

RWB Legal Reflections

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RWB Legal Reflections is a quarterly publication of Rudloff Wood & Barrows LLP

FORETHOUGHT



We hope this issue of *RWB Legal Reflections* finds you well. We have some good news and milestones to let you know about.

First, we are pleased to report that we have heard from the *Northern California*

Super Lawyers advising us that Marjie Barrows, Doug Wood, Dianne Meconis, and yours truly, have been, once again, recognized as Northern California Super Lawyers for 2009 in the primary practice area of insurance coverage. Better yet, our partner, Renee Peters, was also recognized this year for the first time and for the same practice area. We are all very proud to have been selected for this prestigious recognition. *Northern California Super Lawyers* is sponsored by the publishers of San Francisco Magazine and the names of all Northern California Super Lawyers for 2009 will be published in the August issue. Only five percent of the attorneys in Northern California are chosen each year following a nomination process, review of resumes, and a peer evaluation by practice area.

We are also happy to tell you that our very capable and highly talented Executive Director, Jason Santiago, was awarded his M.P.S. (Masters in Professional Services) from George Washington University, Washington, D.C., in the area of Professional Service Management, with an emphasis in Law Firm Management. The degree was conferred in the Fall of 2008 after two years of concentrated study. This degree will go along with his

earlier earned Bachelor's and Master's degrees in philosophy.

Some of you may know that partner Ed Murphy's son, Andrew, graduated from the University of California, Davis, with a law degree last year. Andrew is a law clerk at RWB. He recently received the good news that he is one of the newest members of the California State Bar. Obviously, Ed is very proud of his son as are the rest of us here at the firm.

On another matter, Dianne Meconis just spent several weeks as a member of a San Francisco jury hearing a non-insurance civil trial. How any lawyer let her, another lawyer, sit on the jury is beyond our imagination. However, those of us who have spent our careers trying jury cases would love to have the opportunity to see the process from a different vantage point. Look for an article from Dianne on these pages sometime soon advising of how things at jury trials "look from the inside."

Finally, and despite this truly catastrophic experience in the American economy, we at RWB look forward to partnering with our clients in the coming months ahead to achieve the best possible results in litigation and other matters. We feel very fortunate to be able to work with our very loyal clients, and friends, during probably the worst of all climates for business America. On the other hand, all of us feel truly blessed to have our health, families, and good friends, not to mention our practice.

We take this opportunity to extend our thanks to our very capable associate, Susanna Farber, a 2006 graduate of Hastings College of Law, University of California, for her fine work in editing this issue of the *RWB Legal Reflections*.

California Insurance Coverage Decisions: 2008 Year in Review

by Susanna K. Farber



In 2008, State and Federal California courts issued several significant insurance coverage decisions. We've summarized the key points of several of these cases below.

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Major v. Western Home Ins. Co. 169 Cal.App.4th 1197 (2009)

In *Major v. Western Home Ins. Co.*, the court held that evidence of delays in handling a fire claim was sufficient to support an award for emotional distress, for attorney's fees, and for punitive damages. Further, the court held that the claims adjuster employed by a third party was the managing agent for purposes of imposing punitive damages.

This case involved a fire loss that occurred in October of 2003. Even though the insurer eventually paid benefits to the insureds, by August 2004, the insurer – acting through its third-party adjuster – 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 was required under the policy for reasons not discussed here.

The Court of Appeal affirmed the jury's award to the insureds. However, the court re-iterated the principle that an insured cannot recover emotional distress damages absent a showing of an actual economic loss, and that delay in paying 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." The court went on to hold that, once economic loss is shown, the insured cannot get emotional distress damages

for all bad faith conduct, but only the bad faith conduct tied to the economic loss.

The court further held that an employee of a third-party claims administrator qualified as a "managing agent" of the insurer, and therefore her conduct could subject the company to punitive damages under California's punitive damages statute, Civil Code section 3294.¹ The Court of Appeal relied heavily on the California Supreme Court's decision in *Egan v. Mutual of Omaha*, which concluded that punitive damages can be awarded against an insurance company based on the acts of a claims representative if the claims representative has the effective authority to set corporate policy. The Court of Appeal extended *Egan* a step further, holding that the employee of the third-party administrator had the effective authority to set policy for the insurer, and therefore subject the insurer to punitive damages.

