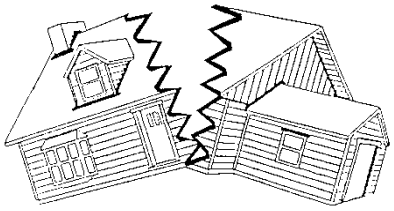
25TH ANNIVERSARY

1993 - 2018

West Coast Casualty's



Construction Defect Seminar
May 16th, 17th and 18th, 2018
The Disneyland Resort Hotel
Anaheim, California, USA

Disneyland Hotel

Seminar Handout

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Construction Defect Event ! ! !

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January 23, 1957 – October 3, 2017

"To the scientist, researchers and pharmaceutical engineers who are all working to fight these terrible diseases which affect mankind. We are behind you and we stand with you on your path to progress for all of humankind."

Coral Stern, President
West Coast Casualty Service, Inc.
January 1, 1999

This 25th Anniversary seminar is dedicated to the life of Coral Stern, the founder and former President of West Coast Casualty Service whose entrepreneurial spirit founded both this company and this seminar series. She remains the sole reason why we gather here today as well as for the past 24 years. We honor her and all women who sought to achieve greatness in business through hard work, dedication, education and charity toward their fellow man.

David Stern, RPA
President
West Coast Casualty Service, Inc.

Dear Friends and Colleagues,

Welcome to the 25th Anniversary of West Coast Casualty's Construction Defect Seminar

Since 1993, when we started these seminars, a lot has changed in the construction defect community and along with those changes, the West Coast Casualty Construction Defect Seminar changed with it.

We believed that educating our community and keeping them up to speed on the newest innovations in the prosecution, defense, coverage, science and technology remained our top priority. In the past 25 years this seminar has become an institution, a staple and ***"must go to"*** event for all the members of the construction defect community. In no other single place can one learn so much about the prosecution, defense, insurance coverage, science and technology regarding this specialized subject of claims and litigation . . . ***and*** . . . in no other place will you be able to meet so many of your colleagues where great long lasting relationships can be established which assist you in your claims and litigation handling throughout the business year.

It has been long said about our event that it helps bridge the gap between parties by giving them an opportunity, in a neutral forum, to resolve many disputes that they couldn't do otherwise or elsewhere.

Our attendees, from the legal, insurance, builder, contractor, subcontractor and numerous other communities averaging in number approximately 1500 per year, come from all across the United States and several foreign countries to hear our speakers views on this continuing and emerging area of claims and law.

Generally, 67 different organizations grant West Coast Casualty the ability to provide some level of continuing education accreditation to their licensee/members.

The ***only reason*** we have achieved this status is because we concentrate our efforts on the most important people in this community, the attendees of our yearly event. Over the past years, we dedicated a lot of time to listening to those we serve at our seminars and we prepared our events with the ideas, suggestions and goals of our attendees in mind.

As you go through the materials in this handout and listen to our speakers, I think you will agree that we achieved that goal.

So on behalf of everyone who worked hard to bring this event to you, welcome to our seminar, the Disneyland Resort and the beautiful city of Anaheim.

Very truly yours,

West Coast Casualty Service, Inc.

David Stern, RPA,
President and Corporate Secretary
davestern@westcoastcasualty.com

S E M I N A R S C H E D U L E

Wednesday, May 16th, 2018

Seminar Registration 12:00 PM – 5:30 PM

1:00 PM – 1:10 PM
Welcome Remarks

1:10 PM – 2:00 PM
Struggles and Successes of the Past 25 Years

Brian Kahn, Esq., Hon. Nancy Saitta (ret), Joseph Vogel, John Osorio, Esq., Wilson Townsend, Ross Feinberg, Esq. and Chelsea Zwart, Esq.

2:00 PM – 3:00 PM
Unwrapped and Unraveled - An insightful (or inciteful?) play at the changing nature of the relationships between the parties in a wrap program who thought the wrap was supposed to take care of everything

Adrienne Cohen, Esq., Hon. Rex Heeseman (Ret.), David Harris Esq., Mathew Adler, Ed Schmidt Esq. and Tim Earl Esq.,

3:00 PM – 3:30 PM
Afternoon Break

3:30 PM – 4:30 PM
East Coast Meets West Coast –
Hot Construction Defect Issues and Coverage Cases from the Other Coast

Anthony Miscioscia, Esq., Mark Parisi, Esq. and Mark McGivern

4:30 PM – 5:30 PM
How to Conduct Your Claim Investigation and Early Claims Handling To Avoid Bad Faith Traps

Jennifer Crow, Esq. Julia Manganaro, Melanie Brown, Brendan Keeley and Lee Wright

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S E M I N A R S C H E D U L E

Thursday, May 17th, 2018

Registration and Breakfast - 7:30 AM - 8:30 AM

Breakfast Sponsored by

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8:30 AM – 9:30 AM
Recent Important Appellate Decisions in California, Nevada, and Arizona

Jon Turigliatto, Esq. and Barry Vaughn, Esq.

9:30 AM – 10:30 AM
Litigating In The Western States - A Judge's Perspective

Holly Davies, Esq. Hon. Justice Michael Cherry,
Hon. Sue Kurita, Hon. Carl Butkus, Hon. Ronald Styn and Hon. Peter Swann

10:30 AM – 10:45 AM
Morning Break

Morning Break Sponsored by

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10:45 AM - 11:45 AM
"Subrogation is not the type of intervention I need.
How a subrogated insurer affects construction defect matters."

Ryan W. Baldino, Esq., Kim Arnal Esq., Paul Nolan Esq. and Al Clarke Esq.

11:45 AM – 12:15 PM

"Ollie", "Legends" and
Silver Stars
Awards Presentation

S E M I N A R S C H E D U L E

Thursday, May 17th, 2018

12:15 PM - 1:30 PM
Lunch
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(Seminar Registration Will be Closed During Lunch)

1:30 PM – 2:30 PM
What Comes Around (Sometimes) Goes Around: Dealing with Recalcitrant Carriers

Elaine Fresch. Esq., Karen Rice, John Thompson, Carolyn Crawford and Jay Sever, Esq.

