
K&L CALIFORNIA INSURANCE LAW UPDATE

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Reinsurance Agreements Are Not Discoverable In Underlying Tort Actions

On August 27, 2007, the California Supreme Court filed its decision in *Catholic Mutual Relief Society v. Superior Court*, 2007 WL 2412234, holding discovery of a nonparty liability insurer's reinsurance agreements was not authorized by a discovery statute permitting limited discovery of a defendant's insurance coverage information.

Factual and Procedural Background

Approximately 140 plaintiffs sued the Roman Catholic Archdiocese of San Diego

IN THIS ISSUE:

- Reinsurance Agreements Are Not Discoverable In Underlying Tort Actions..... 1
- Auto Exclusion Does Not Preclude Coverage For Auto Accident Allegedly Caused By Insured's Creation Of A Dangerous Condition On Public Property..... 3
- No Coverage Under Auto Liability Policy For Claim Alleging Sexual Assault Because Injury Did Not Result From "Use" Of Luxury Shuttle Used To Transport Victim To Driver's Home Where Assault Occurred..... 4
- California Choice Of Law Statute Requires Application of California Law To Determination Of Whether Policy Issued In Texas To A Texas Corporation For California Hazards Includes A Duty To Defend Pollution Claims 5
- Other Insurance Law Developments..... 7

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("Church") for alleged childhood abuse by certain priests. These cases were coordinated with several others in the Los Angeles County Superior Court and are referred to as "Clergy II Cases." In September 2003, the trial court issued an order

directing the Church to turn over copies of all insurance policies that might provide coverage for the plaintiffs' claims. The Catholic Mutual Relief Society ("Society") is a nonprofit corporation that administers a self insurance fund for more than three hundred archdioceses and other entities including the Church. The Society is not an insurance company, but its wholly owned subsidiary, Catholic Mutual Relief Insurance Company of America ("CMR Insurance"), is the Church's liability insurer.

The Church produced copies of its liability insurance policies issued by CMR Insurance. The plaintiffs sought additional financial documents from the Society and CMR Insurance including all writings reflecting the total amount of funds available from reinsurance to satisfy any defense expenses or indemnify losses in connection with sexual abuse claims against the Church. The Society and CMR Insurance moved to quash the subpoenas on the ground they were not reasonably calculated to lead to the discovery of admissible evidence. The settlement judge denied the motions to quash, finding that the requests were clearly relevant and discoverable to inform and facilitate settlement.

The Society and CMR Insurance sought a writ of mandate from the Court of Appeal to vacate the settlement judge's order. The Court of Appeal granted relief, holding the reinsurance information sought was not discoverable and that California Code of Civil Procedure § 2017.210 (the discovery statute authorizing limited discovery of insurance information) was intended only to reach a defendant's direct insurer, and not that insurer's reinsurance agreements.

The plaintiffs appealed and the Supreme Court granted review on the issue of "whether the long-standing California rule that 'has permitted discovery of the existence and extent of liability insurance' allows discovery of reinsurance information that is critical to determine the 'nature and limits' of coverage that may be available to satisfy a judgment as set forth in CCP § 2017.210.

Judicial Holding and Analysis

In a 4 to 3 decision, the California Supreme Court affirmed the appellate decision. The Court explained that although evidence of a

tort defendant's liability insurance generally is not admissible at trial, CCP §2017.210 creates an exception that allows limited discovery of a defendant's liability insurance. A party is entitled to discover the "existence and contents of any agreement under which any insurance carrier may be liable to satisfy in whole or in part a judgment that may be entered in the action or to indemnify or reimburse for payments made to satisfy the judgment."

The limited discovery of a tort defendant's liability insurance is based upon the fact that a potential contractual relationship arises between the liability insurer and any third party who might be injured by its insured. However, this limited discovery of insurance information does not extend to reinsurance, which is defined by statute as "a contract . . . by which an insurer procures a third person to insure him against loss or liability by reason of such original insurance." Reinsurance is a contract of indemnity made for the benefit of the liability insurer. The original insured has no interest in a contract of reinsurance and generally reinsurance has no relevance in underlying tort actions.

The reinsurance contract is not with the insured/policyholder. Rather it is between the insurer and the reinsurer and it is designed to help spread the burden of indemnification. In contrast to a primary liability insurer, a reinsurer has no duty to investigate and defend claims between third parties and the underlying liability insurers or their insureds. Reinsurers do not owe any duty of good faith and fair dealing to the original insureds, unless the reinsurance agreement somehow specifically so provides.

