CAIIA Status Report

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February 2019

Developer's Failure to Plead Amount of Damages in Cross-Complaint Fatal to Direct Action Against Subcontractor's Insurers Based on Default Judgment

Credit to Haight, Brown & Bonesteel, Los Angeles, CA

In *Yu v. Liberty Surplus Ins. Corp.* (No. G054522, filed 12/11/18), a California appeals court held that a developer's failure to allege the amounts of damages sought in its cross-complaint rendered default judgments against a subcontractor void and, therefore, unenforceable against the subcontractor's insurers in a direct action under Insurance Code section 11580(b)(2).

Yu, the owner, hired ATMI to develop a hotel. ATMI subcontracted with Fitch to perform stucco and paint work. Yu sued ATMI for construction defects and the developer cross-complained against its subcontractors, including Fitch, for breach of contract; warranty; indemnity, etc. Yu's operative complaint prayed for damages "in an amount not less than $10,000,000, according to proof." ATMI's cross-complaint stated that it incorporated the allegations of Yu's complaint "for identification and informational purposes only," but "does not admit the truth of any allegations contained therein." The cross-complaint also prayed for damages with respect to the various causes of action "in an amount according to proof."

Fitch defaulted. ATMI then settled with Yu, including an assignment of rights against Fitch. Yu proceeded to prove up a default judgment against Fitch for $1.2 million, which was entered by the court.

Fitch's insurers moved to vacate the judgment, arguing that ATMI had not stated an amount of damages in the cross-complaint sufficient to support a default judgment. That motion was denied on the ground that the insurers lacked standing to contest the validity of the default judgment. In an unpublished opinion the appeals court affirmed, while telling the insurers that they had an alternative remedy of denying any demand for payment and litigating the issue in a coverage action.

Yu then sued the insurers as a judgment creditor in a direct action under Insurance Code section 11580(b)(2). But the court in that action entered summary judgment for the insurers, ruling that the default judgment was void on its face because of the absence of a money demand in the cross-complaint.

The appeals court agreed. The court first pointed out that under Code of Civil Procedure section 425.10(a) in any complaint or cross-complaint "[i]f the recovery of money or damages is demanded, the amount demanded shall be stated." The court cited exceptions to the general rule in cases involving personal injury or wrongful death, or when the plaintiff is seeking punitive damages. (Citing Code Civ. Proc., §§ 425.10(b); 425.11.) And in those cases, the plaintiff must still serve a separate written statement of damages (citing Code Civ. Proc., §§ 425.11 (compensatory damages), and 425.115 (punitive damages), before a default judgment may be taken. (Code Civ. Proc., §425.11(c).)

The *Yu* court explained that it is a matter of due process that the defendant must have notice of the specific relief sought, so that he or she can decide whether to appear and defend. Further, the Legislature has provided that a default judgment cannot exceed the amount demanded, or it is void. (Code Civ. Proc., §§ 580, 585; *Greenup v. Rodman* (1986) 42 Cal.3d 822, 826.)

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President's Message

Desk job? Is that all you can see in it? Just a hard chair to park your pants on from 9 to 5? Just a pile of papers to shuffle around and 5 sharp pencils and a scratchpad to make figures on? Maybe a little doodling on the side? Well that's not the way I look at it, Walter. To me, a claims adjuster [sic] is a surgeon. That desk is an operating table and those pencils are scalpels and bone-chisels. And those papers are not just forms and statistics and claims for compensation. They're alive. They're packed with drama, with twisted hopes and crooked dreams. A claims adjuster [sic], Walter, is a doctor and a bloodhound and a cop and a judge and a jury and a father confessor all in one…..

Barton Keyes (Edward G. Robinson) – Double Indemnity 1944

John Ratto

CAIIA President

I love this movie! Frankly, it's one of the few movies that makes adjusters look interesting! Plus, he gets his man at the end…well Fred MacMurray confesses but that's not the point…watch the movie…

Even after almost 30 years in the business (that's right kids! July 1, 1989 with Fireman's Fund Insurance Company) , I'm still surprised at the things I don't know. I can't imagine what it's like for someone just starting a career in this field what with regulations, educational updates, etc.