2:30 PM – 3:00 PM
Afternoon Break

Afternoon Break Sponsored by

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3:00 PM - 4:00 PM
Effective Use of Experts

Adrienne Cohen, Hon. Rex Heeseman (Ret.), Ken Kasdan Esq.,
Joyia Greenfield Esq., Denise Anderson Esq. and Tim Fitzpatrick

SEMINAR SCHEDULE

Thursday, May 17th, 2018

4:00 PM - 5:00 PM
Claims Managers Speak - A Retrospective & Prospective Discussion

Rachel Ehrlich, Esq., Karen Rice, Todd Schweitzer,
Linda Tonkovich, Steve Lokus, and Phyllis Modlin

5:30 PM – 6:30 PM
Cocktail Reception
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S E M I N A R S C H E D U L E

Friday, May 18th, 2018

7:30AM - 8:30AM
Registration and Breakfast

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South Ballroom
8:30 AM – 9:30 AM

Known Knowns and Known Unknowns, the Ins and Outs of Extrapolation

Tracy Myers,
Elizabeth Rhode Esq.
and Dwight Duncan

Grand Ballroom
8:30 AM – 9:30 AM

Risk Transfer Alphabet Soup - A twelve-year lookback on legislative tinkering with anti-indemnity statutes - where are we now?

Jim Kurkhill, Esq. James Orland Esq.,
Larry Kent, Esq., Gary Baumann, Esq.
and Jack Rubin, Esq.

North Ballroom
8:30 AM – 9:30 AM

Florida - Opening Pandora's Box and How to Close It

Joseph Miele, Esq.,
Mark Boyle, Esq
Paul Amirata, Esq.

South Ballroom
9:30 AM – 10:30 AM

An Update on California's Right to Repair Act, featuring McMillin Albany et al. v. Superior Court

Andrew Morgan, Esq., Jill J.
Lifter, Esq., Susan Benson, Esq.
and Mayo Makarczyk, Esq.

Grand Ballroom
9:30 AM – 10:30 AM

Finding Evidence for your Coverage Case

John Podesta, Esq.
and Sherrianne Hanavan

North Ballroom
9:30 AM – 10:30 AM

Northwest Insurance Coverage and Extra-Contractual Issues

Tom Lether, Esq.,
Sandra Heiden and
Edward McKinnon

10:30 AM – 11:00 AM
Morning Break

SEMINAR SCHEDULE

Friday, May 18th, 2018

South Ballroom
11:00 AM – 12:00 PM

Subcontractor Wars: The Last AI

Richard D. Seely, Esq.,
Alex M. Chazen, Esq.,
Adam C. Flury, Esq.,
Sheila M. Totorp, Esq.
and Michael Chorak

Grand Ballroom
11:00 AM – 12:00 PM

Mediating the Luxury Single Family Home Construction Defect Case

Ross Feinberg, Esq.,
Scott Albrecht, Esq., Brian Kahn, Esq.
Rosemary Nunn, Esq.
Jeffrey Carvalho, Esq.
and Kory Kruckenberg

North Ballroom
11:00 AM – 12:00 PM

Creative Solutions to the Florida Problem: Making No Contribution and No State Law Work for You

Rebecca Appelbaum, Esq.,
Scott Rembold, Esq.,
Christine Gudaitis, Esq.,
Lee Kantor, Esq.
and Mary Rowe

South Ballroom
12:00 PM – 1:00 PM

Everyone is a Small Player

Paloma Ramirez, Esq.,
Patrick Mendes Esq.,
Paul Nolan Esq.,
and Anne Goyette Esq.

Grand Ballroom
12:00 PM – 1:00 PM

Real World Solutions to the Real Problems Presented By Wrap Up Programs

Robert Closson, Esq.,
Bruce Wick, Keith Koeller, Esq.
and Brian Chien, Esq.

North Ballroom
12:00 PM – 1:00 PM

When Mother Nature Attacks, Are you Covered?

Robert Carlson, Esq.,
William Noonan,
Diane Kelly
and John Lupfer, Esq.

Thursday's Lunch Proudly Sponsored by

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Seminar Speakers

Matthew Adler, Senior Claims Consultant
XL Catlin, Los Angeles, CA

Matthew Adler is currently with XL Catlin, a worldwide group of insurance companies and he works out of the Los Angeles office as a senior claims consultant. At X Catlin, Mr. Adler handles a variety of claims including excess, reinsurance and wrap programs involving commercial and residential construction. Mr. Adler was previously with OneBeacon and handled construction defect claims and coverage actions of all types, exposures and jurisdictions across the United States. Mr. Adler's prior work history includes many years at The St. Paul/Travelers and The Zenith Insurance Companies. In addition to the construction field, his experience includes general liability, SIU and Workers Compensation. He is a past President of the Construction Defect Claim Managers Association (CDCMA). Mr. Adler is a frequent speaker at various seminars and industry events on a variety of claims related subjects. Mr. Adler earned his bachelor degree from Pitzer College and is proud to serve as an executive board member of a local theater group, The Production Company.

Paul Amirata, Esq., Senior Vice President, Claims
Enstar (US) Inc., St. Petersburg, FL

Paul Amirata, Esq. has over twenty five years of experience in complex insurance coverage matters with particular expertise in construction defect claims and litigation. His current position is Senior Vice President, CGL Claims at Cranmore, a subsidiary of Enstar Group, a company that acquires and manages insurance and reinsurance companies in run-off and provides management, consulting and other services to the global insurance and reinsurance industry. In this position, Mr. Amirata is responsible for overseeing all of Enstar's construction defect claims handled by Enstar's Third Party Administrators, a portfolio consisting of over 2,000 claim groups. Mr. Amirata has been quoted in The Wall Street Journal and has made appearances on the Bloomberg Television network on various construction related issues. Paul received his Juris Doctorate degree from Hofstra Law School and was admitted to practice law in New Jersey and Pennsylvania in 1990.

