CAIIA Status Report

MAY 2006

Insurance Law Update

Submitted by Sedgwick, Detert, Moran & Arnold, LLP

Subrogation Is an Insurer's Right and Does Not Give Rise to a Bad Faith Claim

Tilbury Constructors, Inc. v. State Compensation Ins. Fund, California Court of Appeal

The California Court of Appeal recently limited the scope of an insured's claims action against an insurer for breach of contract and bad faith, by holding that an insurer's performance in handling subrogation claims cannot form the basis for such claims. *Tilbury Constructors, Inc. v. State Compensation Ins. Fund*, 2006 WL 540736 (CA 3rd Dist., March 7, 2006).

In Tilbury, plaintiff Tilbury Constructors, Inc., a subcontractor working with general contractor Harris Company, Inc., was hired to expand a dairy's facilities in Turlock. Tilbury procured workers' compensation insurance through the State Compensation Insurance Fund ("State Fund"). One of Tilbury's employees sustained injuries when he fell from Harris' ladder, which was not properly secured. State Fund paid workers' compensation benefits to the injured employee and then pursued a subrogation claim against Harris. State Fund subsequently sold its subrogation right to Harris for $10,000, without questioning any employees present on the date of the accident or obtaining any discovery from the injured employee's attorneys.

Tilbury brought suit against State Fund, asserting causes of action for breach of contract, bad faith, and other claims. Tilbury alleged that State Fund failed to properly investigate and obtain a fair settlement from Harris, which resulted in an increase in Tilbury's workers' compensation insurance premiums. The trial court sustained State Fund's demurrer to Tilbury's complaint and Tilbury appealed.

The Third District Court of Appeal found that subrogation is an insurer's right, not its obligation. An insurer has the option of not pursing subrogation recovery at all, a common choice in cases where the benefits are relatively small and pursuing subrogation is economically unreasonable. A carrier's decision to pursue its subrogation rights after it has properly paid claims under an insurance policy does not affect the insured's receipt of policy benefits.

Here, State Fund did not deny Tilbury any benefits due under the policy. The court held that an increase in premium alone does not give rise to a cause of action for bad faith. Rather, it is the underlying conduct concerning an insurer's duty to defend, investigate, reserve and settle claims that may give rise to

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PUBLISHED MONTHLY BY
California Association of Independent Insurance Adjusters

An Employer Organization of Independent Insurance Adjusters

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■ PRESIDENT'S MESSAGE

In the January Status Report a majority of my message was based on a letter that Ronald Bolt, the founder of my company, wrote on May 6, 1965. Recently a situation occurred that caused me to review that letter and allow me to relay to you his thoughts of forty years ago and as they apply today.

The scenario is a claim that was submitted. This was theft of tools, a minor commercial loss. After deductible the loss penciled out at between $700.00 and $800.00.

However, there were three questions that had to be answered by the insured. The first question was why the claim had been reported 4 1/2 months after the incident occurred. The second question was the ownership of the tools – were they employees' or the business owner's tools? The final question was if they were the employees' tools, was the employer legally Liable to replace the tools?

Upon receipt of the assignment the insured was contacted. He stated he did not want to meet with this adjuster, just to simply send him a check. This had been done in the past and he expected it to be done this time. There were a few rather colorful words used by the insured but an appointment was secured for the following Monday at 9:00 A.M.

At exactly 9:00 A.M. I walked in his front door. There was more cussing, but when he finally decided that the information that had been submitted was not complete we started into the claim. The first invoice that had been submitted was for the damage to the pickup truck glass. When he was informed that this was not part of the commercial personal property coverage the insured became verbally abusive using extremely pointed language at this adjuster as well as the company. At that point I simply stated, "I do not have to take this. I will be sending you a letter. Have a nice day." I was in his office for 3 minutes.

A phone call resulted to the agent as well as the company and while the claim has not yet been concluded, at least there is some cooperation on the insured's part.

Mr. Bolt wrote back in 1965:

"When we approach an insured, have all kinds of money. YOU, the adjuster, represent the big, rich insurance company while they are just a little person, but they have rights and will use all of their ability to sell you on their rights. They want their importance recognized. Here sometimes it takes the patience of Job to reason fairly and sell yourself, your company, and your offer of adjustment, but it can be done.