The Court noted that reinsurance arguably falls within the statutory language permitting discovery of insurance because a reinsurer agrees to "indemnify or reimburse for payments made to satisfy the judgment." However, the Court found the statutory language ambiguous when considered as a whole because it neither expressly includes nor expressly excludes reinsurance agreements. The legislative history of the discovery statute supports the interpretation that it was specifically intended to authorize limited discovery of a defendant's liability insurance coverage, which was permitted at common law at

the time the discovery statute was enacted. Nothing in the legislative history discloses an intention to expand the scope of discovery beyond primary liability policies to reinsurance agreements.

The Court also noted that permitting discovery of nonparty insurers' reinsurance agreements could lead to burdensome discovery requests directed at entities who are not even participating in the lawsuits. It seems highly unlikely the legislature would have intended this result when it enacted the discovery statute.

Finally, the Court acknowledged that in rare circumstances in which a reinsurance agreement is functioning as a liability policy through a fronting arrangement, or where the reinsurance agreement is itself the subject matter of the litigation, discovery of the reinsurance agreement would be appropriate.

Three justices dissented on the grounds CCP §2017.210 unambiguously provides for discovery of reinsurance policies by the plain language which includes "any agreement under which any insurance carrier may be liable to . . . indemnify or reimburse for payments made to satisfy the judgment."

Comments and Implications

This decision carefully analyzes the differences between primary liability insurance and reinsurance and recognizes that reinsurance is not relevant in an underlying action because it provides no direct payment to the insured defendant. In a footnote, the Court notes certain federal cases which have interpreted the Federal Rules of Civil Procedure as permitting discovery of reinsurance information, usually in cases involving bad faith claims or declaratory relief actions where the reinsurer is a party or where the reinsurance agreement is directly relevant to the parties' claims or defenses in the litigation. However, the Court found that federal discovery law is not determinative of the issue and does not take into account the legislative history and intent of the California statute. In addition, strong arguments can be made that reinsurance should not be discoverable even in bad faith or coverage actions because it does not have any bearing on

whether or not an underlying claim is covered by a primary liability insurer.

Auto Exclusion Does Not Preclude Coverage For Auto Accident Allegedly Caused By Insured's Creation Of A Dangerous Condition On Public Property

On August 27, 2007, the Fifth Appellate District filed its decision in *Essex Insurance Company v. City of Bakersfield*, 2007 WL 2416712, holding that an auto exclusion in a general liability policy was not plain and clear enough to defeat a City's reasonable expectation that it was covered for claims arising out of the creation of a dangerous condition on public property.

Factual and Procedural Background

On October 15, 2004, Guillermo Mena was driving his tractor-trailer when the tractor-trailer jackknifed causing it to collide with Gloria Navarro's automobile. On the night of the accident, the City of Bakersfield ("the City") was beginning its annual D.A.R.E "Fright Night" fundraising event in a cornfield maze on private property and adjacent to the highway on which Mena and Navarro were driving. On January 26, 2005, Gloria, Jose, and Erick Navarro ("Navarros") filed a civil complaint against Guillermo Mena and his employer, and then amended their complaint to include D.A.R.E. Inc. and the City. The amended complaint alleged that placing Fright Night on a major highway and providing dangerous and inadequate traffic controls and traffic direction were a proximate cause of plaintiffs' injuries.

Essex Insurance Company ("Essex") issued a CGL insurance policy that provided third party coverage for occurrences during the special event of Fright Night. Essex denied the City's request for defense and indemnity on the basis the policy excluded coverage for injury arising out of the ownership, nonownership, maintenance, use or entrustment to others of any auto and later filed a complaint against the City seeking declaratory relief that it was not obligated to defend or indemnify the City in the Navarro lawsuit. The

trial court granted Essex's motion for summary judgment finding the policy did not provide coverage for claims arising out of incidents involving autos owned or not owned by the insured. The City appealed.

Judicial Holding and Analysis

The Court of Appeal reversed, finding the allegations of the Navarro lawsuit alleging bodily injury caused by a dangerous condition created by the Fright Night event raised a potential for coverage and thus a duty to defend.

The Court began its decision by summarizing the fundamental principle that an insurer cannot escape its basic duty to an insured by means of an exclusionary clause that is unclear. Moreover, the insurer has the burden of making coverage exceptions and limitations conspicuous, plain, and clear. Essex argued the policy excluded coverage for any case involving autos by anyone anywhere. The Court found that there was no evidence in the record that Essex's broad interpretation of the auto exclusion provisions was brought to the attention of the insureds. Moreover, the average layperson would not have understood the auto exclusion to apply under these facts.