Seventeen years ago, when Kay and I started this business I thought about building an empire (me not her). After hiring one employee that lasted six weeks (it took six months to clean up his work) and then hiring another employee who was with us for six months (it didn't take as long to clean up that mess), we (I) realized that perhaps we should just keep it small. This was our decision and good or bad it has worked for us to this day. The point I'm trying to make is that this is a hard job and is not for everyone. As confirmed with many of my colleagues, it's getting harder and harder to find not only good employees who have some claims knowledge, but also harder to find anyone who might be looking for a career in this business. Tell them that this job is never boring, and you wouldn't be lying….

To all of you adjusters, be proud of what you do. This job is so damn interesting, and as I've said to anyone who will listen, "we (adjusters) are great at cocktail parties because we know a little something about everything". Maybe if they had a sexier name for what we do, there would be more interest!

The midterm is coming up (look for our announcements soon) and again, we are looking to schedule for late March. At the midterm, we will have a better update for all members regarding the historic change in the bylaws and I will keep you apprised in my messages.

Okay one more line from the movie - Edward G Robinson (the adjuster/ investigator) explaining to his colleague the insurance salesman for the same insurance company – *Look Walter, the job I'm talking about takes brains and integrity. It takes more guts than there is in 50 salesmen. It's the hardest job in the business.*

John Ratto President

CAIIA President

NEWS OF AND FOR OUR MEMBERS

SAVE THE DATE

The CAIIA is proud to be exhibiting at or sponsoring the following upcoming event:

March 5 & 6, 2019	**Combined Claims Conference, Hyatt Regency, Orange County**
March (Date TBD)	**CAIIA Midterm Meeting, location TBD**
August 27-29,2019	**Claims Conference of Northern California, Lake Tahoe, CA**

Attn: CAIIA Members

We are looking for volunteers to represent us in our booth at the Combined Claims Conference in Orange County on March 5 & 6.. If you are available, please contact **Sterrett Harper (harperclaims@hotmail.com)**. It is a good opportunity to meet some new industry people and to catch up with old friends!

Private Abitration Agreements

Credit to Low , Ball and Lynch, San Francisco, CA

New Prime Inc. v. Oliveira

The Federal Arbitration Act requires courts to enforce private arbitration agreements. However, a recent U.S. Supreme Court decision has expanded a key exception to this general rule. Indeed, Section 1 of the Act already included an exception that no provision within the Act should be used to compel arbitration in disputes involving "contracts of employment" of certain transportation workers. The Supreme Court recently enlarged these exceptions by holding that courts, not arbitrators, must first decide whether Section 1 applies to determine if the matter is subject to arbitration. This is true even when the arbitration agreement itself delegates the question of whether the dispute is subject to arbitration to the arbitrator. Also, the Court held the term "contract of employment" under Section 1 refers to agreements to perform work in foreign or interstate commerce, including employment contracts with independent contractors.

Dominic Oliveira was a truck driver for New Prime, Inc., an interstate trucking company. Mr. Oliveira worked under an "operating agreement" which identified him as an independent contractor and contained a mandatory arbitration provision. When Mr. Oliveira later filed a class action lawsuit against New Prime alleging unlawful withholding of wages, New Prime argued that the court should enforce Section 1 of the FAA, and asked the court to compel arbitration pursuant to the employment contract.

In response, Mr. Oliveira argued the Act does not *always* authorize a court to enter an order compelling arbitration. He pointed out that regardless of whether he was an employee or independent contractor, Section 1 carves out exceptions for contracts of employment of workers engaged in foreign or interstate commerce. Mr. Oliveira argued this exception applied to him as an interstate truck driver.

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There was no question that the developer's cross-complaint failed to meet the requirements, but the *Yu* court also held that the allegation incorporating the underlying complaint by reference would not suffice either. The *Yu* court noted that neither statutes nor court rules establish any formal requirements for incorporation by reference, but common law contract principles require that: "(1) the reference to another document [be] clear and unequivocal; (2) the reference [be] called to the attention of the other party, who consented to that term; and (3) the terms of the incorporated documents [be] known or easily available to the contracting parties." (Citing *Kleveland v. Chicago Title Ins. Co.* (2006) 141 Cal.App.4th 761, 765.)

