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California Insurance Coverage Decisions: 2008 Year in Review

Advertising injury, trademark infringement, exhaustion, *Cumis* counsel, stacking, bad faith and punitive damages. The last twelve months have brought some significant commercial insurance decisions in these areas from California courts, both state and federal. The following is a short summary of these, as well as other, insurance decisions from 2008.

Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London, 161 Cal. App .4th 184 (2008)

The insured's excess carrier, Certain Underwriters, had no obligation to reimburse the insured for defense fees and costs where the primary directors' and officers' liability carrier had paid only $16 million of its $20 million in limits.

Qualcomm sought a judicial declaration that its excess carrier was required to indemnify it for approximately $9 million in

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unreimbursed defense fees and settlement expenses incurred in connection with lawsuits brought by current and former Qualcomm employees over unvested rights in company options. The primary carrier had paid $16 million of its $20 million in limits to Qualcomm, and, in exchange, had received a complete release. The excess policy, however, stated that Certain Underwriters' obligations to Qualcomm were not triggered until the primary insurer had "paid" or been "held liable to pay" the "full amount" of the underlying limits.

Finding the language of this condition precedent to be plain and unambiguous, the trial court sustained Certain Underwriters' demurrer without leave to amend on the ground that the primary carrier had not "paid" its limits, as required by the language of the excess policy. The Court of Appeal affirmed the decision, concluding that it was bound to follow the policy language. The appellate court also rejected Qualcomm's argument that as a matter of public policy, the court should compel Certain Underwriters to pay in order to further the goals of promoting settlement and risk-spreading between carriers. Social and economic considerations, the court held, "have nothing whatsoever to do with our interpretation of the unambiguous contractual terms."

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Employers Reinsurance Co. v. Superior Court, 161 Cal. App. 4th 906 (2008)

Course of conduct evidence is admissible to interpret insurance policy provisions, but only so long as the conduct predated claims handling agreements between the parties. Evidence of conduct that postdated the claims handling agreements would potentially be probative of the meaning of *those* agreements, but not of the meaning of prior-in-time insurance policies.

The issue in this opinion (arising out of a large, ongoing complex asbestos coverage action) was whether the underlying asbestos claims brought against Thorpe Insulation Company were "products" or "completed operations" claims that eroded the aggregate limits of the insured's commercial general liability insurance policies. Thorpe asserted that where the underlying plaintiff had alleged exposure to asbestos during Thorpe's insulation activities, such claims were not "products" or "completed operations" claims and therefore were not subject to any aggregate limits.

In response, the insurers sought to introduce evidence that historically the parties had classified all asbestos claims as "products" or "completed operations" claims and applied indemnity payments against the policies’ aggregate limits. The trial court ruled that this course of performance evidence was not relevant. The Court of Appeal, however, held that course of performance evidence is generally admissible in the context of interpretation of insurance policies, including standard form policies, regardless of whether the individuals performing under the policies are the same individuals who negotiated the policies.

As to the claims handling agreements, the Court of Appeal reasoned that the parties’ conduct after entering into a claims handling agreement was pursuant to that agreement and not governed by the policies predating the agreement. Accordingly, course of conduct evidence predating the claims handling agreement was, in fact, admissible.

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Compulink Management Center, Inc. v. St. Paul Fire & Marine Ins. Co., 169 Cal. App. 4th 289 (2008)

In a breach of contract and bad faith action arising over nonpayment of Cumis fees as well as inadequate claims handling, California Civil Code section 2860 mandated arbitration of any issues concerning the amount of attorneys’ fees allegedly owed to the insured.

Compulink, the insured, sued a former distributor and that distributor's new vendor. The defendants cross-claimed, and Compulink tendered the cross-complaint to St. Paul. St. Paul accepted the defense under a reservation of rights, and, in light of a conflict, permitted Compulink to select independent counsel under California Civil Code section 2860 ("Section 2860"), which codifies an insured's right to independent counsel in certain circumstances. The underlying case settled, and Compulink sued St. Paul in state court for underpayment and delayed payment of *Cumis* counsel fees. Significantly, Compulink also asserted several other claims arising out of St. Paul's handling of the underlying claim, including its refusal to attend mediation and refusal to contribute an adequate amount to the settlement. St. Paul moved to compel arbitration under Section 2860, which mandates binding arbitration for "[a]ny dispute concerning attorneys’ fees." The trial court denied the motion on the ground that Compulink's bad faith allegations took the entire action beyond the scope of Section 2860's mandatory arbitration provision.