Denise Anderson, Esq. Partner
Butler Weihmuller Katz Craig, LLP, Tampa, FL

A Partner at Butler, Denise M. Anderson is the Chairperson of the firm's Construction Litigation Practice Group. Denise is Board Certified in Construction Law by the Florida Bar and is an AV peer-rated attorney by Martindale-Hubbell. While she currently practices primarily in the fields of Construction Defect and Product Liability, in her legal career she has handled a large variety of insurance related disputes involving coverage and subrogation. Her construction experience includes the representation of general contractors, developers, designers, every trade in the construction process, as well as suppliers and manufacturers of building components. She has served as the chairperson of several national construction seminars and regularly speaks to clients and peers on a variety of construction and civil litigation topics. She received her Bachelor of Arts, *with high honors*, from Auburn University (1991) and her Doctor of Jurisprudence from Mercer University School of Law (1994). Denise is licensed to practice in the state and federal courts of Florida and the state courts of Georgia. Her professional memberships include the Association Defense Trial Attorneys, Women in Construction Litigation Alliance, The Florida Bar, the State Bar of Georgia, the Hillsborough Bar Association, the American Bar Association, the Hillsborough Association of Women Lawyers, the Defense Research Institute, the National Association of Subrogation Professionals and the Claims & Litigation Management Alliance. She has also been a member of the Junior League of Tampa since 2002, serving on committees for community projects to assist foster children, children aging out of foster care, children's literacy, among others. Denise is a native Floridian and has been employed with Butler since November 1995.

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Seminar Speakers

Rebecca C. Appelbaum, Esq., Special Counsel
Adams and Reese, Tampa FL

Rebecca C. Appelbaum has been a licensed attorney since 1999 and is a member of both the New York and Florida bars. Rebecca primarily practices in the areas of third-party liability coverage routinely addressing coverage issues found in construction defect, personal and advertising injury, professional liability and personal injury matters, and her practice also includes third-party liability defense, extra-contractual, automobile and appellate matters. Rebecca has authored and co-authored several articles concerning liability coverage for various publications, including the International Risk Management Institute, New Appleman on Insurance, Mealey's Bad Faith Reporter, and she has contributed chapters to DRI publications. Rebecca is a member of the ABA Section of Litigation and the Claims & Litigation Management Alliance (CLM). She holds designations of Certified Litigation Management Professional and Certified Claims Professional in Construction and also holds a preeminent "AV" rating from Martindale-Hubbell®.

Kimberly Arnal, Esq., Partner
The Aguilera Law Group, Los Angeles, CA

Kimberly Arnal is a partner in The Aguilera Law Group's Los Angeles office. Ms. Arnal's practice focuses on insurance coverage and contractual liability matters, with an emphasis on third-party construction defect, pollution liability, products liability, general liability, errors & omissions, and insurance guaranty association law. Ms. Arnal represents insurance carriers in a wide range of litigation matters, including declaratory relief actions, equitable contribution matters, bad faith litigation, litigation regarding the right to *Cumis* counsel, appeals, and through intervention in underlying actions. She is a graduate of Hastings College of the Law and UC Berkeley. Ms. Arnal is a Past Present of the Women Lawyers Association of Los Angeles and a member of the Chancery Club. She also serves on the boards of the Harriett Buhai Center for Family Law and the WLALA Foundation.

Gary F. Baumann, Esq., Founding Partner
Baumann, Gant & Keeley, P.A., Fort Lauderdale, FL

Gary F. Baumann is a founding partner of Baumann, Gant & Keeley, P.A., a Florida insurance defense firm with offices in Fort Lauderdale, Tampa and Jacksonville. He earned his Juris Doctorate degree from Nova Southeastern University in 1996, receiving the Book Award in the Trial Advocacy Program. He was admitted to the Florida Bar in 1996 and is a member in good standing. He received his Bachelor of Science degree from West Virginia University in 1990. He was born in Erie, Pennsylvania. Mr. Baumann's primary areas of practice involve construction defect litigation, catastrophic injury, wrongful death, products liability, bad faith litigation and general negligence claims. He has successfully tried to verdict and litigated numerous complex claims across the State of Florida including class action lawsuits. He recently obtained in March, 2017 a $13,000,000.00 complete defense verdict on a negligent security case where the Plaintiff incurred over $1,000,000.00 in medical bills. He also won a $109,000,000 defense verdict, one of the largest in the State of Florida for 2015. Remarkably, he was asked to try this catastrophic case approximately forty-five days before the start of the trial. He is admitted to practice law in all Florida State Courts since 1996 and has been admitted to practice before the U.S. Federal Court for the Southern and Middle District of Florida.

Ryan W. Baldino, Esq. Partner
Hammons & Baldino, LLP, Torrence, CA

Ryan W. Baldino is an AV rated attorney and partner with Hammons & Baldino, LLP, a firm that specializes in representing subcontractors and material suppliers in construction defect actions throughout California. Ryan has represented public entities and school districts in multimillion dollar public works construction cases. He now enjoys representing subcontractors, material suppliers, insurance companies and small business owners in legal disputes involving construction, insurance, personal injury and general liability matters. Ryan obtained degrees in Sociology and Law and Society from the University of California, Riverside and received his Juris Doctorate degree from the University of California, Hastings College of the Law. Ryan currently serves on the Planning Commission for the City of El Segundo.

