
K&L CALIFORNIA INSURANCE LAW UPDATE

KAUFMAN & LOGAN LLP

ATTORNEYS AT LAW

100 Spear Street, 12th Floor, San Francisco, CA 94105

TEL: (415) 247-8300

FAX: (415) 247-8310

E-MAIL: pdonsavage@kllaw.com

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K&L Wins Judgment Of No Coverage Under E&O Policies Issued to Life Insurance Agency For Losses Resulting From Insured's Premium Investment and Financing Program

On June 4, 2007, the Orange County Superior Court entered judgment for American Automobile Insurance Company in *American Auto Ins. Co. v. CBL Ins. Services, Inc., et al.*, No. 03CC00217, declaring that American Auto's policies issued to CBL Insurance Services ("CBL"), a life insurance agency, provide no coverage for any liability arising out of CBL's Investment Program. The Investment Program offered by CBL operated as follows: a life

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Articles by: Jenna E. Settino and Benjamin A. Olson

Edited by Paulette Donsavage

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insurance purchaser could finance 100% of the first year premium through funds loaned to CBL by third party investors and then loaned to the life insurance purchaser by CBL. CBL issued promissory notes bearing a generous return of 2-3% per month for the loans. The loans were repaid to CBL and to the third party investors with commission rebates which generally totaled 120% of the first year premium. Numerous investors

sued CBL when CBL failed to pay the promised return. CBL sought coverage for these claims from American Auto under three professional liability insurance policies. American Auto sued the insureds and the investors for a declaration that its policies provide no coverage for the investors' claims.

The court granted American Auto's motion for a ruling on legal issues finding there were no triable issues of material fact and that coverage is barred by exclusions in the American Auto policies for (1) claims for damages to a person or corporation who is not the insured's client; and (2) claims arising out of the insured's activities as a broker/dealer organization for securities transactions. The court found the investors do not qualify as "clients" under the plain meaning of the policies. The Investment Program constituted an investment product in which the investors placed their money with the expectation of receiving profitable returns. A lender relationship is not a client relationship. CBL was a life insurance agency. Its clients were the customers for whom it placed life insurance policies and not third party investors who loaned money as an investment.

The court further found that coverage was barred by the policies' exclusion for "any claim arising out of the INSURED'S activities as a BROKER/DEALER organization for SECURITIES transactions." Case law and the undisputed facts establish that, as a matter of law, the Investment Program constituted a series of "securities" transactions with the owners of CBL acting as a "broker/dealer." The Investment Program was an investment package, with investors tendering money for the purpose of making a profit based on the skill and talents of another party. There is no coverage for such claims under American Auto's policies.

American Auto has no obligation to pay for any amounts awarded to investors in underlying arbitrations, which totaled in excess of \$5 million.

Two Insureds Under Separate Policies Can Not Recover More Than The Value Of A Property Destroyed By A Single Occurrence

On June 25, 2007, the Second Appellate District filed its decision in *Burns v. California Fair Plan*, 2007 WL 1806171, holding that multiple insureds cannot recover more than the value of the property destroyed on a fire insurance claim resulting from a single occurrence.

Factual and Procedural History

Ann Burns ("Burns") held a life estate in a house in Claremont, California. Mitchell Weiss was a trustee of the Kent Burns Trust ("the Trust"), which held the remainder interest in the property. Burns obtained insurance on her interest in the house through California Fair Plan ("Fair Plan"). The Trust separately insured its interest in the house from Clarendon National Insurance Company ("Clarendon").

The house was destroyed by a fire in 2003. Both Burns and the Trust submitted claims to their insurers. Fair Plan and Clarendon determined that Burns and the Trust were not both entitled to the full insured value of the property on the insurance policies. Instead, the insurers determined that Burns and the Trust should recover their interest on a pro rata basis.

Burns and the Trust filed a complaint for breach of duty of good faith and fair dealing and breach of contract against the insurers seeking full recovery on their respective insurance policies, rather than the pro rata payout. The trial court granted summary judgments in favor of the insurers. Burns and the Trust appealed.

Judicial Holding and Analysis

There was no dispute that Burns and the Trust had separately insurable interests in the house. Because the insureds had separate interests, Burns and the Trust argued that they should be fully compensated for their loss in the fire, even if this amount would almost double the actual damage caused by the fire. The court stated that this reasoning contradicted a California Supreme Court rule, which recognized that the

nature of insurance does not provide for recovery in excess of the value of the property destroyed. This would be considered a profit.

The court also rejected Burns and the Trust's argument that the owner of a life estate may insure his or her estate for the full value of the property and be compensated in that amount; thus each was entitled to recover their full policy limits without regard to any payment to the other insured. The court found that the out-of-state decisions the insureds relied on did not contain a similar fact pattern where the life tenant and remainderman had separate insurance. Thus, the court rejected this argument as well.