The Court of Appeal reversed and remanded. Finding the language of Section 2860 "clear," the Court of Appeal confirmed that where an action is filed in California state court, Section 2860 requires arbitration of "any and all Cumis fee disputes" unless the insurance policy provides for an alternative dispute resolution procedure (which Compulink's policy did not). Where an action is filed in federal court, however, Section 2860 does not govern fee disputes. To the extent that one other appellate case suggested that fee disputes intermingled with other claims (such as bad faith or fraud), taking the action beyond the scope of Section 2860's arbitration requirement, the appellate court held that the decision had been based on a misunderstanding of prior cases and declined to follow it.

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Manzarek v. St. Paul Fire & Marine Ins. Co. 519 F.3d 1025 (9th Cir. 2008)

A Field of Entertainment Limitation Endorsement ("FELE") exclusion in a commercial general liability policy did not bar coverage of trademark and defamation claims brought against Ray Manzarek, one of the founding members of The Doors.

John Densmore, The Doors' former drummer, sued Manzarek alleging that he was infringing on The Doors' name, trademark, and logo. Relatives of Jim Morrison filed a similar lawsuit. In his lawsuit, Densmore also alleged that Manzarek had damaged his stature and reputation by causing people to believe that he was not an integral and respected member of The Doors.

Manzarek tendered the lawsuits to St. Paul. St. Paul denied coverage. Although the underlying lawsuits presented a potential for advertising injury coverage, it believed the FELE exclusion conclusively eliminated that potential, and the district court agreed.

The Ninth Circuit reversed. The FELE exclusion, it held, applied only to advertising in "media," a term that does not clearly include all infringing products that Manzarek was allegedly selling (i.e., a T-shirt with The Doors logo). The Court further held that it was not sufficiently clear that the insured would have understood the import of the FELE exclusion (as St. Paul construed it) because the later policy had not yet been delivered at the time of the tender of the lawsuits, and the record was silent as to the date of delivery of the earlier policy. Finally, Densmore's allegation of damage to his reputation raised the potential for an award of mental anguish or emotional distress damages, which, in turn, potentially triggered "bodily injury" coverage.

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Sony Computer Entertainment Am., Inc. v. American Home Assurance Co. 532 F.3d 1007 (9th Cir. 2008)

Sony Computer Entertainment America, Inc.'s media liability policy afforded no coverage for false advertising claims.

The Ninth Circuit held that Sony Computer Entertainment America, Inc. had no coverage for the class action lawsuits brought against it, which alleged that Sony's PlayStation 2 suffered from fundamental design defects rendering the device unable to play DVDs and certain game discs contrary to Sony's alleged representations in press releases, product packing, instruction manuals and other advertising.

Sony had purchased a $10 million media liability insurance policy that provided coverage for claims alleging, inter alia, "defective advice, incitement, or negligent publication" (emphasis added). Two class actions were brought against it in California state court for breach of express and implied warranties, fraud, negligent misrepresentation, violations of California's Consumer Legal Remedies Act, false advertising and unfair business practices. Sony tendered the class actions to American International Specialty Lines Company ("AISLIC"), the carrier that had issued the media liability policy, and AISLIC declined coverage.

Sony sued, and the issue before the Ninth Circuit was whether the false advertising and negligent misrepresentation claims constituted "negligent publication" within the meaning of the policy. In a matter of first impression, the Ninth Circuit found that Sony's interpretation of that phrase was inconsistent with the policy as a whole. The Court held that the terms "defective advice, incitement or negligent publication" must be construed as related. For instance, in "incitement" cases, the plaintiff alleges that a defendant's publication of material encouraged or instructed the reader to commit a harmful act. "Negligent publication" likewise refers to a "narrow tort in which the publication of material leads the reader to commit a harmful act," (i.e., where a plaintiff sued a magazine for "negligent publication" of an advertisement for firearms that allegedly led her son to accidentally kill himself). The Court also noted that Sony, a sophisticated purchaser, "clearly could have purchased coverage for product defects or false advertising" and, in fact, had previously held such coverage.

Because the class actions did not allege that Sony's published material led readers to engage in harmful acts, no coverage was afforded under the media liability policy. (The Court also rejected Sony's contention that coverage was afforded under Sony's general liability policy for reasons not discussed here.)

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Long v. Century Indem. Co.
163 Cal. App. 4th 1460 (2008)

A fee dispute between an insurer and the insured's *Cumis* (i.e., independent) counsel is subject to mandatory arbitration under California Civil Code section 2860 ("Section 2860"), even where the insurer had not retained counsel of its own.

Harris, a recycling company, was sued in a hazardous waste cleanup action in federal court. Its attorney, Long, tendered the defense to Harris's comprehensive general liability insurer, INA. INA agreed to provide a defense pursuant to a reservation of rights and hired Long to represent Harris as *Cumis* counsel. But INA was unwilling to pay the hourly rate requested by Long, so the parties agreed that Long would represent Harris in exchange for the lower, capped hourly rate INA contended was applicable, and that Long reserved his right to seek payment of his higher, requested rate at a later date. INA was not represented by counsel during the litigation and did not participate in it directly. The litigation ultimately settled as to Harris. Long subsequently sued INA in state court seeking the difference between the amount he was paid by INA and the amount he would have been paid at the rate he sought.