Seminar Speakers

Susan M. Benson, Esq.
Benson Legal, APC, Encino, CA

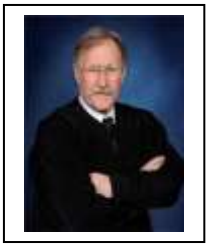
Susan Benson received her undergraduate at University of California, Santa Barbara, B.S. in Economics and Accounting; University of West Los Angeles, School of Law She is admitted in all Federal and State Courts in the State of California. A member of the California State Bar Association; Los Angeles County Bar Association; Encino Bar Association; National Association of Subrogation Professionals (NASP) member. Susan was the Co-Chair of the 2018 Litigation Skills & Management Conference for NASP; Former Member of the Board of Directors of NASP; NASP Co-Chair Education Committee; NASP's President Award Recipient – 2012; NASP's Spirit Award Recipient – 2010; NASP's Chapter of the Year Award Recipient, 2009; Dean's List Honor Graduate from the University of West Los Angeles, School of Law -1990; Authored Automobile Subrogation for the New Appelman on Insurance Law Library Edition which was published in 2015. Certified Subrogation Recovery Specialist (CSRP)- 2014. Susan's practice devoted exclusively to the handling of subrogation claims throughout the entire state of California for 25 years.

Mark A. Boyle, Esq., Partner
Boyle & Leonard, P.A., Fort Myers, FL

Mark A. Boyle is currently a partner with the law firm of Boyle & Leonard, P.A., located in Fort Myers, Florida. Mr. Boyle began his legal career working as an Assistant County Attorney for Pasco County in New Port Richey, Florida. He began his foray into the world of insurance when he became associate general counsel for Armor Insurance Company in Tampa, Florida. In 1996, he entered into private practice with Fink & Lane, P.A., which is now known as Boyle & Leonard, P.A. Mr. Boyle's current areas of practice include civil litigation, with a concentration in the handling of first and third party insurance disputes, including extra-contractual and bad faith matters. Mr. Boyle is a 1993 graduate from Stetson College of Law, located in St. Petersburg, Florida. In 1990, he received a Bachelor of Arts in History and a Bachelor of Science in National Sciences from the University of South Florida.

Melanie M. Brown, J.D., Manager, US Large Accounts
Markel – Claims, Deerfield, Illinois

Melanie leads the A&E and Construction Defect teams at Markel, where she started in 2008. In addition to her current focus on design professionals and construction defect matters, Melanie has experience in all professional liability lines including agents and brokers, lawyers malpractice, medical malpractice and miscellaneous E&O as well as products liability. Prior to joining Markel, Melanie practiced law for 11 years in Chicago at two international firms. Melanie earned her BA with Distinction from the University of Virginia and her Juris Doctor from Washington & Lee University School of Law.



Hon. Carl Butkus, Judge
District Court, Albuquerque, NM

Judge Carl Butkus is a graduate of the University of Pennsylvania (1971) and the Gonzaga U. School of Law (1977). He was appointed District Judge in the Second Judicial District in 2005. Prior to that, he was in private practice from 1978 - 2005. From 1977 - 1978, he was law clerk to Honorable Wm. Hendley of the Court of Appeals of New Mexico. Among other things, he has been past Chair of the Supreme Court Rules of Civil Procedure Committee.

Robert Carlson, Esq. Shareholder
Lee, Hernandez, Landrum & Garofalo APC, Miami, FL

Robert Carlson is a shareholder of the law firm of Lee, Hernandez, Landrum & Garofalo APC and manages the firm's Florida operations. Mr. Carlson is board certified as a specialist and expert in construction law by the Florida Bar. He is also a member in good standings in all State and Federal Courts of Florida, the United States Virgin Islands and Nevada. Mr. Carlson focuses his practice on complex tort and commercial litigation where he has successfully represented clients in high value construction, products liability, class action and insurance matters.

Seminar Speakers

Jeffrey P. Carvalho, Esq., Partner
Ryan Carvalho LLP, San Diego, CA

Mr. Carvalho was born and raised in Mattapoisett, Massachusetts. He received his Bachelor of Arts Degree *summa cum laude* in 1997 from the University of Massachusetts Dartmouth and his Juris Doctorate Degree from the University Of San Diego School of Law in 2001. Mr. Carvalho became a partner in the Firm on February 1, 2011. Mr. Carvalho has extensive experience in construction defect matters representing general contractors, developers and subcontractors. For over 15 years, he has assisted clients navigate through construction defect matters, from the beginning of the process and the procedures of California SB 800 through discovery and up to, and including, trial. In addition, Mr. Carvalho has assisted numerous construction clients through their everyday activities of running their business and construction sites from drafting and reviewing contracts and other legal documents to risk management. In addition to Mr. Carvalho's civilian practice, he served with the Air National Guard from 1991-1997.

Alex M. Chazen, Esq.
Kahana & Feld, LLP, Santa Ana, CA

Alex M. Chazen, Esq., has handled construction cases from all sides for the past five years, representing homeowners, subcontractors, general contractors, and developers, both as retained insurance defense counsel and as personal counsel. He has secured favorable results for his clients, including favorable arbitration awards, settlements, and success in motion practice. Mr. Chazen also has worked with his clients to develop contract and project documents, risk management strategy, and business planning for purposes of obtaining insurance that will meet all contractual requirements. Mr. Chazen graduated from the University of California, Irvine with a Bachelors of Arts in Political Science with an emphasis on public policy degree and received his Juris Doctor from Loyola Law School in Los Angeles.

Hon. Michael A. Cherry, Chief Justice
Nevada Supreme Court, Carson City, NV

Justice Michael A. Cherry has been an attorney in Nevada since 1970 and was elected to the Supreme Court in 2006. He ran unopposed for a second 6-year term in November of 2012, when he served as Chief Justice for the Nevada Supreme Court. Justice Cherry will again serve as Chief Justice through 2017. While he has had a long career in private practice, he always involved himself in public service within the legal community. He began his career as a Deputy Clark County Public Defender before becoming a partner in the law firms of Manos & Cherry and later Cherry, Bailus & Kelesis. In 1981, Justice Cherry was named as Special Master of the MGM Grand Hotel Fire Litigation and in 1983 he assumed the duties of Special Master of the Las Vegas Hilton Fire Litigation. As Special Master, Judge Cherry served as liaison between plaintiffs' attorneys, defense attorneys and the court during these multi-million dollar cases. His work as Special Master gained him nationwide recognition and the procedures he established are now a part of most mass disaster litigation. Justice Cherry served as an Alternate Municipal Judge for the cities of Las Vegas and Henderson, as well as Justice of the Peace Pro Tem and Small Claims Referee for Clark County. Justice Cherry chairs the Indigent Defense Commission that is examining how the justice system deals with criminal defendants who cannot hire their own attorneys. He also is the supervising justice over the Senior Justice and Judge Program. Justice Cherry earned his bachelor's degree from the University of Missouri in 1966 and a juris doctorate degree from Washington University School of Law in 1969. A native of St. Louis, he is the father of two and grandfather of two. Justice Cherry ran unopposed for a second term in November of 2012. His new 6-year term will end in January 2019.

