CAIIA Status Report

DECEMBER 2006

CASE ALERT – Century Surety Co. v. Polisso

Submitted by Rudloff, Wood & Barrows, Emeryville, CA

Century Surety Co. v. Polisso, No. C045334 (Cal.3d App.Dist. May 22, 2006)

In a recent decision, the Third Appellate District Court affirmed a jury award of $637,911 in compensatory damages and $2 million in punitive damages to a contractor against its insurance carrier for breach of contract, insurance bad faith, and malicious prosecution where the insurance carrier rejected his claim for defense and indemnity.

In reaching its decision, the appellate court concluded that: (1) the contractor's spouse had standing to sue as an insured; (2) the "genuine dispute doctrine" did not apply as there was no genuine dispute as to the insurer's duty to defend; and (3) the punitive damages award did not require the jury to consider evidence of comparable civil sanctions.

As background, Charles Polisso dba Kinzel Glass Company ("Kinzel") contracted with S.W. Allen Construction ("Allen") to install seven glass panels in an underground-viewing chamber being built at Taylor Creek near Lake Tahoe. Kinzel purchased a Commercial General Liability ("CGL") policy from Century Surety Co. ("Century") for property damage liability and glass coverage. Kinzel set the glass in its frames and had by mid December 1996 completed its contract work. Before the entire project was completed, a heavy rainstorm hit the Tahoe area and caused the creek to overflow. The viewing chamber was submerged and the floodwater caused solvents to spill into the floodwater, which deposited a film on the glass panels. Subsequent clean-up efforts by Allen's workers scratched the glass.

Allen brought suit against Kinzel for damage to the glass and the chamber. The Polissos submitted the complaint to their insurance broker. Century provided a copy of the complaint to its coverage counsel and informed counsel that, according to the Polissos, the work had been completed prior to the rainstorm. Century's coverage counsel advised Century that the policy did not provide coverage and there was no duty to defend.

Century then filed a declaratory relief against Charles Polisso, Kinzel and Allen on coverage issues. Century also sought reimbursement of legal fees pursuant to its reservation of rights Thereafter, Charles and Terry Polisso, "individually and dba Kinzel Glass Company" counter-claimed against Century for failing to defend them and failing to pay for damage to the glass.

Century and the Polissos each brought motions for summary judgment and summary adjudication. The trial court denied Century's motions and granted the Polissos' motions for summary adjudication. It concluded that Century had a duty to defend the Polissos in the Allen action, and the installation floater to the policy covered damage to the glass.

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■ PRESIDENT'S MESSAGE

Part one of what appears to be a series of many. Well it certainly did not take too long to figure out what to write for this month's status report. I recently received my water bill which I had been anxiously awaiting since I just purchased a new front loading machine which uses only a third of the water as my old washer. To my surprise, my normally $50 a month water bill is $300 and appears to be going up. I immediately called the water company to report that I think someone had misread the meter because there was no way the bill could be that high. However, they came out and advised that we seem to be using about 800 gallons a day. Further they checked their line and found no leaks, so obviously there is a leak somewhere on my property. I feverishly ran around checking the yard and under the house (I sent my oldest son under the house) looking for any signs of water. I got up in the middle of the night and walked the house searching out signs of water running, yet nothing. As an adjuster I began the process of elimination by checking the meter for 30 minutes making sure no water was being used, then turning off the water to the house and checking the meter again. I determined that when we were not using water, then water meter did not move. However, the water company said that did not matter, the water obviously went through the meter therefore, I am responsible for the bill. To top it off, I should hire "plumber" to test for any leaks. Having thought I covered myself by purchasing a home warranty plan, I immediately contacted them for the problem. I was advised however, that unless there was a leak and I knew where it was, the home warranty company could not send out a technician unless of course I wanted to pay my deductible and the technician would come out to tell me exactly what the water company just told me and that is that I would have to find the leak first. In the meantime, my water bill continues to spiral out of control. And while I wait for the plumber/leak detector, I have (compliments of the water company) the earliest appointment available set for the end of November with a water conservationist who is going to come out check my flow rate and discuss water conservation with me. Stay tuned…

SHARON GLENN
President - CAIIA 2006-2007

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The matter proceeded to trial where the jury returned a special verdict in favor of the Polissos awarding them compensatory and punitive damages.