It is my experience that most adjusters have not lost their human touch. Even to the point that sometimes their adjustments are tempered by their emotions. This can be good when it is seasoned with knowledge.

The standard fire policy is as familiar to an adjuster as the pledge of allegiance. Although an adjuster is pretty much an expert, they assume a role of father confessor, rationalist, diplomat, and agency apologists, and you have but a few of the traits which are so unusual in ordinary mankind, but commonplace in any adjuster who has completed their apprenticeship.

A small fraction of adjusters are grumpy, short tempered and blunt. Few adjusters are vindictive and none have ever been known to purposely interpret a contract to the detriment of an assured.

There are not many bad adjusters, true enough, some are better than others, some have a better bedside manner, this is important. These people are highly

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Insurance Law Update

Submitted by Sedgwick, Detert, Moran & Arnold, LLP

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breach of the implied covenant of good faith and fair dealing. The court held that State Fund's determination to exercise its right of subrogation, whether in good faith or bad faith, was not actionable as a breach of the express terms of the insurance contract. Thus, the Court of Appeal affirmed the trial court's ruling as to all causes of action in Tilbury's complaint.

The Phrase "First Made" Is Not Limited to the Initiation of a Formal Legal Proceeding

National Casualty Company v. Sovereign General Insurance Services Inc. California Court of Appeal

In *National Casualty Company v. Sovereign General Insurance Services Inc.* (40 Cal.Rptr.3d 59, March 14, 2006), the California Court of Appeal interpreted a territorial limitations clause, and defined the phrase claim "first brought" as the point in time when the injured party first asserts a claim for damages. Therefore, the court did not limit this phrase to the filing of a formal legal action.

National Casualty issued a claims-made errors and omissions policy to Sovereign. The policy contained a territorial limitations clause restriciting coverage to claims made within the policy period and brought in a specified territory. In 2001, Lloyds sent a notice of claim to Sovereign's Stockton, California office. In 2002, Lloyds sent a further letter invoking the arbitration clause in its contract with Sovereign and demanding that the arbitration proceed in London.

Sovereign tendered the claim to National Casualty, which denied the claim, based on their assertion that "claim first brought" removes their obligation for coverage since the notice and legal proceeding would occur outside the covered territory.

The court disagreed, and found that although the term "claim first brought" is ambiguous, the only reasonable interpretation defines a claim as first "brought" at the place where it is tendered or made. If the notice of the claim occurred during the policy period and in the covered territory, it is irrelevant that legal proceedings may occur outside the territory.

PRESIDENT'S MESSAGE

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regarded by agents who sometimes do harm to this adjuster's future by frequent praise. This comes about because conscientious supervising claims examiners are rarely praised as are adjusters and they are inclined to look suspiciously on the adjuster who gives such a complete and recurring satisfaction. Adjusting just isn't that easy and an occasional agency squawk does the adjuster no harm.

Adjusters are victimized by many loss practices. Normally you can bet that the adjuster's interpretation of the contract is correct. Maybe it wasn't what the customer inferred or the agent implied, but the adjuster has no guidance other than the printed word. He has no authority to consider friendship, relationship or membership in the Mystic Knights. As a matter of fact, the adjuster who strays beyond the contract as a matter of habit soon destroys their usefulness and sacrifices their future advancement, by any such inconsistency they find they are distrusted by the company and particularly appreciated, except for the moment, by his agents.

Every adjuster, by the very nature of their calling has a tough job. The agent by their understanding, but more importantly by his assistance can do a great deal to help the adjuster and himself."

Well, in the case of the tool loss everything is in writing. This is to insure proper claims handling and, if the claim is denied by reason of no coverage for employees' tools, then if the inevitable letter comes from his attorney, we will be able to illustrate that all facts were considered.

Wishing you all a successful May, and have fun doing your job!