After first pointing out that the alleged incorporation by reference was expressly "for identification and informational purposes only," the *Yu* court then found the complaint's allegation of damages "not less than $10 million" to be inconsistent with the cross-complaint's allegation of damages "in an amount precisely unknown," and "subject to proof." Consequently, the incorporation by reference was not "clear and unequivocal," nor was the precise amount "adequately called to the attention of the other party." The *Yu* court ultimately faulted the developer for having failed to state any amounts in the cross-complaint:

"[W]e agree with the trial court's assessment that 'because the cross-complaint filed by ATMI specifically declined to state the amount of damages sought . . . , it seems contradictory to basic notions of due process and fairness to find that cross-defendants [the Fitch Entities] have been put on notice of their potential damages by virtue of an allegation in a complaint filed not against them, but against cross-complainant ATMI.'"

Finally, the *Yu* court rejected an argument that Fitch had entered a general appearance, saying this went to the issue of service or jurisdiction, but not the amount of damages required for a default judgment. Likewise, the *Yu* court rejected an argument that Fitch could have readily calculated the damages because it had performed the work, saying that was no substitute for adequate notice or due process.

Counsel Investigating Coverage Can be Sued for Invasion of Privacy

Credit to Haight, Brown & Bonesteel, Los Angeles, CA

In *Strawn v. Morris, Polich & Purdy* (No. A150562, filed 1/4/19), a California appeals court held that policyholders could state a claim for invasion of privacy against an insurer's coverage counsel and law firm, where the counsel had disseminated inadvertently produced tax returns to forensic accountants while evaluating coverage.

In *Strawn*, a couple's home was destroyed by fire and the husband was prosecuted for arson, but the criminal case was dropped. Notwithstanding, their insurance claim was denied on the ground that the husband intentionally set the fire and fraudulently concealed his actions. In addition to the insurance company, the insureds also named the carrier's coverage counsel and his firm in the ensuing bad faith lawsuit, alleging causes of action for elder financial abuse and invasion of privacy.

Although the trial court sustained the attorneys' demurrer without leave to amend, the appeals court reversed as to the invasion of privacy claim. The attorney had been tasked with the coverage investigation, and had demanded production of financial records from the couple. Although they had objected to producing tax returns, the couple's accountants inadvertently included the tax returns, which counsel then provided to a forensic accounting firm for analysis. The couple alleged that this constituted a publication of private information.

The *Strawn* court first held that the litigation privilege of Civil Code section 47(b) would not apply. The court agreed with the attorneys that the "publication" to the forensic accountants constituted a "communicative act." However, the court said that prelitigation communications are only protected when litigation is imminent. The transmittal of the tax returns was a full year before the lawsuit, and the court said that it was by no means certain that the couple would ever sue, so the litigation privilege did not attach.

The *Strawn* court then found the invasion of privacy claim viable. The court noted that tax returns are clearly protected as private, but relevance can overcome the privilege and Insurance Code section 2071 establishes relevance in an insurance claim, because the statute requires the insurer to advise their insureds that tax returns may be "necessary to process or determine" claims but "maintains the insured's taxpayer privilege against disclosure, in essence permitting the taxpayer to determine whether to disclose the returns despite potential consequences in terms of the processing of the claim."

The *Strawn* court said that whether relevance overcame the privilege was a fact question that could not be decided on demurrer:

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"[W]hether the public policy of preventing insurance fraud outweighs the confidentiality of tax returns would depend, in part, on the extent to which the financial information appellants did disclose was sufficient to allow State Farm to determine appellants' financial condition, and the extent to which the returns revealed confidential information not relevant to State Farm's investigation (e.g., medical deductions). Similarly, the seriousness of the privacy invasion worked by disclosure of the tax returns would depend on what information was contained in the returns that was not also contained in the voluntarily disclosed financial documents from which the tax returns were prepared. In short, the seriousness of the alleged invasion of privacy presented a question of fact that could not be resolved on demurrer."