On appeal, Century contended that Mrs. Polisso did not have standing to sue for breach of contract and breach of the implied covenant of good faith and fair dealing. Century argued that Mrs. Polisso was not a named defendant in the Allen action, nor was she a named insured under the policy.

The appellate court looked to the policy to determine its plain meaning. The court concluded that Therese Polisso was an insured under the policy's definition of an insured, which included the insured's spouse.

Further, the court examined the meaning of the phrase "legally obligated to pay". The court reasoned the Kinzel was a family owned business and the Allen contract was entered into and performed for the benefit of the family. Since Mrs. Polisso had a community property interest in the business, she would be legally obligated to pay a judgment against it. Reading the policy as a whole, the only purpose for designating the spouse of an individual business owner as an insured is to protect the spouse's community interest. Accordingly, giving her standing to sue Century for breach of that duty.

Century also argued that a "genuine dispute" existed as to Century's legal liability under the CGL policy and the installation floater, requiring reversal of the bad faith and punitive damage awards.

Century claimed there was a genuine dispute whether under the contract at the time of the flood and whether the property damage was caused by an excluded cause of loss, i.e., Kinzel's alleged faulty workmanship.

The appellate court disagreed. A liability insurer owes a broad duty to defend its insured against claims that create a *potential* for indemnity. Even if there were genuine disputes regarding coverage, there was no genuine dispute as to Century's duty to defend.

The facts known by Century created a potential for coverage. The disputes cited by Century were questions relevant only to Kinzel's liability to Allen and not Century's *duty to defend*. As such, the genuine dispute doctrine was not applicable.

The appellate court then examined the jury's $2 million punitive damage award looking to the three guideposts in *BMW of North America, Inc. v. Gore* (1996) 517 U.S. 559, 568 and *State Farm Mutual Auto Insurance v. Campbell* (2003) 538 U.S. 408. These are:

(1 the degree of reprehensibility of the defendant's conduct; (2) the ratio between the harm and the compensatory damages; and (3) the difference between the punitive damage award and civil penalties authorized in comparable cases.

Century finally raised instructional and constitutional challenges to the punitive damages. Century argued that the jury instructions violated due process because the instruction did not require the jury to consider the third guidepost, i.e., "the difference between the punitive damages award and comparable civil penalties".

The appellate court disagreed. Instead, the court held that this guidepost was a question of law for the court when conducting its independent judicial review of a punitive damage award. Therefore, this guidepost was beyond the province of the jury.

The appellate court also examined the reprehensibility of Century's conduct. There was substantial evidence that Century acted with reckless indifference to the Polissos' health and peace of mind. Century refused to pay for the Polissos' defense costs, knowing that the Polissos' were financially vulnerable. Moreover, the stress of the Allen litigation adversely impacted the Polissos' health.

Finally, early in the litigation, Century's coverage counsel advised Century there was a "potential for coverage" to create a duty to defend. Here, Century engaged in a course of conduct over a five-year period intended to avoid paying the policy benefits.

The Polissos were awarded $622,911 in compensatory damages and $2,015,000 in punitive damages, a ratio of 3.2 to 1. The appellate court affirmed this noting that while the compensatory damages were substantial; the ratio was warranted given the reprehensibility of Century's conduct.

This case has several key findings, which may impact insurers. First, where a CGL policy provides coverage for an individual doing business as a sole proprietorship, there may also be a duty to defend and indemnify the spouse in a suit against the business. Second, a dispute over whether a duty to defend exists and a dispute over whether coverage exists are two different issues. Finally, in punitive damage case, an insurer may be limited in obtaining a jury instruction that equates any award to comparable civil penalties.

News of Members

Harper Claims Service, Inc.
is pleased to announce the relocation of its office to 265 East Orange Grove Ave., Ste. C, Burbank, CA 91502. The P.O. Box and phone numbers will remain the same.

