the Professional Line

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Interpreting the Competing Interests of the CGL Insured and Insurer

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An insured's ignorance or misunderstanding of its rights under its CGL policy is not sufficient to require coverage of pretender fees or costs.

Several provisions in standard commercial general liability "occurrence" policies regulate the parties' duties and obligations in response to a claim or suit. The conditions state, for example, that the insured must provide notice of an "occurrence" as soon as practicable, and that the insured must provide immediate notice of suits. The insured also must cooperate in the investigation, defense and settlement of suits. Nonetheless, in about two thirds of the states, an insurer cannot assert as a defense the insured's failure to comply with these notice and cooperation defenses as a policy defense unless the insurer is able to show that it was substantially and materially prejudiced by its insured's violation of one of these conditions.

Two other conditions, however, are sometimes interpreted in favor of the insurer without a showing of prejudice. One of these is the "voluntary payments" clause, which provides that, "No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation or incur any expense, other than for first aid, without our consent." The voluntary payments clause allows the insurer to exercise its right to control the investigation, defense and settlement of claims. This clause is often invoked when an insured incurs attorneys' fees and other legal expenses before it tenders defense of a suit to its insurer.

The second such clause is the "no action" clause, which provides that no third party may sue the insurer for damages unless there has been an agreed settlement or a final judgment against the insured obtained after an actual trial. (In more recent policy forms, the requirement for an "actual trial" has been replaced by "final judgment," in recognition of the fact that policies now define a "suit" to include arbitration proceedings.)

Unlike the notice and general cooperation conditions, the "voluntary payments" or "no action" conditions are more strictly enforced in some states than the late notice condition. In other states, these conditions and the notice conditions are similarly enforced, requiring insurers to prove prejudice to assert any of the conditions as defenses.

California recognizes distinctions between the late notice, voluntary payments and no action conditions. In California, insurers are not required to show that they were prejudiced by an insured's unauthorized payments, including fees and costs incurred prior to tender. Instead, the burden is placed on the insured to show that its unauthorized payments were caused by "extraordinary circumstances."

California courts routinely find that voluntary payments clauses are enforceable, as long as the insurer properly assumes a required defense from the time of tender. The insured's burden of proving extraordinary circumstances is not an easy one. The kinds of "extraordinary circumstances" that would require an insurer to pay pretender fees and costs would include cases where an insurer breached its duty to defend; where the insured (e.g., a successor) was not aware of the identity of the insurer before an answer had to be filed; where payment was necessary for reasons genuinely beyond the insured's control; or, where the insured faced a situation requiring an immediate response to protect is legal interests. An insured's ignorance or misunderstanding of its rights under its CGL policy is not sufficient to require coverage of pretender fees or costs. *Jamestown Builders, Inc. v. General Star Indem. Co.* (1999) 77 Cal.App.4th 341, 346-348.

The voluntary payments condition is not solely restricted in application to situations where an insured has incurred pretender fees and costs. At least in California, it can also be applied to settlements negotiated without an insurer's authorization after a case has been tendered. *Low v. Golden Eagle*, 110 Cal.App. 1532, 1544 (Cal.App. 2003), rev. denied, a case with rather unusual and complicated facts, reaffirmed California's strict interpretation of the voluntary payments condition. There, even though the insurer engaged in a 20-month investigation of the insured's tender and never actually assumed the defense, the court relied on the voluntary payments condition to find that the insurer was not obligated to indemnify the insured for a settlement that was negotiated without its knowledge or consent.

California courts also have applied the reasoning employed to interpret voluntary payments clauses to contests between insurers and insureds in equitable contribution disputes. In *Truck Ins. Exchange v. Unigard Ins. Co.*, 79 Cal.App.4th 966, 979 (2000), the plaintiff settled five construction defect claims against its insured and then sued other insurers for contribution. One of those co-insurers was never notified of these suits and did not learn of them until the contribution claim was filed. The court found that this insurer was not required to contribute because it had not enjoyed the right to participate in the defense or settlement. The plaintiff insurer was not allowed to pull the co-insurer into the fray after the settlement.