The *Strawn* court also saw a fact question as to whether the insureds had waived the privilege by virtue of having pursued an insurance claim. Citing *Wilson v. Superior Court* (1976) 63 Cal.App.3d 825 and *Fremont Indemnity Co. v. Superior Court* (1982) 137 Cal.App.3d 554, the *Strawn* court said that "Whether that reasoning applies in the present circumstances would depend, again, on what information was revealed in the tax returns beyond that contained in the material appellants agreed to disclose."

While finding that the insurer's counsel could be liable for invasion of privacy, the *Strawn* court rejected the elder abuse claim. The court said that the Elder Abuse Act (Welf. & Inst. Code, § 15610), is more in the nature of a heightened remedy for other wrongs, and was therefore an extension of the underlying bad faith claim. Consequently, it was subject to the rule that only the contracting insurer can be liable for breach of contract or bad faith: "An insurer's bad faith denial of a claim can support a cause of action for financial elder abuse. [] But to say that an attorney who assists the insurer in investigating the claim, acting solely as representative of the insurer, can be liable for financial elder abuse would impose liability where [*Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal.3d 566.] held there could be none."

DOI Announcement

Supreme Court denies review of decision upholding Commissioner's Fair Claims Settlement Practices Regulations

LOS ANGELES, Calif. - After a decade of legal wrangling over the regulations that implement the Unfair Insurance Practices Act (UIPA), the California Supreme Court let stand the decision of California Court of Appeal, 4th Appellate District, upholding the Insurance Commissioner's Fair Claims Settlement Practices Regulations, which prescribe how insurance companies must process insurance claims. The regulations are the foundation in determining the number of violations committed when assessing fines against insurers that have committed unfair claims practices.
Department of Insurance examinations of PacifiCare's claims-handling uncovered evidence of numerous unfair claims practices-which included wrongful denials for life-saving treatment for people battling serious illness and claim payment denials for providers and hospitals-all because the insurer was focused on maximizing profits through what it called "efficiencies" after the 2015 botched $9 billion acquisition of PacifiCare by UnitedHealthcare. The Department examinations also uncovered evidence the company was well aware of the egregious issues.

Under the Insurance Code, these unfair acts or practices include misrepresenting what medications or treatments an insurance policy covers, failing to promptly pay claims where liability is reasonably clear, and forcing claimants to file lawsuits to get full payment, and other acts. The Insurance Code allows the commissioner to impose fines of up to $5,000 each time an insurer commits an unfair act or practice on a consumer, or up to $10,000 each time if the insurer did so willfully.

"UnitedHealthcare purchased PacifiCare and imposed cost-cutting measures that destroyed PacifiCare's claims-handling processes and its arguments in litigation that insurance companies should be allowed to willfully harm consumers as long as they don't do it too often, reflect a gross disregard of the lives and well-being of the consumers who paid for the promise of coverage," Commissioner Jones said. "Customers have no choice but to rely on the integrity of their health insurance companies. PacifiCare breached that trust. By any measure, 908,000 violations reflect a general business practice of violating consumer protection laws. I am delighted the Supreme Court has rejected further challenges to the insurance commissioner's authority to punish insurance companies for knowingly harming even one consumer."

Based on departmental examination results and following an administrative hearing that took three years, Insurance Commissioner Dave Jones found PacifiCare committed 908,547 separate violations of the UIPA, and he imposed fines aggregating $173,603,750 in penalties. On behalf of PacifiCare, UnitedHealthcare sued the commissioner, arguing that none of its harmful conduct violated the Insurance Code.

PacifiCare argued that insurers are immune from fines for committing these unfair acts, even if the insurer did so intentionally, unless the

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commissioner is also able to show that the insurer knew it had committed the acts frequently enough to constitute a "general business practice." The court of appeal rejected the argument, stating: "PacifiCare's interpretation of section 790.03(h) is not only internally problematic, it stands in contrast to virtually every other statute the Legislature has enacted in connection with (1) enforcement of the Insurance Code against insurers generally; (2) enforcement of the UIPA in particular; and (3) the imposition of administrative penalties against insurers in other contexts."