The court concluded that a relatively low punitive damages award was appropriate because the harm to the plaintiff was purely economic, the case did not involve a disregard of health or safety, and there was no evidence that the defendant had ever engaged in similar misconduct towards other insureds.

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

In *Brehm v. 21st Century Insurance Co.*, the Court of Appeal reversed a demurrer to a bad faith action. The appellate court held that the trial court misapplied the "genuine dispute" rule, which holds that where reasonable minds could have differed, an insurer's coverage position, even if ultimately deemed to have been wrong, does not constitute bad faith.

The parties disputed the extent of the plaintiff's injuries and thus the amount to which he was entitled un-

der the policy. The matter was scheduled for arbitration, but prior to that date the plaintiff made a settlement demand for \$85,000. 21st Century rejected this offer and countered with \$5,000, based on an evaluation conducted by its medical expert, who concluded there was no objective evidence of an injury and that surgery was unnecessary. In response, the plaintiff submitted the opinion of an independent medical expert, who concluded that the plaintiff did indeed suffer objective injuries and it was "more likely than not" surgery would be required. Further negotiations were unsuccessful, and at arbitration the plaintiff was awarded \$90,000. The insured then sued 21st Century for bad faith.

The insurer demurred arguing that its coverage position was supported by an expert medical opinion, and thus not made in bad faith under the "genuine dispute" doctrine. The trial court granted 21st Century's demurrer without leave to amend. The appellate court reversed the trial court's holding. The court held that the "genuine dispute" doctrine could not be invoked to protect an insurer's denial or delay in payments of benefits unless the insurer's position was both reasonable and reached in good faith. Further, the court stated an expert's testimony will not automatically insulate an insurer from a bad faith claim based on a biased investigation. The court found that the plaintiff's allegations that the evaluation performed by 21st Century's expert was used for the sole purpose of providing 21st Century with a "genuine dispute" defense, if true, were sufficient to support a cause of action for bad faith.

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City of Hollister v. Monterey Insurance Company

165 Cal.App.4th 455 (2008)

In *City of Hollister v. Monterey Insurance Company*, the appellate court affirmed a declaratory judgment allowing an insured additional time to contract for the replacement of a building and make a replacement cost claim.

Monterey Insurance Company's ("MIC's") policy allowed the City of Hollister to recover "the cost to replace [a] damaged building" with a "functionally equivalent" building, but only if the City "contract[ed] for repair or replacement" within 180 days of the loss. The City suffered the total loss of one of its buildings in a fire and gave MIC notice of the loss, but the City did not contract for the replacement of the building within 180 days.

The trial court found that MIC's conduct in handling the claim had "prevented [the City] from entering into a contract." On that basis, the trial court found MIC temporarily "estopped from enforcing or otherwise relying on the 180-day provision." The insurer appealed.

The Court of Appeal affirmed. The court criticized MIC for not "communicat[ing] constructively" with the City regarding the benefits available under the policy and the time limits for perfecting a claim for those benefits. As long as MIC refused to say whether it would honor a claim for functional replacement benefits, the City could not comply with the condition.

The court did not, however, wholly relieve the City of the conditions to the replacement cost coverage. The court affirmed the declaratory judgment, thus requiring the City to comply with the contracting condition when the litigation was over.

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

The insured, Qualcomm, sought a judicial declaration that Certain Underwriters, the insured's excess carrier, was required to indemnify it for unreimbursed litigation costs and defense fees. The court found that Certain Underwriters had no duty to reimburse the insured where the primary insurer had not paid the full amount of its limits.

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. The trial court found the language of this condition precedent to be plain and unambiguous, and sustained Certain Underwriters' demurrer without leave to amend, and the appellate court affirmed. 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."

Everett v. State Farm General Insurance Company

162 Cal.App.4th 649 (2008)

In *Everett v. State Farm*, the appellate court affirmed an entry of judgment in favor of State Farm in an action for declaratory relief, bad faith, promissory fraud, fraudulent misrepresentation and reformation. The dispute arose out of a claim for damage sustained to the plaintiff's home in 2003. The plaintiff had been insured under State Farm policies since 1991. In 1997, State Farm sent her a notice advising that it would no longer provide "guaranteed replacement cost coverage" for homes, and that coverage for losses from that date forward would be afforded up to a stated limit

of liability under the policy. The plaintiff did not deny she received the notice, only that the policy Declarations that limited coverage for loss to stated limits was ambiguous and that she was entitled to guaranteed replacement cost coverage. In affirming the trial court's decision, the appellate court held that insureds cannot pursue contract or tort remedies where (1) the policy language clearly limits coverage to the stated limits and the insurance company paid all that was owed, (2) the policy unambiguously states that it is the insured's responsibility to maintain adequate insurance, and (3) there is no evidence that the agent who sold the policy made any misrepresentations. The California Supreme Court has denied a request to depublish the opinion.