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Seminar Speakers

Brian C. Chien, Esq., General Counsel, Corporate Officer
Kenyon Construction, Inc., Martinez, CA

Brian C. Chien is General Counsel and a Corporate Officer of Kenyon Construction, Inc. and serves on its Board of Directors. Kenyon specializes in large scale commercial/residential lath and plastering with operations in Arizona, California, Colorado, Nevada, New Mexico and Texas. As Kenyon's General Counsel since 2005, Mr. Chien has managed and directed all of Kenyon's legal affairs in a broad range of areas including civil litigation, claims adjusting, construction, contracts, employment, insurance coverage, overseas investments, personal injury, real estate, regulatory compliance, state legislative lobbying, and workers' compensation. As a Corporate Officer and member of the Board of Directors, Mr. Chien plays an integral part in providing guidance regarding complex business issues, corporate strategy and risk aversion practices. Prior to joining Kenyon, Mr. Chien was a civil litigator in private practice representing developers, general contractors, subcontractors and design professionals in all aspects of construction related law and litigation. Mr. Chien received his Juris Doctor degree from California Western School of Law and his Bachelor of Science degree, *magna cum laude*, in hotel management from Golden Gate University. Mr. Chien is also a licensed general contractor in the State of California.

Michael A. Chorak, Director of Casualty Operations – West Region
Engle Martin & Associates, Las Vegas, NV

Michael Chorak is currently the Director of Casualty Operations/West Region for Engle Martin and Associates which is a leading national independent loss adjusting and claims management provider. The firm provides a comprehensive line of service offerings including commercial property, casualty, inland marine/cargo, heavy equipment and large loss adjusting, as well as TPA/claims management and subrogation services. Mr. Chorak has been in the insurance industry for over 20 years with an emphasis on construction defect claims throughout the Western U.S.

Robert V. Closson, Esq.
Hirsch Closson, APLC, San Diego, CA

Following graduation from law school in 1986, Mr. Closson initially served as a multi-lines claims representative with Travelers Companies in San Diego before entering private practice in 1987. For the past 30 years he has concentrated his AV rated practice almost exclusively in insurance coverage litigation and appeals, and the rendering of coverage opinions for insurers and insureds. His insurance practice has involved the property and casualty fields of commercial and personal lines policies with an emphasis on construction defect, intellectual property, business litigation and environmental claims. His clients have included insurers, risk retention groups, builders, subcontractors, and trade associations. Mr. Closson is admitted to practice before the California state courts and the U.S. District Courts for the Southern, Central and Northern Districts of California, the U.S. District Court for the District of Colorado, and the U.S. Ninth Circuit Court of Appeals. Mr. Closson lectures both locally and nationally.

Seminar Speakers

Al Clarke, Esq., Principal
Clarke Mediation Inc., San Diego, CA

Al Clarke was admitted to the practice of law in 1980. As a sole practitioner and a name partner in a San Diego law firm, he enjoyed a general law practice that ranged from construction defect litigation to personal injury suits to drafting construction related contracts to class action securities litigation. He has been actively involved in construction defect related cases since 1984, and is uniquely positioned to understand the issues concerning this area of law as he has over the years represented plaintiffs (homeowner's associations and homeowners), developers and subcontractors as he was panel counsel for several insurance carriers. His representation of numerous suppliers in mechanic's lien cases and litigants in construction contract disputes provided him with insight to the transactional side of construction litigation. In 2000 Al channeled his efforts away from the litigation side of construction cases and became a full time mediator/arbitrator with an emphasis on construction related cases. In 2000, he was appointed as a San Diego Superior Court Pro Tem Settlement Judge and Arbitrator. He was the Co-Chairman for three years of the Alternative Dispute Resolution Section of the San Diego County Bar Association. In 2001 he was appointed as a member of the Mediation Bench-Bar Committee of the San Diego Superior Court on which he served for two years. In his over 18 years of providing arbitration and mediation services to the legal community, Al has successfully resolved hundreds of complex, multi-party construction defect cases, homeowner/homeowner association disputes, real estate contract disputes, mechanic's lien actions, employment law litigation (wrongful termination and discrimination) and personal injury actions.

Adrienne D. Cohen, Esq., Founder
Law Offices of Adrienne D. Cohen, Santa Ana, CA

Adrienne D. Cohen is the founder and principal of the Law Offices of Adrienne D. Cohen, a ten-attorney firm with offices in Santa Ana and San Rafael, California. Ms. Cohen received her Juris Doctorate from the USC School of Law and her Bachelor of Arts in Political Science from UCLA. Ms. Cohen has represented major insurance companies and their insureds for over 20 years in the areas of insurance coverage and defense. Ms. Cohen is an executive board member and past president of the William P. Gray Legion Lex Inn of Court. She has been an instructor in the UCI paralegal program, where she taught legal writing, ethics and insurance law. Ms. Cohen is AV Rated by Martindale-Hubbell and has been named a Southern California Super Lawyer. Ms. Cohen has tried many jury and court trials. She is a proud member of the American Board of Trial Advocates. She has argued and won many appeals, including those dealing with complex coverage issues.