In the states that require a showing of actual prejudice to enforce a voluntary payments defense, insurers can meet this burden by showing that the insured's failure to make a timely tender of the defense or the insured's assumption of unauthorized liability caused the insurer to lose its contractual right to control the defense and settlement of the proceeding against the insured. Washington, Illinois and Massachusetts are examples of states in which an insurer must show that it was actually prejudiced by an insured's voluntary payments. In *Westchester Fire Insurance Co. v. G. Heileman Brewing Company, Inc.*, 747 N.E. 2d 955 (Ill. App. 2001), the insurer showed actual prejudice where its insured had been conducting its own

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RECENT RULINGS:

Construction Contractors

Premises Owner's Liability to an Independent Contractor's Employee to be Decided by California Supreme Court

Kinsman v. Unocal Corporation

On October 29, 2003, California's Supreme Court granted petition for review of Kinsman v. Unocal Corporation (2003) 110 Cal.App.4th 826. In Kinsman, an employee worked as a carpenter at defendant's refinery. He was employed by an independent contractor that the refinery owner hired to perform scaffolding work during periods of "shutdown" and repair at the refinery. The independent contractor built and dismantled scaffolding using insulators. The employee's work exposed him to airborne asbestos, which was produced by the insulators.

The employee sued the refinery owner and submitted his case at trial, in part, on the theory that the refinery owner was negligent in the use, maintenance or management of the areas where the employee worked. The jury found in favor of the employee on this theory and assigned fault.

On appeal, the Kinsman court held that a premises owner has no liability to an independent contractor's employee for a dangerous condition a contractor has created on the property unless the dangerous condition was within the property owner's control and the owner exercised this control in a manner that affirmatively contributed to the employee's injury. Because the jury instructions in the trial court did not reflect these limitations in the premises owner's liability, the appellate court reversed for a new trial.

California's Supreme Court will decide the following issue: Whether a premises owner's liability for injuries suffered by an independent contractor's employee, due to a dangerous condition on the property created by the contractor, is limited solely to those cases in which the owner has control over the dangerous condition and acts, or fails to act, in a manner that affirmatively contributes to the employee's injury.

Attorneys

Complaint Fails to State a Cause of Action

Wolkowitz v. Redland Insurance Company

Edward M. Wolkowitz, as chapter 7 bankruptcy trustee for Shamrock Tire, Etc., Inc., sued Shamrock's insurer, Redland Insurance Company, and the attorneys retained by Redland to defend Shamrock, alleging (1) the insurer's bad faith refusal to accept a pre-trial offer to settle a personal injury action against Shamrock within policy limits and (2) the attorneys' legal malpractice and breach of fiduciary duty in connection with the refusal to settle. Wolkowitz sought to recover the amount of an allowed claim filed by the personal injury claimant.

The Second District Court of Appeal held that Wolkowitz's complaint failed to state a cause of action against both the insurer and the attorneys because it failed to allege facts sufficient to establish that Shamrock suffered any damages as a result of the refusal to settle claimant's action. Specifically, the court held that, in the absence of an excess judgment determining the fact and amount of Shamrock's liability, Redland could not be liable for alleged bad faith refusal to accept a policy limits settlement offer. Additionally, even if a judgment had been entered in excess of policy limits in the underlying personal injury action, Shamrock's pre-existing insolvent status established that it suffered no compensable harm from any act or omission by the attorney defendants.

Real Estate Agents

The Residential Lead-Based Paint Hazard Reduction Act Does Not Apply to a Buyer's Agent

Griffin v. Bruner, 2003 WL21674327 (Ill. App. Ct., Opinion issued 7/15/03).