Burns and the Trust next argued that pro rata payments on fire insurance are appropriate only where this is "double insurance." Although the court agreed that the case did not involve double insurance, the court stated that there was legislative intent to allow pro rata payment of insurance benefits other than where there is double insurance, such as when there are "other insurance" provisions as defined by the Insurance Code Sections 2070 and 2071. Insurance Code Section 2071 provides that an insurer shall not be liable for a greater proportion of any loss than the amount insured bears to the whole insurance covering the property.

In this case, both the Fair Plan and Claredon insurance policies contained "other insurance" provisions and the court held it was proper for the insurers to use pro rata payments based on the legislative intent of Sections 2070 and 2071.

Comments and Implications

This ruling reaffirms that the nature of insurance does not provide for recovery in excess of the value of the property destroyed where there is only one loss. However, the court limited its ruling to cases where there is a single occurrence. Would a pro rata formula under the "other insurance" provisions still be reasonable if there were multiple occurrences? Depending upon the case, a court would probably weigh whether the insurers created a fair and equitable way to indemnify the insureds, while at the same time preventing the insureds from profiting from their loss.

Attorney Fees and Costs Incurred By Insured Should Not Be Deducted When Calculating "Made-Whole" Amount Under Insured's No-Fault Medical Payments Coverage

On June 14, 2007, the Fourth Appellate District filed its decision in *Allstate Ins. Co. v. Superior Court (Delanzo)*, 2007 CDOS 6840, holding that in calculating the "made-whole" amount under an insured's no-fault medical payments insurance coverage, the insured's total recovery should not be reduced by attorney fees and costs incurred by the insured to obtain compensation from a third party tortfeasor.

Factual and Procedural Background

Tony Delanzo filed a class action complaint against Allstate Insurance Company ("Allstate") regarding Allstate's no-fault medical payments insurance coverage ("med-pay coverage") pursuant to its automobile policies. Delanzo alleged that the coverage encompassed reasonable and necessary medical expenses incurred because of an automobile accident and was designed to provide an additional source of funds for such expenses.

Delanzo received \$4,200 in medical payments coverage from Allstate after he suffered injuries in an auto accident with a third party. Delanzo then settled his claim against the third party tortfeasor for \$11,000, and received a settlement payment in full. Delanzo alleged he incurred attorney fees of \$3,850 and costs of \$2,076 to obtain the settlement. Allstate asked Delanzo to repay the \$4,200, but accepted as full reimbursement Delanzo's proffer of \$1,696 based on the common-fund rule that an insurer is required to deduct from its reimbursement a pro rata portion of the insured's attorney fees and costs incurred to recover losses against a third party tortfeasor when the insurer had knowledge, but did not participate in, the litigation.

Delanzo sued on several causes of action, the legal basis of which was that Allstate was not entitled to reimbursement because he was not "made whole" by the third party settlement plus the amount received from Allstate when taking

into account the attorney fees and costs that he incurred to obtain the settlement. Allstate demurred, contending that Delanzo failed to state a claim. The trial court overruled the demurrer and found that under the made-whole doctrine an insurer that did not participate in litigation against the third party was entitled to reimbursement only when the amount the carrier paid was not exceeded by the attorney's fees and costs incurred by the insured to obtain a tort recovery. Allstate petitioned for a writ of mandate.

Judicial Holding and Analysis

The court of appeal granted the petition, finding that the trial court erred in overruling Allstate's demurrer. The court held that in determining whether an insured has been made whole, the amount of the insured's total recovery should not be reduced by the attorney fees and expenses incurred by the insured to obtain the recovery from a third party tortfeasor. Absent governing case authority in California the court examined public policy grounds behind the made-whole doctrine. The made-whole doctrine is a common law exception to an insurer's subrogation right. The rule precludes an insurer from recovering third party funds unless and until the insured has been made whole for the insured's loss. However, under the American rule, tort plaintiff's attorney fees generally are not included when determining the plaintiff's total losses. By extension, the court reasoned full compensation means payment for all damages suffered, not including attorney fees.

The court determined that Delanzo received total recovery for his personal injury losses from the third party and received credit for that portion of his attorney fees and costs attributable to recovery of the covered losses from the third party. Delanzo could not have reasonably expected insurance coverage that would compensate him for damages over and above his medical payments or for his litigation expenses to collect these uncovered damages.

The court opined that any other result would be inconsistent with the general rule that an insurance company may be obligated to pay attorney fees to its insured only in disputes

between the insured and the insurer and only under certain circumstances.

Comments and Implications

This decision is good for insurers because it prevents policy holders from subtracting attorney fees and costs from their total recovery when determining whether they have been made-whole. As the court noted, any other decision would have had the effect of implicitly providing coverage for attorneys fees and costs incurred by an insured who seeks damages from a third party, even when no such coverage is provided by the policy.