STEVE WAKEFIELD
President - CAIIA 2005-2006

Weekly Law Resume

Prepared by Low, Ball & Lynch, Attorneys at Law

Bad Faith - Negligent Investigation and Handling

Magda Benavides v. State Farm General Insurance Company, Court of Appeal, Second District - February 23, 2006

California case law has long held that there is no liability for bad faith where there is no coverage. This case addressed the issue of whether there is liability for negligent handling of a claim where there is no coverage.

Magda Benavides owned a ground floor condominium in Santa Monica, California. Mold was found in the exterior walls of the property, including the walls adjacent to her unit. Mold was subsequently found inside her unit. Ms. Benavides was advised to move out of her unit. She submitted a claim for additional living expenses to State Farm General Insurance Company. State Farm investigated the claim, and denied it based upon a mold exclusion.

Ms. Benavides sued State Farm and an upstairs neighbor for damages. A jury found there was no coverage and no breach of the insurance contract. However, it also found that State Farm negligently investigated the claim and caused Ms. Benavides $260,000 in damages.

State Farm appealed.

The Court of Appeal reversed the judgment on the jury verdict. The Court noted that the State Farm insurance policy issued to the plaintiff contained a mold exclusion. However, if the mold developed due to water from the neighbor's upstairs unit, the loss was covered. The issue of whether the plaintiff's loss was caused by mold as a result of water from the upstairs unit was submitted to the jury for determination. The jury found that water from the upstairs unit was not the predominant cause of mold in the plaintiff's unit. No covered efficient proximate cause of the loss was proven.

The Court stated that tort liability to an insured only lies where there has been a breach of the implied covenant of good faith and fair dealing. An insured, to establish a breach of the covenant of good faith and fair dealing, must first show benefits were due under the policy, and the benefits were withheld without proper cause. A claim for breach of the implied covenant does not exist absent a covered loss. Thus, if an insurer's investigation of a loss results in a correct conclusion of "no coverage," no tort liability arises for breach of the covenant of good faith and fair dealing.

Furthermore, there is no tort liability for improperly investigating a first-party insurance claim where there is no coverage. Where no benefits are due, a negligent investigation does not frustrate the insured's right to benefits of the contract. An insured who is not entitled to insurance proceeds has suffered no injury, no matter how the investigation was conducted. Conduct amounting to breach of contract becomes tortious only when it violates a duty independent of the contract arising from principles of tort law. The negligence claim of Ms. Benavides did not constitute a claim other than the contractual duty owed to her. Thus, her negligence verdict and judgment were reversed. The Court stated that other decisions holding that there might be liability independent of coverage had not considered recent Supreme Court decisions limiting tort liability in a breach of contract situation.

The judgment, in favor of Ms. Benavides and against State Farm, was reversed.

COMMENT

This is a very important decision for its holding that, absent extenuating circumstances, there is no bad faith liability independent of coverage. The decision is well written and worthy of review for those handling such problems.

Coverage - Rescission - Material Misrepresentation

TIG Insurance Co. of Michigan v. Homestore, Inc., et al., Court of Appeal, Second District - March 13, 2006

Rescission of an insurance policy by an insurer allows an insurer to void a policy, even after a claim has been made. This case explores the permissible grounds for rescission.

Homestore, a publicly traded company, announced an audit of its books for a possible restatement of certain financial statements. As a result, federal securities class-actions and derivative liability lawsuits were filed against Homestore and its current and former officers and directors. Homestore's former Chief Financial Officer pled guilty to one count of conspiracy to commit securities fraud.

The Chief Financial Officer had signed an application for Directors & Officers Liability coverage with Genesis Insurance Company. As part of the application process, Homestore was required to submit a financial statement. A $10 million D&O policy was issued based on the application, which stated that the application and the materials submitted therewith were material to the acceptance

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of the risk. Further, the application stated that, if any misrepresentations were made, the policy was void, and could be rescinded. The same application was submitted to TIG to obtain excess D&O coverage.

TIG filed a complaint to rescind the policy. The trial court granted summary judgment for TIG. A similar action was filed by Genesis in Federal Court, and a similar summary judgment motion was granted. Homestore and several of its officers and directors appealed the judgment for TIG.