The federal Residential Lead-Based Paint Hazard Reduction Act of 1992 (42 U.S.C. §4852b(A)(4)(2000) the "Act") requires owners of certain real estate and their agents to disclose knowledge of the existence of lead-based paint and provide certain information relative to the hazards of lead-based paint. Pursuant to the Act, the EPA and HUD promulgated regulations defining an agent as "a party that enters into a contract with a seller or lessor, including any party that enters into a contract with a representative of the seller or lessor, for the purpose of selling or leasing target housing. The term does not apply to purchasers or any purchaser's representative who receives all compensation from the purchaser." 24 C. F.R. §35.86.

Notwithstanding the EPA and HUD regulations, an Illinois appellate court recently held that the Act does not apply to a buyer's real estate agent. In Griffin, Plaintiffs purchased residential property and alleged after taking possession that their minor child became ill with lead poisoning. They sued, among others, their real estate agent and broker for failing to comply with the Act and otherwise insuring compliance with lead-based paint disclosure requirements. They sought money damages, attorney's fees and costs pursuant to the Act.

The real estate broker and agent filed a motion to dismiss the complaint contending that the Act did not apply to them because they were the buyers', not the seller's agent. Plaintiffs asserted that since their agent shared in the real estate commissions paid by the seller, the EPA and HUD regulations include a buyer's agent. The real estate broker and agent argued that the EPA and HUD regulations are inconsistent with the very terms of the Act and should not be considered. In the case argued by Hinshaw attorneys, the Illinois appellate court agreed.

The Griffin court rejected the plaintiffs' administrative construction, noting that the clear statutory mandate under the Act was to impose responsibility to insure compliance with lead-based paint disclosure solely on the seller and the seller's real estate agent, not a buyer's agent. The Illinois Appellate Court followed the reasoning of the only two other opinions issued on this subject from federal district courts in Chicago and Maine. The Griffin court agreed with the federal decisions that the EPA and HUD regulations are inconsistent and fly in the face of the clear statutory mandate of the Act; thus the court was obligated to enforce the terms of the Act only. Accordingly, a buyer's agent has no duty under the Act to insure lead-based paint disclosure requirements.

Attorneys

Appellate Court Affirms Refusal to Vacate Arbitration Award

Pour le Bebe, Inc. v. Guess?, Inc.

Nationwide On October 15, 2003, the Court of Appeal of the State of California, Second Appellate District issued its opinion in Pour le Bebe, Inc. v. Guess?, Inc. The parties' dispute arose from a series of license agreements, under which Guess?, Inc. ("Guess") granted Pour le Bebe ("Bebe") the right to use its trademark. In arbitration, Bebe filed a motion to disqualify Guess' counsel alleging that Guess' counsel was concurrently representing Bebe in other matters and/or that counsel's past representation of Bebe resulted in disclosure of confidential information substantially related to the issues in arbitration. The arbitration panel denied Bebe's motion because the evidence was insufficient to support Guess' counsel's disqualification.

Bebe sought a temporary restraining order ("TRO") and order to show cause ("OSC") from the Superior Court. The court denied the application, agreeing on the record with

CASE SUMMARIES & CONCLUSIONS

Guess that Bebe's sole remedy was to obtain relief from the arbitrators and that it lacked the power to adjudicate the dispute.

On appeal, Bebe contended that Guess obtained the award by undue means as a result of its representation by counsel that had a conflict of interest. The appellate court agreed that Bebe had at least a "colorable claim that [Guess' counsel] engaged in a conflicted representation or violated its duty of loyalty by undertaking the representation of Guess in the underlying arbitration." The appellate court held, however, that Bebe failed to show by clear and convincing evidence that a conflict existed and that it had a substantial impact on the arbitration panel's decision. Accordingly the appellate court affirmed the trial court's refusal to vacate the arbitration award on the ground that is was procured by undue means.

Insurance Agents

A Stipulated Judgment Containing a Covenant Not to Execute Cannot Create a Presumption of Liability

Alma Valentine V. Membrila Insurance Services

In 1997, the Martinezes requested insurance broker, Membrila Insurance Services (Membrila) to procure a comprehensive general liability (CGL) policy for a restaurant/nightclub owned by the Martinezes. One million CGL coverage was obtained through Scottsdale Insurance, which policy contained a broad assault and battery exclusion.