Instead, the Court ruled that a layperson would interpret the auto exclusion as applying to lawsuits involving the use of or other acts relating to any "auto" by any insured or on the insured premises. In addition, no public entity would have reasonably expected that the insurance policy would protect it from liability for negligently creating a dangerous condition of public property in all cases except where the dangerous condition leads to an automobile accident involving vehicles that had no connection to the public entity. The City reasonably expected Essex would defend it from a claim that the City created a dangerous condition of public property that arguably led to the auto accident.

The Court further found that the case law regarding auto exclusions addresses situations where the automobile involved was owned, maintained, or used by an insured or an insured's agent or employee. Here, the city had no connection to the autos involved in the accident. In addition, given that the City could not get

separate auto insurance for the accident in the Navarro suit, the auto exclusion should not be interpreted to deny coverage for a claim alleging the City created a dangerous condition of public property that contributed to an auto accident.

Comments and Implications

This decision interprets the auto exclusion in the context of the facts of the underlying claim and focuses on the reasonable expectations of the insured to find coverage. The insured's alleged negligence was based upon creating a dangerous condition of public property, and did not specifically involve the insured's use of any automobile. Under these circumstances, the auto exclusion does not apply.

No Coverage Under Auto Liability Policy For Claim Alleging Sexual Assault Because Injury Did Not Result From "Use" Of Luxury Shuttle Used To Transport Victim To Driver's Home Where Assault Occurred

On August 28, 2007, the First Appellate District filed its decision in *R.A. Stuchbery & Others Syndicate 1096 v. Redland Insurance Company*, 2007 WL 2420266, affirming the trial court's ruling on summary judgment finding no coverage under an auto policy for an underlying action alleging sexual assault after the victim was transported to shuttle driver's home in the insured's shuttle.

Factual and Procedural Background

R.A. Stuchbery & Others Syndicate 1096, as Underwriters at Lloyds, London ("Stuchbery"), insured M & M Luxury Shuttle, Inc. ("M & M") and its officer and director Mostafa Tehrani (together, "Insureds") under a general liability policy. Stuchbery defended and indemnified the Insureds in the underlying action that a passenger filed against them and an individual M & M driver.

The passenger, who was 16-years old at the time of the incident, alleged several causes of action including common carrier liability, sexual assault, negligent hiring, negligent training and

false imprisonment. She testified in a concurrent criminal action that she accepted a shuttle ride from the San Francisco Civic Center to a shelter for homeless people and run-away teens. The driver instead took her to his apartment and raped her. In the criminal action, the passenger testified that she first saw the driver outside of a diner with a shuttle, interacted with the driver in his capacity as an employee, and would never have entered the shuttle if she believed it was a private vehicle. She exited the M & M shuttle and entered the driver's private home on his suggestion that she wait there, while he worked, until a shelter opened; he said he would return in five hours to get her. He then assaulted her, holding her in his apartment for five hours by threat of further violence.

The Insureds tendered their defense and indemnity in the underlying action to Stuchbery and later to Redland Insurance Company ("Redland"), which issued a business auto policy to the Insureds. Stuchbery agreed to defend under a reservation of rights. Redland initially accepted the tender under a reservation of rights, but after investigation declined to defend or indemnify. Stuchbery incurred \$274,549.40 in defense costs, and \$250,000 to settle the claims against the Insureds. Stuchbery sued Redland for reimbursement or, in the alternative, equitable contribution.

The trial court granted Redland's motion for summary judgment asserting no potential for coverage existed. Stuchbery appealed.

Judicial Holding and Analysis

The Court of Appeal affirmed, holding that as a matter of law, the victims injuries did not result from the "use" of the M&M shuttle. Redland's policy provided coverage for a "bodily injury" . . . resulting from the . . . use of a covered auto." The Court cited prior case law interpreting similar language and finding that a mere "but for" connection between the use of an auto and the alleged injuries is insufficient to bring a claim within coverage. Instead, the test is whether the use of the auto was the predominating cause/substantial factor of the injury. To hold otherwise would convert auto policies into general liability policies. Here, the injury resulted from

the driver's intent to rape the victim in his apartment. The use of the shuttle merely to drive the victim to the driver's apartment did not establish a sufficient causal connection between the "use" and the injury.