The Court of Appeal affirmed. The Court noted that California law permitted rescission of a policy where there is a misrepresentation or concealment in the application. The Court held that rescission was effective even as to innocent directors and officers who did not know of the misrepresentation. This was because the policy was void in its entirety. Relying on Insurance Code Section 650, the Court stated that the right to rescind applied as to all insureds. The Court stated that this result could be avoided by obtaining a policy with a severability provision, which would render the policy void only as to the insured who made the misrepresentation. This policy did not contain such a provision.

The Court further refused to apply the rules of interpretation used for exclusions to the rescission provision. The Court stated the provision was not an exclusion, and therefore, did not need to comply with those types of provisions. In addition, the Court found the provision to be clear.

Finally, the Court held that the financial statements attached to the application overstated Homestore's revenues and understated its losses. The Court found the misrepresentations to be material to acceptance of the risk as a matter of law. Testimony was presented by the TIG underwriter as to the materiality of the information. As such, the trial court correctly reached its decision. The judgment was therefore affirmed.

COMMENT

The rules regarding rescission of policies are complex and require strict compliance with policy and statutory provisions. This case is helpful in laying out those standards.

Bad Faith - Splitting Breach of Contract and Bad Faith Causes of Action

Lincoln Property Co., N.C., Inc. v. The Travelers Indemnity Co., Court of Appeal, First District - March 20, 2006

We have previously reported on cases which hold that a breach of the covenant of good faith and fair dealing cause of action cannot be brought without a finding of a breach of contract by an insurer. This case addressed the issue of whether a breach of the covenant cause of action can be filed in a separate action from the breach of contract cause of action.

Lincoln Property Company constructed Larkspur Court in a joint venture with Prudential Insurance of America. It entered into a painting contract with Krata, Inc. doing business as Five Star Services to paint and repair siding on 25 buildings in the Larkspur Court complex. Krata carried general liability insurance with Travelers Indemnity Company, and named the joint venture as an additional insured. On July 13, 1998, Michael Patton, a Krata employee, fell from the roof of a building. Mr. Patton filed an action against Lincoln, the joint venture, and Prudential to recover damages for the injuries he sustained. Lincoln tendered the defense of the Patton action to Krata and Travelers. Travelers initially did not respond to the tender. Lincoln also tendered to its own insurer, which accepted the tender, and began providing a defense. In that action, Lincoln filed a cross-complaint against Krata and Travelers for breach of the duty to defend and indemnify Lincoln. At that point, Travelers agreed to participate in Lincoln's defense under a reservation of rights.

Lincoln filed a separate bad faith action against Travelers, alleging breach of the covenant of good faith and fair dealing. That action was stayed pending resolution of the Patton action.

The Patton action was eventually settled, with Travelers paying $1,000,000, and obtaining a general release. In addition, Travelers paid Lincoln for the costs it had incurred prior to the time it was defended by its own insurance company. At that point, Travelers moved for summary judgment on the cross-complaint, and the trial court granted the motion, finding there were no damages.

Travelers then demurred in the bad faith action. The trial court sustained the demurrer without leave to amend, concluding the bad faith cause of action should have been joined with the breach of contract action, and now was barred by reason of the final judgment in the Patton action. Lincoln appealed.

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Weekly Law Resume

Prepared by Low, Ball & Lynch, Attorneys at Law

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The Court of Appeal affirmed the trial court. Under California Civil Procedure, a cause of action is comprised of a primary right that gives rise to but a single cause of action. That primary right may give rise to multiple legal theories of liability and multiple remedies. However, the violation of a primary right gives rise to but one cause of action, which cannot be split into two separate law suits.

The claim for the breach of the covenant of good faith and fair dealing was part of the same primary right asserted in Lincoln's prior action for breach of the duty to defend. The claim for the breach of contract was based upon a failure to defend. The claim for the breach of the covenant of good faith and fair dealing was based upon the same claim.

Lincoln attempted to argue that the bad faith lawsuit did not focus on the benefits provided by the insurance policy, but rather on the manner in which Lincoln was treated during the claims process. The Court noted that the covenant of good faith and fair dealing is implied in every contract as a supplement to the express contractual covenants. The primary right is to receive the benefits of the contract. The right to receive prompt benefits is an auxiliary benefit implied in the contract, and did not exist separately from the contractual obligation.