Carolyn J Crawford, Director, Construction Defect
Nationwide Insurance Company, Columbus, OH

Nationwide is number 85 on the Fortune 500 list of companies and a two time recipient of the J.D. Power 100 Best Places to Work. Carolyn Crawford is Commercial Claims Director for Nationwide leading the national Construction Defect segment of the Complex Claims organization. Carolyn has over 30 years in the Insurance Industry with a wide range of disciplines and specialty handling to include Construction Defect, General Liability, Workers Compensation, Commercial and Non Standard Auto and National Accounts. During her 30 plus years in the industry, Carolyn has held both technical and leadership positions with major carriers such as Fireman's Fund, CNA, AIG, One Beacon, Travelers and now Nationwide. Carolyn currently serves as a member on the CLM Construction Defect Advisory Board.

Jennifer Crow, Esq., Partner
Scheer Law Group, Portland OR

Jennifer Crow is a Partner in Scheer Law Group's Portland office. She practices in the areas of construction defect, premises liability, personal injury, professional liability, insurance coverage, and commercial litigation. Jennifer is licensed to practice in the state and federal courts of Oregon, Washington, and Idaho. Jennifer has several years of experience representing both general contractors and subcontractors in construction defect matters related to both residential and commercial projects. In addition to acting as defense counsel, she routinely handles cases as monitoring or excess counsel. Jennifer received her J.D. from the University of Oregon School of Law in 2010 and her B.S. in Finance from Oregon State University in 2005.

Seminar Speakers

Holly Davies, Esq., Partner
Lorber, Greenfield & Polito, LLP, AZ, NM and CO

Holly Davies is a partner with Lorber, Greenfield & Polito, LLP, and practices out of the Arizona, New Mexico, and Colorado offices. She joined the firm in 2004, and focuses her practice on handling construction law and general litigation cases. Her practice includes a significant amount of construction related matters, including construction defect litigation, construction contract disputes, bodily injury litigation at construction sites, coverage issues, lien issues, contract drafting, and pre-litigation matters on behalf of commercial and residential contractors and developers. She is licensed in Arizona, Colorado, and New Mexico, and handles matters in the state and federal district courts in these states. Ms. Davies is the past president of the Arizona Association of Defense Counsel, where she has also served as the editor for the bi-annual publication "Common Defense" for the past several years. She also serves on the Board of Directors for Women in Construction – West Coast Conference. In addition, Ms. Davies is a member of the Maricopa County Bar Association, New Mexico Association of Defense Counsel, Homebuilders Associations of Central New Mexico and Arizona, and DRI. Her past speaking engagements include, West Coast Casualty Construction Defect Seminar, MC2 Annual West Region Construction Defect & Insurance Coverage Conference, State Bar of Arizona, NBI, and various insurance carrier seminars. She has spoken on topics ranging from trends in construction defects, duties of an insurer, condo conversion and bankruptcy issues in construction defect matters, and the right to repair process in western states. Ms. Davies graduated from the University of Notre Dame and earned a Juris Doctor from the University of Arizona College of Law.

Dwight J. Duncan, M.S., CFA, Founder
EconLit LLC., Phoenix, AZ

Mr. Duncan is the founder and Managing Director of the Phoenix, Arizona based firm of EconLit LLC. He is an economist who also holds the Chartered Financial Analyst designation and has over 22 years of experience in economic and financial consulting. Areas of expertise include economic analysis, intellectual property analysis, securities litigation, valuation of closely-held businesses, environmental damage quantification, class certification/class action analysis, general lost profits analysis and minority shareholder disputes. He has consulted with and been engaged as an independent expert witness for companies ranging from sole proprietorships to Fortune 500 in a wide range of industries throughout the U.S.

Timothy C. Earl, Esq., Shareholder
Sullivan Hill Lewin Rez & Engel, San Diego, CA

Timothy C. Earl is a shareholder of the law firm Sullivan Hill Lewin Rez & Engel, with offices located in San Diego, California and Las Vegas, Nevada. Mr. Earl's practice focuses on the representation of policyholders and insurance companies in a variety of insurance coverage disputes primarily involving property damage or bodily injury arising out of construction defect and asbestos claims, including but not limited to contractual and extra-contractual claims. He has significant experience in complex insurance coverage disputes involving wrap-up insurance policies, additional insured endorsements, and the allocation of claims amongst multiple insurers. Mr. Earl also represents developers, architects, engineers, general contractors and trade contractors in construction disputes in both residential and commercial contexts. Mr. Earl has served as a panelist for construction and insurance issues on multiple occasions at bar associations and regional and national conferences. Mr. Earl received his B.A. degree from the University of California, Davis in 1991 and his Juris Doctorate from the University of San Diego School of Law in 1994. Mr. Earl has an AV® Preeminent™ Peer Review Rating by Martindale-Hubbell. Mr. Earl has received a variety of other awards and distinctions, including recently being named a Top Lawyer of Southern California in 2015 and 2016 by the LA Times, Top San Diego Lawyer in 2015 and 2016 by San Diego Magazine, and a Top San Diego Attorney in Insurance Coverage in 2015 by San Diego Daily Transcript. He was also recognized in the top 1% of The American Registry, "Best of the Best" for 2016.

Seminar Speakers

Rachel K. Ehrlich, Esq., Mediator/Arbitrator
Judicate West, San Francisco, CA

Rachel Ehrlich is a nationally recognized, multi-jurisdiction mediator specializing in complex civil disputes and is affiliated with Judicate West. She mediates litigated and non-litigated matters involving insurance coverage and bad faith, real estate including landlord-tenant, personal injury, construction defect, environmental, and other subjects. Prior to becoming a full-time neutral, she spent 20 years in insurance as a coverage attorney, claims executive, and underwriter. Rachel mediates in several court programs including the Federal District of Northern California, trains mediators and mediation advocates, and regularly presents on mediation of insurance coverage, bad faith, mediation confidentiality, and ethics to varied audiences.