Weekly Law Resume

Prepared by Low, Ball & Lynch, Attorneys at Law - San Francisco, CA

Duty to Defend - Supplementary Payment Provision

Jack Combs v. State Farm Fire & Casualty Company, Court of Appeal, First District - October 16, 2006

The supplementary payment provision of an insurance policy obligates an insurer to pay the various supplementary amounts incurred in addition to a judgment, settlement, and defense costs. In this case, the insured contended that the insurer was required to reimburse him for the attorneys' fees he was ordered to pay to the prevailing party in a housing discrimination case that was not covered.

Jack Combs was sued in Federal Court for racial discrimination in the management of an apartment complex in violation of Federal and State Law. He was provided with a defense by State Farm Fire & Casualty Company, the insurer for the building. During the course of the action, Mr. Combs' answer was stricken, and his default entered for failure to comply with discovery orders. Following an evidentiary hearing, the Court found Combs to be liable for compensatory and punitive damages based upon a finding of racial animus. In addition, the Court awarded attorneys' fees to the prevailing party pursuant to the provisions of Federal and State law. This was augmented by additional attorneys' fees incurred on appeal.

State Farm defended the action through the denial of a petition for certiorari filed in the United States Supreme Court. Following the entry of judgment, State Farm refused to pay any portion of the judgment. Combs sued State Farm for breach of contract. On cross-motions for summary judgment, the trial court denied Combs' motion, and granted summary judgment to State Farm. Combs appealed.

The Court of Appeal affirmed. The Court noted that Insurance Code Section 533 prohibited State Farm from reimbursing Combs for any willful act. Intentional racial discrimination is a willful act under Section 533. Thus, Combs was not entitled to be indemnified for the compensatory and punitive damages for which he was liable.

This did not mean that State Farm was not obligated to provide a defense. State Farm did so, and did not request reimbursement. However, Combs asserted that, since State Farm did defend, they were also obligated under the supplementary payments provision to reimburse him for the attorneys' fees awarded against him as costs of the action.

The Court found that the award of attorneys' fees to the prevailing party flowed from the intentional racial discrimination. It did not flow from the defense obligation. Insurance Code Section 533 prohibits coverage for any loss caused by the willful misconduct of the insured. Liability for the adversary's costs and attorneys' fees in this case was caused by and incurred as a result of Combs' intentional racial discrimination. Thus, Insurance Code Section 533 precluded payment of the attorneys' fees.

Providing a legal defense did not constitute indemnification for a loss. In fact, insurers are often obligated to provide a defense where willful misconduct of the insured is alleged. However, the supplementary payment provision was not a necessary component in providing the insured with a defense. It arose only after liability was established. Permitting a wrongdoer to be reimbursed for these sums that had to be paid as a result of willful misconduct would undercut Insurance Code Section 533, and permit a wrongdoer to avoid a consequence of that wrongdoing. Insurance Code Section 533 prohibited State Farm from reimbursing Combs for these costs.

The Court rejected any argument that allowing such costs to be reimbursed encouraged meritorious civil rights actions. While having a solvent insurer to pay such sums was beneficial, it was outweighed by the loss of deterrence if parties believed they could engage in willful misconduct and not worry about any financial consequences. The judgment was therefore affirmed.

COMMENT

This is the first opinion to clearly link the supplementary payment provision to the duty of an insurer to indemnify its insured for damages. It remains to be seen whether the holding will remain limited to Insurance Code Section 533 cases, or might be expanded more broadly to include other instance where an insurer is not obligated to reimburse the insured for a settlement or judgment.

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Damages - Evidence of Total Amount of Medical Bills

Greer v. Buzgheia, Court of Appeal, Third District - August 1, 2006

Under the cases of Hanif v. Housing Authority (1988) 200 Cal App. 3d 635 and Nishihama v. City and County of San Francisco (2001) 93 Cal App. 4th 298, a plaintiff in a tort action cannot recover more than the amount of medical expenses actually paid or incurred, even if the billable or market value of the medical expenses is a greater sum. Defendants have relied on these cases to exclude evidence of the amount of plaintiff's medical bills exceeding the amount paid.