The insurer's obligation to provide a defense was a provision of the contract, and the obligation to act reasonably in a timely manner was part of the implied covenant to do so in good faith. The same conduct gave rise to both causes of action and the damages claimed under each theory of liability. They both arose out of the same breach of the same primary right. The additional damages that Lincoln sought in the bad faith case should have been pursued in the prior litigation. Since the bad faith cause of action was dependent upon, and arose out of Travelers' breach of the duty to defend, it was part of the same primary right, and thus was barred inasmuch as the prior action had been concluded.

The Court therefore affirmed the trial court.

COMMENT

This case again exemplifies the rule that, without a breach of the contract, there cannot be a breach of the covenant of good faith and fair dealing. It further holds that both theories of liability and causes of action must be pursued in the same complaint.

Insurance Commissioner John Garamendi Announces Arrest of East Palo Alto Resident for Auto Insurance Fraud

Investigators say East Palo Alto woman filed fraudulent insurance claim and submitted altered receipts – booked in San Mateo County Jail on $20,000 bail

SACRAMENTO – Insurance Commissioner John Garamendi announced today the arrest of Charleen Smith, 37, for automobile insurance fraud after an investigation by the California Department of Insurance (CDI).

Smith, who was involved in a hit and run auto collision in November, 2004, was charged with four felony counts of filing a fraudulent insurance claim and three felony counts of submitting altered and misleading receipts. She was booked into the San Mateo County Jail on $20,000 bail.

"Insurance fraud picks all of our pockets by raising our insurance rates," said Insurance Commissioner John Garamendi. "Those who have the urge to cheat the system should be aware that this Department and authorities across California are coordinating resources to catch them and prosecute them."

According to CDI investigators, on November 18, 2004, Smith was involved in a hit and run automobile collision and her vehicle was deemed a total loss. She then filed an uninsured motorist claim with the California State Automobile Association (CSAA). On December 8, 2004, Smith allegedly submitted altered vehicle repair receipts and misleading receipts for items that were not on her vehicle.

CSAA did not pay out any money on the fraud portion of this claim. The San Mateo County District Attorney's Office is prosecuting the case.

CAIIA *Calendar*

CAIIA Annual Convention
October 11-13, 2006
Sheraton Grand Hotel, Sacramento
Contact Sharon Glenn at 925-277-9320

Claims Conference of Northern California
September 21-22, 2006
Contact F. Michael Sowerwine at
(510) 740-0377

CAIIA SEED Program
(Seminar for the Evaluation of Earthquake Damage)

As an authorized California DOI education provider (CDI# 20638), the California Association of Independent Insurance Adjusters (CAIIA) will be presenting its annual Fair Claims Settlement Practices Regulations (FCSPR) seminars and, at two of the locations, we will also be offering SEED (Seminar for the Evaluation of Earthquake Damage) program seminars. The SEED program addresses the training and certification required by CCR, Title 10, Chapter 5, Subchapter 7.5.1, Article 1, Section 2695.40 through Section 2695.45. Those regulations set forth the requirements of Insurance Adjuster Training for Evaluating Earthquake Damage which are now required for any insurer who may have earthquake claims in the state of California. It is extremely important that insurance adjusters be trained and certified before the next earthquake. Failure to do so will require insurers to report to the Department of Insurance on each and every claim file the identification of any non-certified adjuster that was involved in handling or supervision of the file. It will be no surprise if this information is used against carriers if consumers complain about claims handling by non-certified adjusters.

At locations in Fresno (5/12/06), Glendale (5/9/06), San Diego (5/11/06) & San Ramon (5/12/06), we will be offering only the FCSPR seminars.

In Sacramento (5/18/06) and Buena Park (5/25/06) we will be offering both the FCSPR seminars and the SEED program seminar. You can attend either or both programs at those locations. There is no discount for not attending the FCSPR seminar at a SEED location.

Register now for the seminar you wish to attend. Be sure and mark the appropriate location in the box to the right.

Complete a form for each person.
There is limited seating.