Compulink Management Center, Inc. v. St. Paul Fire & Marine Ins. Co.

169 Cal.App.4th 289 (2008)

In *Compulink Management Center v. St. Paul*, the Court of Appeal held that Civil Code section 2860, which codifies an insured's right to independent counsel in certain circumstances, (referred to as *Cumis* counsel), mandates arbitration for any and all *Cumis* fee disputes when an action is filed in California state court, unless other procedures are provided for in the insurance policy at issue.

The insured, Compulink, tendered a cross complaint against it to its insurer, St. Paul. St. Paul accepted the defense under a reservation of rights, and permitted Compulink to select *Cumis* counsel. The case eventually settled, and thereafter, Compulink sued St. Paul in state court for breach of contract and bad faith as well as for underpayment and delayed payment of *Cumis* counsel fees. St. Paul moved to compel arbitration of the *Cumis* issue under section 2860. The Court of Appeal found the mandatory arbitration language of section 2860 clear and held that where an action is filed in state court, section 2860 mandates arbitration of "any and all *Cumis* fee

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disputes.” The appellate court declined to follow *Gray Cary Ware & Freidenrich v. Vigilant Ins. Co.*, 114 Cal.App.4th 1185 (2004), stating that the *Gray Cary* decision that fee disputes intermingled with other claims removed the action beyond the scope of section 2860’s arbitration requirement was based on a misunderstanding of prior cases.

Bruyn v. The Superior Court of Los Angeles County

158 Cal.App.4th 1213 (2008)

In *Bruyn v. The Superior Court of Los Angeles County*, the court held that even though “sudden and accidental” water damage – a covered peril – was the predominant cause of mold, a policy’s “absolute” mold exclusion was enforceable because the exclusion clearly communicated that mold “however caused” was never covered.

The dispute arose out of water damage sustained by the plaintiff’s home as a result of various water leaks. In addition, the plaintiff discovered mold. Although the policy covered losses caused by a “sudden and accidental discharge” of water from a plumbing system or household appliance, the policy also included an “absolute” exclusion for mold.

The plaintiff sued Farmers based upon Farmers’ denial of coverage for the mold-related damage resulting from the water leaks. The plaintiff alleged that the “absolute” mold exclusion was invalid pursuant to California’s predominant cause doctrine as set forth in Insurance Code section 530.

The appellate court held that the

“absolute” mold exclusion was valid. The court stated that the purpose of predominant cause doctrine is to bring about “a fair result within the reasonable expectations of both the insured and the insurer.” The court also stated that as long as “[a] reasonable insured would readily understand from the policy language which perils are covered and which are not,” an insurer may limit coverage to some, but not all, manifestations of a given peril. The court found that the policy “plainly and precisely communicate[d] an excluded risk” to a reasonable insured.

Sony Computer Entertainment Am., Inc. v. American Home Assurance Co.

532 F.3d 1007 (9th Cir. 2008)

In *Sony Computer Entertainment America, Inc. v. American Home Assurance Co.*, the Ninth Circuit held that the defendant’s “professional liability” and “general liability” policies did not obligate the insurers to indemnify or defend against class actions alleging false advertising claims.

The class action lawsuits alleged that Sony’s PlayStation 2 had design defects which made the device unable to play DVDs and certain games, contrary to Sony’s alleged advertising and representations. Sony tendered the class actions to American International Specialty Lines Company (“AISLIC”), the carrier that had issued the media liability policy. AISLIC declined coverage.

Sony sued AISLIC for breach of contract and bad faith. One issue before the Ninth Circuit was whether the false advertising and negligent mis-

representation claims constituted “negligent publication” within the meaning of the AISLIC 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 AISLIC policy obligated AISLIC to indemnify Sony and provide defense costs for lawsuits arising from certain “wrongful acts,” including “negligent publication.” The AISLIC policy defined wrongful acts in seven different sub-sections, each including a list of related terms. The Court held that the location of the term “negligent publication” within the one of these subsections meant it referred 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.