In this case, the question was whether a jury should receive evidence of the total amount of medical bills charged to plaintiff, not just the amount of medical bills actually paid. Plaintiff Robert Greer was injured when Defendant Hossam Ali Buzgheia' vehicle collided with Greer's vehicle. Greer filed suit against Buzgheia and claimed a low back injury, necessitating spinal fusion surgery. Greer incurred medical bills of $216,000. Prior to trial, Greer's employer reached a compromise agreement with Greer's medical providers to satisfy his entire medical tab for the sum of $132,984.92.

Defendant brought a motion in limine to exclude Greer from submitting evidence of medical bills exceeding the amount of money which the medical providers agreed to accept as payment in full. Defendant argued that the jury should not be permitted to hear evidence that the reasonable value of the medical services exceeded the amount paid, because no one was obligated to pay the difference. The trial court denied the motion.

At trial, the jury heard evidence of the amount of medical expenses billed and that the amount was reasonable. The special verdict form lumped medical expenses together with wage loss and other economic damage. Plaintiff prevailed and was awarded the total sum of $321,500. Defendant appealed. The Third District Court of Appeal affirmed the judgment.

On appeal, Defendant contended that the trial court erred by denying his motion in limine to limit the evidence of the amount of Greer's medical bills to what was actually paid. The Third District held that the trial court correctly denied Defendant's motion in limine and that a jury should receive evidence of the total amount of medical expenses charged to a plaintiff in addition to evidence of the amount actually paid. The Court of Appeal further held that a trial court may reduce the amount of medical expenses awarded to a plaintiff as economic damages in a post-trial motion pursuant to Hanif and Nishihama.

Interestingly, Defendant Buzgheia filed a post trial motion to reduce the amount of Greer's economic damages. The post-trial motion was denied by the trial court because the verdict form presented to the jury did not separate an award of medical expenses from an award of lost earnings when awarding past economic loss to Greer. The Court of Appeal ruled that the trial court properly denied the post-trial motion because it was not possible to determine the amount of past medical expenses which the jury awarded to Greer. The judgment in favor of Greer was therefore affirmed.

COMMENT

This decision allows plaintiffs to introduce evidence of the billed or market amount of medical bills at trial, even though a plaintiff may not recover more than the actual amount paid. Defendants must now file a post-trial motion to reduce excessive awards of medical specials. We anticipate that this issue will eventually be addressed by the California Supreme Court.

Civil Procedure - Waiver of Jury Trial

Woodside Homes of California v. Superior Court Court of Appeal, Third District - August 21, 2006

In Grafton Partners v. Superior Court (2005) 36 Cal 4th 944, the California Supreme Court invalidated a contract provision where the parties agreed to waive trial by jury. The Supreme Court held that a waiver of the right to trial by jury must be prescribed by statute. The Grafton case was thought to invalidate pre-dispute jury waivers. This case addresses

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whether parties can create a jury waiver through the use of different language in the contract.

Plaintiff Kimberly Wheeler bought a home in Stockton from Defendant Woodside Homes (Woodside). The written real estate purchase contract contained a provision that set forth that all disputes relating to the contract would be submitted to a referee, pursuant to California Code of Civil Procedure sections 638 and 641 through 645.1. Following the purchase of the home, Wheeler filed a construction defect lawsuit against Woodside. Woodside, in turn, filed a motion for appointment of a referee for all purposes, pursuant to the contract. The motion was granted.

Subsequently, the Supreme Court issued its ruling in Grafton. Wheeler then made a motion to invalidate the referee provision in the contract on the ground that it constituted a pre-dispute jury waiver, which was unenforceable under Grafton. The Superior Court granted the motion and vacated the reference order. Woodside then filed a petition for writ of mandate. The Court of Appeal, Third District reversed the lower court ruling and issued a peremptory writ of mandate.