INA demurred on the ground that Long's lawsuit was subject to the mandatory arbitration provision of Section 2860. The trial court granted INA's demurrer and, on appeal, the Court of Appeal affirmed. It rejected Long's argument that Section 2860's obligation to provide *Cumis* counsel - and the accompanying mandatory arbitration provision - does not apply unless the insurer first retains defense counsel of its own. As the Court noted: "The insurer . . . may elect not to retain counsel to protect its own interest, and such election does not obviate the need to provide Cumis counsel if a conflict or potential conflict exists." Even though INA did not hire its own counsel and did not participate in the underlying litigation, INA's decision to hire Long to defend Harris subject to a reservation of rights created a conflict between INA and Harris that invoked Section 2860, and Long's related fee dispute was therefore subject to arbitration. Long could not plead around these principles and the carrier's demurrer was sustained without leave to amend.

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City of Hollister v. Monterey Ins. Co. 165 Cal. App. 4th 455 (2008)

The City of Hollister's property insurer was estopped from relying on a policy provision requiring, as a condition precedent to coverage, that the insured enter into a contract for the repair or replacement of damaged property within 180 days of the loss.

A municipal building at the City airport caught fire, and shortly thereafter, the independent adjuster retained by the carrier declared it a total loss. Under its property policy, the City was entitled to coverage for the "functional replacement" of the building so long as the City contracted for the replacement within 180 days after the loss. In this instance, the functional replacement of the building was in excess of one million dollars. If the City failed to enter into a contract, however, the policy only covered the fair market value of the building, estimated at $150,000.

In the City's subsequent coverage action, the trial court found that the carrier had refused to render a timely coverage decision as to whether the "total loss" to the building was covered. Specifically, the trial court found that the carrier had engaged in a variety of tactics to prolong the investigation while aware that the City had no money to front replacement of the damaged building and therefore could not enter into a contract with a thirdparty without knowing whether coverage was intact. Reviewing California law addressing estoppel, the California Court of Appeal - affirming the trial court's findings - acknowledged that estoppel does not require "affirmative conduct or fraudulent intent" by the insurer. Instead, estoppel is predicated on a failure to speak where the carrier is bound to do so. Here, the court found that the carrier had "patently failed to cooperate with and assist the insured" in determining the carrier's obligation to pay by (1) threatening to deny coverage to the insured; (2) raising grounds for denial that the court found "nebulous to the point of invisibility"; and (3) "implying a universe of undisclosed information and unperformed duties" on the part of the City, when, in fact, none existed. Accordingly, the City was placed in an untenable position: It could forgo the possibility of coverage altogether or attempt to comply with the 180-day provision only to find itself not only without coverage, but also with substantial liability to a third party. In light of its conduct and failure to timely communicate a coverage decision, the carrier was estopped from denying functional replacement coverage for failure to comply with the contracting provision.

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Major v. Western Home Ins. Co. 2009 Cal. App. LEXIS 4 (2009)

In a bad faith claim arising under a homeowner's policy, a two-to-one ratio of noneconomic to economic damages is reasonable; further, the claims adjuster employed by a third party was the managing agent for purposes of imposing punitive damages, which the jury awarded in a constitutional one-to-one ratio.

In October 2003, the insureds' house burned to the ground. By August 2004, the carrier -acting through its third-party adjuster - still had not reviewed the insureds' personal inventory, had not made mortgage payments on the insureds' behalf, had not paid for the insureds' temporary housing, and had not increased the policy's limits, as it was obligated to do under the policy (for reasons not discussed here). The third-party adjuster also refused to pay for the replacement cost of the insureds' personal property, claiming that the receipts were faxed and therefore illegible when, in fact, the receipts had been mailed to her. Three months after the insureds had filed a bad faith lawsuit, the carrier paid all benefits due under the policy.

On appeal, the Court of Appeal affirmed the jury's award to the insureds, as follows: First, the court held that the delayed payment of benefits alone, absent resulting economic damages, will not support an award of emotional distress damages because mental distress is compensable "as an aggravation of the financial damages." Here, however, benefits were, in fact, owed, and the jury's award of noneconomic damages of $450,000 bore a reasonable relationship to total economic damages of $220,000 (which included *Brandt* fees), and was therefore not excessive. Second, the third-party adjuster retained by the carrier was the managing agent for purposes of imposing punitive damages. Specifically, the adjuster's regional manager/supervisor was not supervised by the carrier. She managed claims covering a large geographic area; she personally assumed claims handling responsibilities for the insureds' claim following the fire; and she made the decision not to pay the benefits the jury ultimately found owing. Third, the amount of punitive damages withstood constitutional challenge. Acknowledging that few punitive awards exceeding a single-digit ratio can withstand challenge and that only tort damages could be considered in assessing the award's validity, the court found that the jury's punitive damages award of slightly more than a one-to-one ratio of the tort damages (which consisted of both emotional distress damages and *Brandt* fees) was reasonable.

