceable if not issued to a contractor or whether the Washington Supreme Court would find the insurance policy violates some other "public policy" of the State of Washington.