In 1998, Valentine was shot and seriously injured leaving the nightclub and sued the Martinezes and the privately hired security firm, Metro Security. Scottsdale denied the Martinezes tender of defense and indemnity under their CGL policy. Metro, under a separate CGL policy with Scottsdale, received a defense and a settlement was ultimately entered with Valentine for $925,000. Valentine resolved her litigation with the Martinezes by entering into a $6 million stipulated judgment which contained a covenant not to execute.

Importantly, Valentine agreed not to execute or attempt to execute on the judgment on any asset of Martinezes and to limit enforcement of the judgment to future litigation filed against Scottsdale and Membrila. The stipulated judgment was signed by the court but never entered.

Valentine, both individually as an assignee of the Martinezes, then brought suit against Membrila and Scottsdale for breach of their respective duties. Scottsdale ultimately settled its bad faith claim for $240,000, and the matter proceeded to a bench trial as to Membrila only.

Although the court found that Membrila had committed broker negligence, no damages were found due to offsets charged against the potential award. The trial court offset the $1 million limits under the CGL policy with the $240,000 settlement with Scottsdale and the $925,000 received by Valentine from Metro in the underlying action, leaving a zero net recovery.

The Court of Appeal affirmed the judgment of the trial court and concluded that a stipulated judgment containing a covenant not to execute cannot create a presumption of liability or damages in a suit against a negligent broker, and damages were not otherwise established. The Court restructured the damage calculation, however, finding that the only evidence of recoverable damage was $16,000 in defense costs and after applying the $240,000 offset from the Scottsdale settlement, there was a net recovery of zero.

Attorneys

Arbitration Affects Only the Choice of Forum and Not Substantive Rights

EEOC v. Luce, Forward, Hamilton, & Scripps (2003 DJDAR 11124)

The law firm of Luce, Forward, Hamilton & Scripps offered plaintiff Donald Lagatree a position with the firm as a legal secretary. The offer letter included a provision that required Lagatree to submit all employment disputes to binding arbitration. Lagatree refused to sign the provision, and Luce Forward withdrew its offer of employment. The Equal Employment Opportunity Commission (EEOC) sued Luce Forward on behalf of Lagatree, arguing that employers may not demand arbitration provisions as a condition of employment, and that by refusing to hire Lagatree, Luce Forward unlawfully retaliated against him for asserting his constitutional right to a jury trial.

A three judge panel of the Ninth Circuit Court of Appeal held that employers may require employees to sign agreements to arbitrate Title VII claims as a condition of their employment. EEOC v. Luce, Forward, Hamilton & Scripps 303 F.3d 994, 997 (9th Cir. 2002). Sitting en banc, the Ninth Circuit Court of Appeal agreed to rehear the case. The court held that the EEOC's contention that compulsory arbitration weakens Title VII conflicts with the United State Supreme Court's stated position that arbitration affects only the choice of forum and not substantive rights. See EEOC v. Waffle House, Inc. (2002) 534 U.S. 279, 296.

Real Estate Brokers

Real Estate Broker's Duty of Care is Owed Only to the Parties in a Real Estate Transaction

Coldwell Banker Residential Brokerage Co., Inc. v. Superior Court (2004) 117 Cal.App.4th 158

Recently, a California appellate court reaffirmed the general rule that a real estate broker's duty of care is owed only to the parties in a real estate transaction. Marcos Salazar, a minor child, developed asthma allegedly caused by toxic mold in the home his mother purchased. He sued the listing agent, Coldwell Banker Residential Brokerage Company, Inc. ("Coldwell") and others, alleging various breaches of duties of care, including the failure to disclose the existence of toxic mold in the property. Salazar argued Coldwell owed him a duty of care because it knew he was the buyer's child who would be living in the residence, so a foreseeable risk of injury existed due to Coldwell's non-disclosure of the toxic mold.