¹ Section 3294 provides that punitive damages cannot be awarded against a corporation based on the wrongful acts of a corporate employee unless an officer, director, or managing agent of the corporation participated in, authorized, or ratified those acts.

Narrow Interpretation of the “Professional Services” Exclusion in CGL Policy

by Anna A. Chopova

The recent case *Food Pro International, Inc. v. Farmers Insurance Exchange*, 169 Cal.App.4th 976 (Dec. 30, 2008) held that an insurer had a duty to defend a consulting company in a tort action by a construction worker injured while working on a

project supervised by the insured. In part, the Sixth District Court of Appeals based its decision on a narrow interpretation of the “professional services” exclusion in the Commercial General Liability (“CGL”) insurance policy at issue.

Food Pro International, Inc. (“Food Pro”) was retained by the food processing company Mariani Packing Company (“Mariani”) to plan and supervise Mariani’s relocation to a new plant. While the relocation work was

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proceeding, an electrical worker with a company hired by Mariani fell through an opening in the floor and was injured. At the time of the inci-

dent, a Food Pro consultant was on site supervising the relocation process. Food Pro's consultant was aware of the opening, and had told Mariani about it. The injured worker filed a lawsuit against Food Pro for general negligence and premises liability, alleging that Food Pro "failed to properly cover and guard the hold and/or place warnings around the hole creating a dangerous condition" and "negligently allowed and/or required and ordered [the injured worker] to work in the area of the dangerous hole."

Food Pro tendered the defense of the lawsuit to its insurer Farmers Insurance Exchange. Farmers denied the tender of defense on the basis of the professional services exclusion, which excluded coverage for bodily injury "arising out of the rendering or failure to render any professional services ... including: ... 2. Supervisory, inspection or engineering services." In the subsequent lawsuit against Farmers for breach of the insurance contract and for bad faith, the trial court found that the undisputed extrinsic evidence known to Farmers at the time of tender conclusively negated coverage and established that the only reasonable conclusion possible was that the injury "arose out of the rendering or failure to render professional services." Food Pro appealed.

While recognizing that Food

Pro did indeed engage in professional services as the term was used in the CGL policy, the Court of Appeal focused the duty to defend analysis on the connection between the professional services provided by Food Pro and the injury. Thus, even though Food Pro was providing professional services on the site, there was a dispute as to the nature and scope of those services: there had been specific discussions that it was Mariani's responsibility to cover the opening and that Food Pro was not in charge of ensuring the safety of the site. As such, there was evidence that Food Pro's supervisory role was limited to coordination of the overall process only, and that Food Pro's professional services did not extend to the creation of the opening, the safety of the site, or the direction of the workers working near the opening. The Court of Appeal concluded that, at the time of the tender, the evidence regarding the scope and nature of Food Pro's professional services was in dispute, and therefore the duty to defend was triggered.

In its analysis, the court rejected Farmers' argument that, regardless of what its professional services entailed, its employee was at the site only to perform his professional duties, thus, any act of his at the site that resulted in injury must have arisen from excluded professional services. Adopting a narrow interpretation of the professional services exclusion, the Court of Appeal held that just because Food Pro happened to be rendering engineering services at the site at the time of the injury was not sufficient to trigger the professional services exclusion. The Court of Appeal distinguished the present facts from cases where the injury arose from the performance of professional services as opposed to at the same

time as the happening of professional services. (e.g., the piercing of a customer's ear constitutes a professional service (*Hollingsworth v. Commercial Union Ins. Co.* (1989) 208 Cal. App. 3d 800); a heat lamp actively used in a chiropractic treatment fell and burned a patient (*Antles v. Aetna Casualty & Surety Co.* (1963) 221 Cal. App. 2d 438); an escrow company wrongfully failed to close escrow on a home thereby causing a home purchase to fail (*Tradewinds* 97 Cal. App. 4th 704)). The Court of Appeal reasoned that this conclusion was consistent with the requirement that policy exclusions must be construed narrowly, otherwise Farmers' proposed interpretation would have rendered the CGL policy inapplicable to any incident that occurred while Food Pro was on a project site as an engineering consultant.¹