The court also rejected PacifiCare's argument that the commissioner must prove an insurer had "actual knowledge" of its illegal conduct and held that it was within the commissioner's authority to hold the insurer responsible if its agents or employees were aware of facts that would cause a reasonable person to know of the violations. The court also found the commissioner's reasoning was sensible in that restricting the definition of "knowingly" to one particular individual's actual knowledge would fail to take into account that many people handle a claim, and an unfair practice can be committed by cumulative acts, not simply the intentional act of one person."

Further, the court of appeal also upheld the commissioner's interpretation that an insurer's "willful" violation of the act may be established by showing a purpose or willingness to commit the act and agreed that penalties for willful violations do not need to require a showing that the insurer intended to violate the law or injure someone. The court held, "As the Commissioner points out, he engaged in an extensive, formal rulemaking process in the course of promulgating these regulations. That careful consideration, combined with the Commissioner's expertise in the area, weighs in favor of according significant deference to the Commissioner's interpretation of the terms, and we do so."

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New Prime responded with two primary arguments. First, the arbitration agreement controlled, and any question of whether Section 1 applied should be decided by the arbitrator. Second, even if the court could address the question, Section 1's term "contracts of employment" only refers to employment contracts that create an employer-employee relationship. Thus, New Prime argued that the Section 1 exception did not apply to Mr. Oliveira.

Ultimately, the district court and First Circuit decided in favor of Mr. Oliveira.

The U.S. Supreme Court then took the case, and provided its reasoning to uphold the decisions of the lower courts. Essentially, the statutory mechanisms a party can invoke to stay litigation and compel arbitration come under Section 3 and 4 of the FAA. However, the powers under these provisions are limited by the provisions that came before them. Specifically, Section 2 states that the Act only applies when the parties' written arbitration agreement involves a maritime transaction, or a transaction involving commerce. Further, Section 1 helps define the terms of Section 2 by stating that "nothing" in the Act "shall apply" to "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."

Basically, the Court decided that courts should decide for themselves whether Section 1's "contracts of employment" for these types of workers should apply prior to ordering arbitration. Therefore, regardless of how clearly the arbitration agreement states a preference for arbitration, courts must first determine whether the Act allows the court to force the parties to go to arbitration.

Concerning the issue of Mr. Oliveira's employment status, the Court chose to use the "plain language" approach to interpreting Section 1. Even though nowadays the term "contract of employment" may sound like an employer-employee relationship specifically, the Court looked to the definition of this term when the provision was written back in 1925. At that time, this term usually meant "nothing more than an agreement to perform work." Therefore, since this term was not used to refer to an employer-employee relationship at the time Section 1 was enacted, the Court decided Mr. Oliveira and New Prime's operating agreement was subject to the Section 1 exception, regardless of his status as an independent contractor.

This case presents a big blow to arbitration agreements. Specifically, "delegation clauses" may now be subjected to court interpretation before matters are sent to an arbitrator. Moreover, the distinction between "employee" and "independent contractor" no longer appears to be a viable argument to invoke the FAA provisions for a court to stay litigation and order arbitration. Rather, courts may now lack a significant amount of authority to order arbitration when it comes to seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce. This case has a very broad reach since so much commerce is now interstate.

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Happy Valentines Day

On the Lighter Side...

Not to brag, but I just went into another room and actually remembered why I went in there.

It was the bathroom,but still....

During labor, the pain is so great that a woman can almost imagine what a man feels like when he has a fever.

When I finish eating something I have to show my hands to the dog like I'm a blackjack dealer...

SOME PEOPLE WON'T ADMIT THEIR FAULTS. I WOULD, IF I HAD ANY.

The older you get the more you appreciate cancelled plans, early nights, thunderstorms and alcohol that is on sale.

I'M AT THAT DELUSIONAL AGE WHERE I THINK EVERYONE MY AGE LOOKS WAY OLDER THAN I DO

EVERY REFRIGERATOR HAS A CRISPER DRAWER

WHICH IS A GREAT PLACE TO HIDE YOUR VEGETABLES WHILE THEY ROT

COMMON SENSE IS LIKE DEODORANT. THE PEOPLE WHO NEED IT MOST NEVER USE IT.