Ross W. Feinberg, Esq., Mediator
JAMS, Orange, CA

Ross W. Feinberg, Esq. specializes in disputes involving business commercial, complex construction defect, construction delay and contractual matters, bad faith insurance, homeowners association and real estate issues. Mr. Feinberg, an AV rated attorney, is the author of the text, *Construction Defect Litigation* (Amazon.com), which covers CD law and legislation throughout the country. He has been involved in mediations totaling over $400 million of recoveries and is a well-known advocate of ADR who is respected by all sides and facets of the bar as well as builders and insurance companies. For more than 23 years, Mr. Feinberg effectively represented parties in construction defect litigation and related class actions. He is widely recognized for his ability to initiate open communication with all parties leading to constructive resolutions. Mr. Feinberg is a frequent national speaker and lecturer on construction defect litigation and community association law. He has received numerous national and local awards from homeowners association organizations and the construction defect industry including being honored with West Coast Casualty's prestigious Jerrold S. Oliver award of Excellence (the "Ollie" Award) named after the former JAMS neutral. After more than two decades as a litigator, Mr. Feinberg successfully transitioned to full time dispute resolution services with JAMS, concentrating his practice in California. He is admitted to the bar in the states of California, Nevada and Colorado. Numerous dispute resolution references are available upon request.

Timothy Fitzpatrick, Principal Consultant
Axis Construction Consulting, Inc. Concord, CA

Timothy Fitzpatrick, principal with Axis Construction Consulting, Inc., is a licensed General Contractor and has been providing expert testimony for over 15 years. He began his career in the construction industry over 30 years ago. Mr. Fitzpatrick has in their Northern California office and has been in construction industry for over 30 years. He specializes in expert witness testimony. Perform forensic deconstruction investigation of defective construction claims and litigation. Provide opinions to counsel, insurance representatives and other participating consultants on matters of damage and claims assessment, methods of repair and repair cost preparation. Construction litigation consultation and report production.

Seminar Speakers

Adam C. Flury, Esq., Partner
Massie Berman, San Diego, CA

Adam C. Flury is a partner in Massie Berman which is a boutique law firm located in San Diego that primarily represents homeowners associations as both corporate counsel as well as in construction defect disputes throughout Southern California. Since 2005, Mr. Flury's practice has focused on representing homeowner associations and single family homeowners in construction defect litigation, including every facet of the pre-litigation SB800 process through multiple construction defect trials to successful judgments on behalf of his clients. Mr. Flury also has an insurance coverage background which he utilizes to assist his clients in all aspects of their insurance related needs from securing appropriate coverages to insurance coverage disputes and bad faith litigation.

Elaine K. Fresch, Esq., Partner
Selman Breitman LLP, Los Angeles, CA

Recognized by the Daily Journal in 2016 as one of the "Top Women Lawyers" in California, Elaine K. Fresch serves on the firm's Executive Committee, is the managing partner of the firm's construction practice, and is the managing partner of the firm's Law Vegas office. Her primary focus includes construction defect litigation, representing developers and general contractors, as well as all types of subcontractors and product manufacturers. While it is rare to take a complex construction defect case to trial, Elaine has done so. She has also handled a variety of commercial/real estate litigation matters, including trial in the U.S. District Court. Additionally, Elaine represents product manufacturers in complex subrogation claims as well as defends a variety of clients in general liability lawsuits. With an established Equine Law practice, Elaine is one of few in the state who, not only fully understands the complexities of horse-related cases and claims, but who is also a trained and awarded equestrian of more than 20 years. In this capacity, Elaine regularly advises clients on their contracts and releases and litigates matters ranging from personal injury to contract claims relating to purchases, sales and loss-of-use. Elaine is a member of CLM's Construction Advisory Board and is a co-chair of CLM's Diversity in Construction Litigation Committee. She has been invited to speak at numerous seminars sponsored by such organizations as West Coast Casualty, CLM, and DRI on a variety of topics related to the construction industry and the defense of construction defect cases. She is also a fellow of the Litigation Counsel of America and has received the Syhre Award for her contributions to the construction industry.

Anne Lawlor Goyette, Esq. ADR Neutral
Griffiths Goyette, Burlingame, CA

A full time ADR neutral with Griffiths Goyette since 1998, Anne Lawlor Goyette employs the talent and experience of counsel for all parties to tailor effective, clear and cost efficient dispute resolution strategy for each dispute. She minimizes expense and delay by prioritizing information needed for meaningful negotiations, simultaneously managing focused discovery and pre-trial preparation. Ms. Goyette conducts regular group teleconferences to identify issues, obstacles and solutions early and design and implement fair and aggressive action plans. She promotes effective communication and timely execution through consistent, straightforward reports. Ms. Goyette also engages decision makers early in scheduled one-on-one conversations to understand their goals, address obstacles and develop effective settlement strategies. Through prepared and productive negotiations, Ms. Goyette has resolved hundreds of complex cases and civil disputes and thousands of construction related claims, with settlements ranging from cost waivers to $35 million.

Joyia Greenfield, Esq. Founding Partner
Lorber, Greenfield & Polito, LLP, Poway, CA

Ms. Greenfield is one of the founding partners of the firm Lorber, Greenfield & Polito, LLP. She holds an AV Peer Review Rating with Martindale-Hubbell. She has handled numerous multimillion dollar cases on behalf of developers throughout California. Ms. Greenfield served as an Arbitrator with the American Arbitration Association, and as a Judge Pro Tem. In addition, she conducts seminars in the areas of construction defect litigation. An English and American studies major at Dickinson College, Ms. Greenfield attended California Western School of Law, earning her J.D. in 1982. She is admitted to The California Bar; and the United States District court for the Southern District of California. Ms. Greenfield was elected and served as Treasurer on the Board of the San Diego Defense Lawyers. She is a current member of the San Diego County Superior Court Case Management Order Committee. Ms. Greenfield is an active member and volunteer for the Susan G. Komen Breast Cancer Foundation. She enjoys fly-fishing with her family, and playing tennis and golf.