When parties elect a judicial forum to resolve their civil disputes, article I, section 16 of the California Constitution provides the right to trial by jury. The Third District, interpreting the Grafton decision, reiterated that any waiver of the right to jury must be by consent of the parties as provided by statute. In Grafton, the Supreme Court had invalidated a contract provision which set forth that the parties agreed not to demand a trial by jury in any action arising out of the contract. The Supreme Court held that there was no statute that clearly addressed this language.

The Court of Appeal distinguished the language in the Wheeler-Woodside agreement from the contractual language in Grafton. In the Wheeler-Woodside agreement, the parties agreed to refer all disputes to: "general judicial reference pursuant to California Code of Civil Procedure sections 638 and 641 through 645.1". C.C.P. section 638 sets forth in pertinent part that a referee may be appointed in a civil action to hear and determine all issues of fact or law. The Third District held that this was an example of explicit statutory authorization of waiver to the right to jury trial. The Court, therefore, issued its writ of mandate directing the Superior Court to vacate its order granting the motion to "invalidate" the reference provision in the contract and vacating the referral to a referee.

COMMENT

This case holds that a pre-dispute agreement to send a case to a judicial referee is not an impermissible jury waiver. This case provides an exception to the Grafton decision, which was thought to invalidate pre-dispute jury waivers.

Duty of Care - Assumption of Risk

*Jane Hemady v. Long Beach Unified School Distric*t, Court of Appeal, Second District - September 28, 2006

This case concerned the standard of care which applied to a school for injuries occurring in a middle school golf class. It also discussed the application of the assumption of risk doctrine.

Jane Hemedy, a 12 year old student, was struck in the face with a golf club by another student during a seventh grade physical education golf class. She sued the Long Beach Unified School District and Brian Feely, the instructor. The trial court granted the defendants' motion for summary judgment, holding the primary assumption of the risk doctrine applied to limit liability. Hemedy appealed.

The Court of Appeal reversed. The Court stated that the applicable duty of care depends on the nature of the sport at issue and the parties' relationship to the sport. The Supreme Court has established an exception to this rule in certain sport settings. Under the primary assumption of the risk doctrine, a coach or co-participant's potential liability is not governed by a prudent person standard, but by a standard to avoid intentionally injuring a player, or engaging in conduct that is so reckless so as to be outside the range of ordinary activity involved in the sport. In this case, the Court decided not to apply the primary assumption of the risk doctrine. The Court decided that being hit in the head by a golf club swung by another golfer was not an inherent risk of the game, especially in a physical education golf class taught to a group of seventh graders. Thus, applying ordinary rules of negligence would not require a fundamental alteration of the game, and would not chill a coach's role to challenge student athletes or discourage competition or vigorous participation.

The Court determined that applying the prudent person standard of care to determine whether the school district or its

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employees were liable for the injuries to the student, which occurred during school hours, was most appropriate. The Court felt that applying this standard was more consistent with prior cases that have analyzed liability in analogous situations. Further, there was no indication that the Supreme Court in its holding on primary assumption of the risk intended to overrule this line of cases.

The judgment was reversed and remanded to the trial court.

COMMENT

This opinion again exemplifies the rather fact-specific analysis that is necessary in order to determine the applicability of the assumption of the risk doctrine, even in sport settings. Also, the overriding consideration in this matter seems to be the Court's concern with injuries that occurred at a mandatory physical education class.

Coverage - Property Insurance - Under Construction

TRB Investments, Inc. v. Fireman's Fund Insurance Co., California Supreme Court - November 13, 2006

The California Supreme Court was called upon in this case to construe a property insurance policy that withdrew coverage while a building was vacant, but contained an exception for buildings that were "under construction." The issue involved whether the exception applied to only new construction or any type of construction.

TRB Investments, Inc. purchased a property insurance policy from Fireman's Fund Insurance Company. The policy contained a vacancy exclusion which excluded coverage for loss caused by vandalism, sprinkler leakage, glass breakage, water damage, or theft if the building was vacant for more than sixty consecutive days prior to the occurrence of a loss. However, buildings under construction were not considered vacant.