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Great Western Drywall, Inc. v. Interstate Fire & Cas. Co.
161 Cal. App. 4th 1033 (2008)

A cross-suits exclusion applied to preclude coverage of a suit by one insured against another.

The general contractor for a condominium project obtained a commercial general liability policy. A subcontractor sued the general contractor for fees. The general contractor cross-complained, alleging that the subcontractor had been overpaid and had performed work negligently, causing property damage. The subcontractor was an insured under the general contractor's policy, but the policy contained an exclusion for suits by one insured against another. Although an exception to the exclusion covered actions to apportion liability between insureds "where any Insured has been sued for a covered loss," that exception did not apply here. The court held that, by implication, the exception requires a third-party suit against an insured and here, in contrast, there was no third-party suit and thus no liability to a third party to be apportioned.

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Brehm v. 21st Century Insur. Co.
Cal. App. 4th 1225 (2008)

Factual issues alleged in the complaint precluded an insurer’s demurrer to a bad faith claim on the basis of the "genuine dispute" doctrine.

The "genuine dispute" doctrine is a defense to bad faith claims against insurers. Where reasonable minds could have differed, an insurer's coverage position, even if ultimately deemed to have been wrong, does not constitute bad faith.

In this case, the insured and the insurer disagreed over the amount of the insured's medical damages, and the insured ultimately prevailed in arbitration. The insured then sued for bad faith.

The insurer demurred (i.e., asked the court to dismiss the lawsuit entirely on the basis of the complaint alone) arguing that (1) its coverage position could not have been in bad faith because it was supported by an expert medical opinion, and (2) its coverage position could not have been adopted in bad faith because it had the right to have the issue decided through arbitration. The Court of Appeal held that it was error to grant the demurrer where the insured alleged that the insurer procured a bogus medical opinion in bad faith. As to the insurer's right to invoke arbitration, the court reasoned that that right does not somehow free the insurer of its obligation to act in good faith in dealing with an insured to resolve claims without arbitration.

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Employers Mut. Cas. Co. v. Philadelphia Indem. Ins. Co.
169 Cal. App. 4th 340 (2008)

Two of four carriers accepted an insured's tender in connection with an underlying lawsuit that ultimately settled for $3 million. A portion of the settlement, $1.8 million, was allocated to cover attorneys' fees and costs pursuant to a statutory prevailing party provision. The two carriers that had not accepted coverage were then sued in a contribution action.

The trial court allocated the defense fees and costs and settlement to the non-defending carriers based on the "time on the risk" method. The Court of Appeal affirmed the ruling. In doing so, it rejected the nondefending insurers' argument that attorneys' fees and costs paid to plaintiffs in the underlying action were not "taxed," and therefore not covered, because were not judicially assessed. The appellate court, however, broadly construed the term "taxed" to include anticipated costs in a settlement. The court also rejected the nondefending insurers' argument that the obligation to pay taxed costs did not arise because liability was never established, and instead held that a settlement does establish liability for insurance purposes. The court likewise found that the plaintiffs in the underlying case were the "prevailing parties" by virtue of the settlement agreement, thus entitling the underlying claimants to statutory fees and costs.

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Medina v. Safe-Guard Products
164 Cal. App. 4th 105 (2008)

A consumer who innocently purchases insurance from an unlicensed carrier is entitled to enforce the insurance contract, but the purchase of a policy from an unlicensed carrier alone does not constitute harm sufficient to confer standing under California's Unfair Competition Law.

The insured purchased a vehicle service contract from a company not licensed to sell insurance in California, and subsequently brought a claim against the insurer under California's Unfair Competition Law. The trial court sustained a demurrer to the complaint (dismissed the case), finding that the insured had not suffered any "injury in fact" and thus had not lost "money or property" as a result of the alleged unfair competition.

The Court of Appeal affirmed on the ground that the insured had not suffered any loss as a result of the insurer's unlicensed status. The insured contended that he bought a void, unenforceable contract and thus he received no benefit for the money paid. The appellate court disagreed that there was no benefit and instead held that a consumer who innocently purchases a policy from a company unlicensed in California may still enforce that insurance contract and make claims under the policy. Where the only illegality in the contract is the unlicensed status of the insurer, and a statutory scheme of penalties for its unlicensed status already exists, the contract could be severed to enforce its lawful portions.

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