Coldwell demurred to the complaint on the ground that it did not owe Salazar a duty of care because he was not a party to the real estate transaction. The trial court dismissed the fraud and misrepresentation causes of action, but held Salazar sufficiently stated causes of action for negligence, nuisance, and intentional infliction of emotional distress. Coldwell petitioned for writ of mandate.

The appellate court issued the writ, directing the trial court to vacate its order overruling the demurrer and enter a new order sustaining the demurrer on all causes of action, without leave to amend. It held the statutory duty of disclosure, California Civil Code section 2079 et seq., applies exclusively to prospective buyers, and not to non-parties to the real estate transaction. "Only a transferee, that is, the ultimate purchaser, can recover from a broker or agent for breach of these duties." Accordingly, the court held Coldwell did not owe Salazar a duty of care under any available legal theory. The court further held that Salazar was not an intended beneficiary of factual disclosures regarding the value and desirability of the residence his mother purchased.

This decision follows FSR Brokerage, Inc. v. Superior Court (1995) 35 Cal.App.4th 69, holding a broker's duties of inspection and disclosure do not extend to third parties who reside on the property, such as nannies and children.

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defense of a suit for more than a year before it purchased its initial policy, and then failed to notify the insurer of the suit until almost two and a half years after the complaint was filed. In *Atlas Tack Corp. v. Liberty Mut. Ins. Co.*, 721 N.E.2d 8, 12 (Mass.App. 1999), a Massachusetts court enforced a voluntary payments provision where an insured that owned a large industrial site had entered into a consent judgment to clean up its industrial waste lagoon without notice to its insurer. Some time later, a much more expansive cleanup suit was filed against the insured, related to pollution from the same lagoon. The court found that the earlier consent judgment had violated the voluntary payments clause, so that the insurer was relieved of all liability under the policy, including the obligation to defend or indemnify the second proceeding. See, *Griffin v. Allstate Ins. Co.*, 29 P.3d 777, 783 (Wash.App. 2001).

The two primary purposes of a no action clause are to prevent collusive settlements when an insurer is providing a defense and to prevent third parties from suing insurers for payment until the right to damages has been fixed by judgment or by an approved settlement. There are, of course, circumstances which allow an insured to settle a case without the insurer's consent. For example, when an insurer reserves its right to deny coverage, the insured may enter into an unauthorized settlement, provided the insured's agreement is reasonable and fair and free of all fraud or collusion, and that it is made with adequate notice to the insurer. The insured also must give the insurer a reasonable opportunity to participate in the settlement. 14 Couch on Ins. (3d ed. 1999) § 199:48, p. 199-192.

An issue closely related to the contractual reasoning that supports the voluntary payment and no action conditions, is the pre-lawsuit claim. In *Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal.4th 857, 878, the California Supreme Court explained that most standard liability policies require an insurer to defend a "suit," but give the insurer discretion to settle a "claim." In *Foster-Gardner*, the Court addressed the notion of what is a "suit" that triggers a duty to defend under a CGL policy. The Court held that a pre-complaint administrative order that the insured take remedial action to clean up pollution is not a "suit" obligating the insurer to defend. The Court stated the rule that "'a suit' is a court proceeding initiated by the filing of a complaint" for purposes of analyzing a duty to defend. A "'claim' can be any number of things, none of which rise to the formal level of a suit-it may be a demand for payment communicated in a letter, or a document filed to protect an injured party's right to sue a governmental entity, or the document used to initiate a wide variety of administrative proceedings." The Court stated a preference for a "bright-line rule that, by clearly delineating the scope of risk, reduces the need for future litigation." It also noted that, in many instances, there is an inherent incentive for an insurer to participate at the pre-litigation stage to minimize the indemnity exposure, but that this does not translate into a duty to defend.

Similarly, under California law, there is no duty to indemnify an insured for pre-lawsuit claims. Most standard liability policies provide that the insurer "will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." The requirement that the insured is "legally obligated to pay" money for which it seeks indemnity ensures that the policy does not cover liability the insured voluntarily assumes, such as "good will" payments made to a customer who the insured was not legally obligated to indemnify. The term "damages" in a standard liability policy is limited to money a court orders the insured to pay and does not include non-litigated settlements. *Certain Underwriters at Lloyd's of London v. Superior Court* (Powerine I) (2001) 24 Cal.4th 945.