¹ Separately, the Court of Appeals upheld the trial court's summary adjudication of Food Pro's claim for punitive damage. The court observed that, although Farmers had a duty to defend Food Pro, in its denial of defense it relied on two coverage opinions, and moreover, its denial position could not be deemed "so unreasonable as to evidence malice, fraud, or gross negligence." Moreover, just because Farmers' files did not indicate that it seriously considered the alternative to provide a defense under a reservation of rights, such absence does not suffice to show that Farmers' actions were malicious, fraudulent or in blatant violation of law or policy. Food Pro could not make a case for punitive damages by pointing to the alleged lack of evidence, it needed to show "clear and convincing evidence of tortious conduct" to justify the imposition of punitive damages.

AN INSURED MAY STACK POLICY LIMITS

by Andrea Bednarova

In *State v. Continental Insurance Co.* (Jan. 5, 2009) 170 Cal.App.4th 160 ("*Continental*"), the Fourth District of the California

Court of Appeals held that standard policy language permits the stacking of policy limits. The decision arose from an underlying Federal action

involving groundwater contamination resulting from leakage at an industrial waste site in Riverside County,

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from 1956 until the early 1970s. In 1998, the State of California was held liable for past and future remediation costs related to the cleanup of the waste site.

The *Continental* suit involved several insurers who had issued excess policies to the State between 1964 and 1975. Among other issues decided, the trial court ruled that the State could not recover more than the total policy limits for any one

policy period. The State appealed.

As the *Continental* court explained, stacking issues arise where, as in *Continental*, the entire “loss is greater than the limits of any applicable policy.” The *Continental* court rejected the anti-stacking rule articulated in the 1998 decision *FMC Corp. v. Plaisted & Co.* (1998) 61 Cal.App.4th 1132 (“*FMC*”). On facts similar to *Continental*, the *FMC* court had held that an insured could not recover under every policy triggered by the occurrence; instead, the insured could choose one policy period and recover up to the limits of that policy. In rejecting stacking, the *FMC* court reasoned that stacking of policy limits affords the insured much more coverage than the insured bargained for.

The Fourth District categorically disagreed with this analysis, reasoning that the *FMC* opinion incorrectly assumed that standard policy language did not provide for stacking. The court noted that in the absence of an anti-stacking provision, “standard policy language *does* provide for stacking, and therefore that is *exactly* what the insured has bargained and paid for.” Further, the *Continental* court noted that allowing the insured to choose the applicable policy period under which the insured wants to recover necessarily “exposes the fallacy at the heart of the antistacking rule,” because if the insured is entitled to choose, then each of the policies triggered by the occurrence affords coverage, up to its limits.

RWB SPORTS UPDATE

Triathlon

Partner Renee Peters, an accomplished cyclist and triathlete, is well at work in preparation for her entry into the one-half Vineman Triathlon. The race is scheduled for July in the Russian River area of Sonoma County. Renee, along with her husband, Kai, will do the race. It begins with a 1.2 mile swim, followed by a 56 mile bicycle ride, concluding with a one-half marathon (13.1 miles). Renee is no newcomer to ultra distance athletic challenges. Some years ago, she participated in a 3700 mile bicycle ride. The ride began just south of San Francisco where the riders dipped their wheels into the Pacific Ocean, and finished 52 days later in Portsmouth, New Hampshire, where the riders again dipped their wheels, this time in the Atlantic Ocean.

Golf

In September, RWB partner Kathleen DeLaney participated in the Nike One Man Scramble Golf Tournament. After winning her qualifying round at Paradise Valley Golf Course, Kathleen participated in the Nike Regional Championship at Shadow Lakes Golf Club, where she won the Women’s Division with a gross score of 76 and a net score of 61, taking home a new Nike golf bag and a nice plaque.

Swimming

Managing partner Ed Rudloff finished the 2008 swim season in high style. The Olympic Club of San Francisco named him “Rough Water Swimmer of the Year” for having gone undefeated in open water races stretching from the Hawaiian Islands to the San Francisco Bay and to many of the inland waterways of California. He was also awarded the coveted Loughborough Award, yearly given to the Olympic Club Masters’ most inspirational swimmer. Finally, in November, The Olympic Club honored Ed as The Olympian of the Year for Athletic Achievement. This annual award is given to a single athlete in competition with all others in the various sports representing The Olympic Club.