Stuchbery argued that where a common carrier is involved, the vehicle is necessary to any driver-victim relationship and therefore always a substantial factor in injuries from a driver's physical assault. Stuchbery's argument seems to, in effect, apply the lesser "but-for" test. (But for the vehicle, there would be no relationship and no assault.) The Court rejected this argument under the facts before it and found the relationship between the "use" of the shuttle and the rape inside the driver's apartment was too attenuated to trigger Redland's duty to defend or duty to indemnify. In making its determination, the Court focused on the passenger's prior testimony that she exited the shuttle "without being subject to either physical or verbal coercion . . . 'figur[ing]' she would sleep there for a few hours until the shelters reopened in the morning."

Comments and Implications

The Court stops short of stating that "use of a motor vehicle" may still be an ambiguous phrase where common carriers are involved, or that the "but-for" test may still be used in certain cases. But it finds in this case, given that the assault did not take place in the shuttle, there is no coverage under the auto policy. The Court leaves open the possibility of finding coverage where an injury occurs in a common carrier's auto.

California Choice Of Law Statute Requires Application of California Law To Determination Of Whether Policy Issued In Texas To A Texas Corporation For California Hazards Includes A Duty To Defend Pollution Claims

On August 6, 2007, the Second Appellate District reversed the trial court in its decision in *Frontier Oil Corporation v. RLI Insurance Company*, 153 Cal.App.4th 1436, holding that California law governs interpretation of an insurance policy issued in Texas to a Texas

corporation but covering a risk in California. The Court also held the insurer must defend personal injury actions arising out of oil and gas production facilities in Beverly Hills, California because there was a potential for coverage.

Factual and Procedural Background

RLI Insurance Company's ("RLI") predecessor in interest issued a commercial general liability policy to Frontier Oil Corporation's ("Frontier") predecessor in interest, Wainoco Oil Corporation ("Wainoco"). The contracting parties were both Texas entities and entered into the insurance contract in Texas. The policy generally provided both a duty to defend and duty to indemnify covered losses. The policy contained an "absolute pollution exclusion", however, this exclusion was deleted by a pollution liability endorsement providing indemnity coverage for bodily injury or property damage caused by a "pollution incident," which was defined as a sudden and accidental release resulting in environmental damage. The pollution liability endorsement did not mention a duty to defend.

Frontier and Wainoco were sued in 2003 by numerous plaintiffs who alleged that the companies' oil and gas operations at locations in Beverly Hills caused releases of toxic chemicals into the environment resulting in personal injury and death. Over the next two years, six additional actions with similar allegations were filed against Frontier and Wainoco, all of which were tendered by them to their primary liability insurers, including RLI. RLI denied coverage and a defense.

Frontier and Wainoco filed a complaint in Los Angeles Superior Court for declaratory relief, breach of contract, and breach of the covenant of good faith and fair dealing. In its motion for summary judgment, RLI argued that Texas law governed the dispute under California Civil Code § 1646, which states a contract is to be interpreted according to the law of the place where it is to be performed only if the contract indicates a place of performance, and otherwise it is to be interpreted according to the place where the contract was made. RLI argued that under Texas law, the pollution liability endorsement does not promise a

defense of pollution claims, but rather only indemnity for such claims and that the allegations did not create a potential for coverage. The trial court concluded that under Civil Code § 1646, Texas law governed the dispute because the insurance contract was made and accepted between a Texas insurer and a Texas-based insured in Texas and was to be performed under Texas law. The trial court granted summary judgment in favor of RLI holding that the policy did not include a duty to defend pollution claims because the pollution liability endorsement did not expressly promise a defense. Frontier and Wainoco appealed.

Judicial Holding and Analysis

The Court of Appeal reversed, first finding that Civil Code § 1646 is indeed the choice of law rule that determines the law governing the interpretation of contracts, such as insurance policies, notwithstanding the application of the judicially developed governmental interest analysis to other choice of law issues. Second, the Court determined that Civil Code § 1646 was intended to give effect to the parties' presumed intention that the law of the place a contract is to be performed should govern its interpretation. A contract "indicates" a place of performance within the meaning of § 1646 if the intended place of performance can be gleaned from the nature of the contract and its surrounding circumstances. As the RLI policy did not expressly state that the place of performance is California, the Court of Appeal looked to the terms of the policy to make that determination. The policy specifically refers to claims arising from oil and gas operations at a drill site in Beverly Hills, California. Moreover, two policy endorsements name the City of Beverly Hills and the Department of Transportation of the City of Los Angeles as additional insureds with respect to claims arising out of such operations.