TRB added a former bank building to the policy. The property was rented for one year, and then the property remained vacant until TRB contacted a contractor to renovate the property for a new tenant. Work began less than sixty days prior to the date of the loss, and in the last two weeks before the loss, the contractors worked periodically at the building in testing various new components of the building. During this work, it was discovered that there was a water line or water heater loss causing significant damage. The improvements to the structure continued in the ensuing months. The water damage portion of the work was submitted to Fireman's Fund for payment. Fireman's Fund denied payment and this lawsuit resulted. The trial court granted summary judgment for Fireman's Fund and the Court of Appeal agreed. The Court of Appeal held that the "under construction" exception did not apply to renovations to an existing structure. Upon petition to the California Supreme Court, review was granted.

The California Supreme Court reversed the Court of Appeal decision. The Court stated that this issue was one of first impression for California. It noted that courts from other states had reached different interpretations of this provision. Looking at the language involved, the Court concluded that the term must include not only new construction but also substantial improvements or modification to an existing structure. The Court felt that this interpretation made the most sense. Vacant buildings face an increased risk of property loss. The construction exception makes sense where there is substantial construction activity on the premises which makes the risk of loss less likely than with a vacant building.

The Court stated that the proper standard to apply is whether a building project results in substantial continuing activities by persons associated with the project at the premises during the relevant time period. Sporadic construction activities are insufficient to meet this standard. In this case, since this standard had not been enunciated before, the motion for summary judgment did not direct its attention to the facts regarding the standard. The question of whether the loss was covered therefore could not be resolved on the facts before the Court.

The Supreme Court therefore reversed the Court of Appeal decision with directions to remand the matter to the trial court to permit the parties to file a new summary judgment motion addressing the standard outlined by the Court.

COMMENT

The standard for interpretation of policy language enunciated by the Court in this decision follows recent Supreme Court decisions which emphasize the mutual intent of the parties. Under this standard, there is less emphasis on whether a policy is ambiguous and more emphasis on whether the position advocated by the insured comports with the mutual intention of the parties.

Montana Cowboy

A Montana cowboy was overseeing his herd in a remote mountainous pasture when suddenly a brand-new BMW advanced out of a dust cloud towards him. The driver, a young man in a Brioni suit, Gucci shoes, Ray-Ban sunglasses and YSL tie, leans out the window and asks the cowboy, "if I tell you exactly how many cows and calves you have in your herd, will you give me a calf?"

The cowboy looks at the man, obviously a yuppie, then looks at his peacefully grazing herd and calmly answers, "Sure, why not?"

The yuppie parks his car, ships out his Dell notebook computer, connects it to his Cingular RAZR V3 cell phone, and surfs to a NASA page on the Internet, where he calls up a GPS satellite navigation system to get an exact fix on his location which he then feeds to another NASA satellite that scans the area in an ultra-high-resolution photo. The young man then opens the digital photo in Adobe PhotoShop and exports it to an image processing facility in Hamburg Germany.

Within seconds, he receives an email on his Palm Pilot that the image has been processed and the data stored.

He then accesses a MS-SQL database through an ODBC connected Excel spreadsheet with email on his Blackberry and, after a few minutes, receives a response. Finally, he prints out a full-color, 150-page report on his hi-tech, miniaturized HP LaserJet printer and finally turns to the cowboy and says, "You have exactly 1,586 cows and calves".

"That's right. Well, I guess you can take one of my calves", says the cowboy.

The cowboy watches the young man select one of the animals and looks on amused, as the young man stuffs it into the trunk of his car.

Then the cowboy says to the young man, "hey, if I can tell you exactly what your business is, will you give back my calf?"

The young man thinks about it for a second and then says, "Okay, why not?'

You're a Congressman for the U.S. government", says the cowboy.

"Wow! That's correct", says the yuppie, "but how did you guess that?"

"No guessing required", answered the cowboy.

"You showed up here even though nobody called you; you want to get paid for an answer I already knew, to a question I never asked. You tried to show me how much smarter than me you are; and you don't know a thing about cows . . . this is a herd of sheep. Now, give me my dog back."