This issue also was addressed in *San Diego Housing Com'n v. Industrial Indem. Co.* (1998) 68 Cal.App.4th 526. There, the court held that an insured is not "legally obligated" until a lawsuit is filed, and a court of law is given the opportunity to recognize the insured's liability. There, the owner of low income housing units was named as an additional insured of a CGL policy issued to the general contractor who built the units. After construction, the tenants complained of several defects. The owner repaired the defects and tendered a claim for the cost of repair under the additional insured endorsement to the general contractor's CGL policy. The claim was refused, and the owner sued the insurer for breach of contract and bad faith.

The appellate court reversed a jury verdict in favor of the owner. The court stated that the insurer was not obligated to reimburse payments made to repair damage caused by the general contractor's negligence where the tenants had not sued the owner. Relying on *Foster-Gardner*, the court stressed the distinction between a suit, which triggers an insurer's duties under the policy, and a claim, which does not. While acknowledging that early intervention before a dispute ripens into a lawsuit is usually in the insurer's best interest, the court reasoned that "discretionary ability on the part of an insurer to 'make such investigation and settlement of any claim . . . as it deems expedient' is not the same as a contractual duty of the insurer to respond to an insured's request for coverage that is based on an actual third-party claim against it." In other words, the court held that while the insured incurred expenses to repair the property, "the statutory and contractual duties on which it relies [to claim coverage] . . . are not enough to implicate [the] liability policy. . . . They do not create 'damages' paid out by [the insured]."

This rationale also extends to some non-standard liability policies. For example, in *County of San Diego v. ACE Property & Casualty Ins. Co.* (2003) 106 Cal.App.4th 349, several landowners near a hazardous landfill requested that the County purchase their property without the necessity of litigation. The County agreed to do so, and paid the negotiated amounts. The County then sought indemnification from its insurer, ACE, for the amount of the settlements, and the cost of a prior clean up order. Unlike most CGL policies, the insuring agreement obligated ACE to indemnify against "all sums which [the County] is obligated to pay by reason of liability imposed by law or assumed under contract or agreement" for "damages . . . by reason of injury of any nature sustained by any person or persons" or for "damages because of injury to or destruction of tangible property." The ACE policy also did not obligate the insurer to defend. Despite these differences, the Court of Appeal, affirming the lower court's decision that ACE had no duty to indemnify, held that the reference to "damages" in the insuring agreement holds the same meaning as that term contained in the standard CGL policy-damages means a sum stated in a judgment or court-approved settlement.

However, this holding may not extend to excess or umbrella policies, which have vastly different insuring language. In *Powerine Oil Co. v. Superior Court* (2002) 104 Cal.App.4th 957 (Powerine II), the Court of Appeal considered a standard umbrella liability policy, in which the excess insurer agreed to cover "damages . . . all as more fully defined by the term "ultimate net loss." The excess policy defined "ultimate net loss" broadly to include both settlements and expenses incurred irrespective of whether a "suit" is actually filed. Thus, the Court of Appeal held that the traditional definition of "damages" did not apply to bar coverage for agency-ordered cleanup costs, or for extrajudicial lawsuit settlements.

Several jurisdictions do not follow California's bright-line rule that, under standard CGL policies, a duty to defend is not triggered until a traditional court proceeding is instigated, and that a duty to indemnify is not triggered until a court has ordered the insured to pay money damages. Many courts hold that the term "suit" is ambiguous. These courts construe "suit" in favor of the insured. In the context of environmental cleanup actions, this means that the term does not refer exclusively to the commencement of a traditional lawsuit, but also encompasses administrative actions taken against the insured that are the "functional equivalent" of a suit brought in a court of law. See, American Law Reports, 48 A.L.R.5th 355 (Copyright 1997-2004 Lawyers Cooperative Publishing, a division of Thomson Informative Services).

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