The Court of Appeal found that the parties anticipated that a suit arising from its Beverly Hills operations would likely be prosecuted in California and that RLI would be obligated to provide a defense in California if the claims were potentially covered under the policy. Accordingly, the Court concluded that California was the intended place of performance of the

contract with respect to such claims, that the policy “indicates” a place of performance within the meaning of Civil Code § 1646 in connection with the underlying suits, and that California law governs the interpretation of the policy.

The Court concluded that under California law the policy includes a duty to defend pollution claims because the pollution endorsement deletes the absolute pollution exclusion and does not clearly and unmistakably exclude pollution claims from the duty to defend expressly granted in the policy’s basic insuring clause. Therefore, pollution claims are not excepted from the duty to defend.

Finally, the Court concluded that under either California or Texas law there is a duty to defend the underlying personal injury actions which allege damages potentially covered by the policy and do not foreclose the possibility that the damage was caused by a sudden and accidental release.

Comments and Implications

This decision applies Civil Code § 1646 to determine choice of law issues in connection with interpreting insurance contracts, notwithstanding the most prevalent modern choice of law rule in California – the governmental interest analysis. The judicially developed governmental interest analysis, which involves an examination of the interests of each jurisdiction and a comparative impairment analysis if each respective jurisdiction’s law were not applied, does not supplant the legislative command of § 1646.

Other Insurance Law Developments

Fairbanks v. Superior Court, 2007 WL 2381006

The Second District Court of Appeal was presented with an issue of first impression, i.e. whether insurance is subject to the protections of the California Consumer Legal Remedies Act (“CLRA”). The insured, a purchaser of life insurance, sought damages for unfair and deceptive marketing of universal life insurance policies by Farmers New World Life Insurance Company. The Court held that insurance is

neither a “good” nor “service” within the meaning of the CLRA.

The Court easily dismissed the notion that insurance was a good under the CLRA by the plain reading of statutory language which provides that “goods” are defined as tangible chattels bought or leased for personal, family or household use. (Civ. Code § 1761). The issue of whether insurance is a service required a more detailed analysis.

The Court reviewed case law which strongly suggests that insurance is not a service, and the legislative history behind the CLRA, and found that insurance was specifically omitted from the definition of “services” under the CLRA. Further, the court reasoned that to rule otherwise would be contrary to the policy considerations of the California Unfair Insurance Practices Act which predates the CLRA and already prohibited unfair and deceptive practices in the insurance business. In light of these factors, the court concluded that the Legislature did not have insurance in mind when it enacted the CLRA.

California Capital Insurance Co. v. Nielsen, 153 Cal. App. 4th 1221

The Court of Appeal for the Third District affirmed judgment in a declaratory relief action, holding that an automobile not covered by an automobile liability policy was not an uninsured motor vehicle where a personal umbrella policy provided coverage.

The action stems from a single vehicle automobile accident wherein the subject vehicle was not covered by any auto liability insurance. However, at the time of the accident, both the owner and the driver of the vehicle were covered by a \$1 million personal liability umbrella policy. The injured passenger recovered the full policy limit under the personal liability policy. However, he also sought to recover under his father’s auto liability policy for its per-person limits of \$100,000 in uninsured motorist benefits.

The Court of Appeal concluded that when an owner and an operator of an otherwise uninsured motor vehicle have bodily injury liability insurance coverage under a personal

liability umbrella policy that covers the ownership and use of that vehicle in the accident at issue, that vehicle cannot be an uninsured motor vehicle triggering payment under the injured person's uninsured motorist provision.

***Intri-Plex Technologies v. The Crest Group,
2007 WL 2410170.***

The United States Court of Appeals for the Ninth Circuit affirmed the district court's grant of Crest's motion to dismiss Intri-Plex's complaint on the ground that it was an impermissible splitting of a single cause of action and therefore barred by res judicata. Intri-Plex had an insurance policy with Atlantic Mutual Insurance Co. ("AMI"). AMI filed a subrogation action against Crest for its defective product and later settled with Crest. Later, Intri-Plex filed this action against Crest for similar allegations as AMI's suit. The Court stated that the rule against splitting cause of action is violated where both the insurer and the insured pursue separate claims. The Court found that this action and AMI's action grew from the same violation. Further, the Court stated that a tortfeasor that has knowledge of an insurer's subrogation claim may not settle the entire cause of action by settling only with the insured and thereby foreclosing a subsequent action by the insurer. This rule exists to protect the insurer, not the insured, when the insured and the tortfeasor voluntarily settle and release all claims with knowledge of the insurer's subrogation rights. Here, Intri-Plex, the insured, did not succeed to the rights of AMI, so Intri-Plex did not have any subrogation rights to protect.