Name_____
Co._____
Address_____
City_____ Zip_____
Phone_____
E-mail Address: _____

Fees (circle one): Reg's Only Reg's & SEED

CAIIA Member fee	$40.00	$ 90.00
Ins. Co. Employee fee.	$50.00	$100.00
Non-Member I/A fee	$60.00	$160.00*

Amount Enclosed - $_____

Payment must accompany registration.

Credit Card Pymt: Am Ex_____ Visa _____ M/C _____
Ex. Date:_____ Cardholder:_____
Card No:_____
Signature:_____

Make checks payable to CAIIA, mail registration and payment to:

CAIIA c/o Peter Schifrin
Schifrin, Gagnon & Dickey, Inc.
14530 Delano Street, Suite 200
Van Nuys, CA 91411

Questions? Call Peter Schifrin @ (818) 909-9090

FCSPR and SEED Seminars Schedule
for all locations:

Registration 8:00 a.m. to 9:00 a.m.
FCSPR Seminar 9:00 a.m. to 10:00 a.m.
SEED Seminar 10:10 a.m. to 5:00 p.m.

FCSPR & SEED SEMINAR LOCATIONS/DATES:

_____May 18, 2006
Sacramento: Doubletree
2001 Point West Way
(916) 929-8855

_____May 25, 2006
Buena Park: Embassy Suites
7762 Beach Blvd.
(714) 739-5600

FCSPR SEMINARS ONLY DATES"

_____ May 12, 2006
Fresno: Ramada Inn
324 E. Shaw Ave.

_____May 9, 2006
Glendale: Carl Warren
500 N. Central, 4th Floor

_____May 10, 2006
Redding: Swanson & Assoc.
375 Smile Place

_____May 11, 2006
San Diego: American Technologies
1830 Gillespie Way
El Cajon

_____May 12, 2006
San Ramon: Bishop Ranch
2440 Camino Ramon, Suite 295

Deli Lunch/refreshments served at SEED Program locations only. Please visit www.caiia.org for more information. Special room rates available by mentioning CAIIA Seminar.

**CAIIA will agree to offset any membership dues for Non-CAIIA Independent Adjusting Firms joining the CAIIA within 30 days, up to $80.00 total for each adjuster, from non-member firm with a cap of $160.00.*

This Is So Funny

Be sure and cancel your credit cards before your die.

This is so priceless, and so easy to see happening, customer service being what it is today.

A lady died this past January, and Citibank billed her for February and March for their annual service charges on her credit card, and then added late fees and interest on the monthly charge. The balance had been $0.00, now is somewhere around $60.00.

A family member placed a call to Citibank:

- Family Member: "I am calling to tell you that she died in January."
- Bank: "The account was never closed and the late fees and charges still apply."
- Family Member: "Maybe you should turn it over to collections."
- Bank: "Since it is two months past due, it already has been."
- Family Member: "So, what will they do when they find out she is dead?"
- Bank: "Either report her account to the frauds division or report her to the credit bureau, maybe both!"
- Family Member: "Do you think God will be mad at her?"
- Bank: "Excuse me?"
- Family Member: "Did you just get what I was telling you – the part about her being dead?"
- Bank: "Sir, you'll have to speak to my supervisor."

Supervisor gets on the phone:

- Family Member: "I'm calling to tell you, she died in January."
- Bank: "The account was never closed and the late fees and changes still apply."
- Family Member: "You mean you want to collect from her estate?"
- Bank: (Stammer) "Are you her lawyer?"
- Family Member: "No, I'm her great nephew." (Lawyer info given)
- Bank: "Could you fax us a certificate of death?"
- Family Member: "Sure." (Fax number is given)

After they get the Fax:

- Bank: "Our system just isn't set-up for death. I don't know what more I can do to help."
- Family Member: "Well, if you figure it out, great! If not, you could just keep billing her. I don't think she will care."
- Bank: "Well, late fees and charges do still apply."
- Family Member: "Would you like her new billing address?"
- Bank: "That might help."
- Family Member: "Odessa Memorial Cemetery, Highway 129, Plot Number 69."
- Bank: "Sir, that's a cemetery!"
- Family Member: "What do you do with dead people on your planet?"