Seminar Speakers

Christine A. Gudaitis, Esq. Shareholder
Ver Ploeg & Lumpkin, P.A., Miami, FL

Christine A. Gudaitis is a shareholder in the law firm of Ver Ploeg & Lumpkin, P.A., with offices in Miami and Orlando. She practices in the area of complex insurance coverage litigation, representing corporate policyholders in state and federal courts in Florida and nationwide. Her clients include general contractors, developers, pharmaceutical corporations, chemical manufacturers, municipalities and brokerage houses, as well as various non-profit organizations. In addition to litigation, she helps clients assess and manage risk through insurance programs and provides guidance on contracts impacting coverage and liability. Ms. Gudaitis received her B.A. from Mount Holyoke College and her J.D., *cum laude*, from the University of Miami School of Law. She is a member of the Dade County and American Bar Associations, the Florida Association of Women Lawyers, the Miami-Dade Justice Association, the Miami-Dade County Bar Association Construction Law Committee, the Florida Justice Association and the Women's Construction Litigation Alliance. In addition, Ms. Gudaitis is a panelist for United Policyholder's "Ask an Expert" forum, Vice-Chair of the Miami-Dade County Library Advisory Board, a Trustee for the Miami-Dade County Law Library, and a member of the University of Miami Citizens Board, The Commonwealth Institute, 100+ Women Who Care, CREW-Miami, and a South Florida alumnae representative for Mount Holyoke College.

Sherrianne Hanavan, Claims Supervisor
Catalina U. S. Insurance Services, Inc., San Diego, CA

Claims Supervisor at Catalina U. S. Insurance Services, Inc., Sherrianne Hanavan was born in Vancouver, British Columbia but has lived in San Diego for most of her life. She is a graduate of the University of Phoenix with a Bachelor of Science in Business Management. Ms. Hanavan is an accomplished insurance claims professional with expertise in construction defect, general liability, personal injury, auto and property claims adjusting. Her claims experience includes over 30 years in the industry. For the last 16 years Ms. Hanavan has been involved in the management side of claims. Ms. Hanavan also holds adjusting licenses in over 40 states. She is a graduate of the FDCC Litigation College and the Graduate Litigation College.

David Harris, Esq., Field Counsel
Santana and Vierra, San Francisco, CA

David Harris is a Field Counsel with Santana and Vierra in San Francisco, California. Mr. Harris is a seasoned litigator, and has been lead counsel on complex, multi-party cases in federal, state and administrative courts. His focus is on construction defect and personal injury matters. In addition to his litigation strengths, Mr. Harris has many years of experience representing clients in mediation and pre-litigation settlement negotiations. Prior to joining Santana and Vierra, Mr. Harris was the Chief Legal Counsel for one of the nation's largest roofing and solar corporations. While Chief Legal Counsel, Mr. Harris handled a myriad of complex claims involving construction defects, mechanic's liens, performance and payment bonds, products liability, prevailing wage, and personal injury claims. In his capacity as Chief Legal Counsel, Mr. Harris personally litigated and resolved more than 500 cases. Mr. Harris began his legal career in San Francisco where he represented corporate and individual clients in construction defect, personal injury, insurance coverage, bad faith, employment & labor and contract matters. Mr. Harris is an avid cyclist, and is a certified spin instructor for the past 20 years.

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Seminar Speakers

Hon. Rex Heeseman (Ret.), Mediator
JAMS, Los Angeles, CA

Hon. Rex Heeseman (Ret.), after serving over nine years as a Judge of the Los Angeles Superior is at JAMS, Los Angeles, after serving over nine years as a Judge of the Los Angeles Superior Court. Following his graduation from Stanford Law School, he was an Assistant United States Attorney. Commencing in 1974, he practiced as a business litigator at private law firms and acted as an arbitrator and expert witness. Judge Heeseman actively manages the resolution of complex, multi-party construction disputes concerning owners, developers, general contractors, subcontractors and design professionals. His experience includes trials, arbitrations and mediations spanning a wide array of construction, construction defect, engineering and infrastructure disputes involving single family homes, public facilities, condominiums and high rise buildings. Judge Heeseman is widely known for his insurance expertise which he often applies to the resolution of construction matters. He coauthors The Rutter Group's *California Practice Guide: Insurance Litigation*. He frequently writes and lectures on insurance, construction and business torts topics.

Sandra Heiden, Senior Complex Claims Specialist
Navigators Insurance Group, Irvine, CA

Sandra Heiden is a Senior Complex Claims Specialist at Navigators Insurance Group. The Navigator's Group, Inc. is an international commercial property & casualty specialty insurance company. Sandra has over 25 years experience in the legal and claims industry. She has been in the Construction Defect unit at Navigators since 2011. Prior thereto, Sandra was a Claims Specialist at CNA and Lancer Claims, as well as several years as an insurance defense attorney. Her specialty has been multi-state construction defect wrap, subcontractors & developer's cases but she has extensively handled primary and excess commercial and personal lines complex casualty claims, stock broker/investment cases, fraud investigations, real estate, errors and omissions, excess/surplus lines and product liability cases. She is a graduate of UCLA (B.A., major- Music Education), and Western States University, School of Law. She holds adjusters licenses in all States.

Brian Kahn, Esq., Partner
Chapman, Glucksman, Dean, Roeb & Barger, LLP, Los Angeles, CA

Brian Kahn is a Partner with Chapman, Glucksman, Dean Roeb & Barger. His law practice focuses on complex civil litigation, large casualty losses, business and the representation of general contractors, developers, construction managers and design professionals throughout the state of California. He has trial, arbitration and mediation experience. Mr. Kahn earned his B.A. degree from the University of Southern California and his J.D. from Pepperdine University School of Law. While in school he became active in politics, working in various capacities for the U.S. Senate, Governor's office and the White House. Prior to joining Chapman, Glucksman, Dean, Roeb & Barger, Mr. Kahn practiced with various law firms, where his practice included complex litigation, construction litigation, insurance bad faith, toxic tort, business litigation and provided general business advice. Mr. Kahn is a returning speaker at West Coast Casualty's Construction Defect Seminar and continues to co-author Thomson Reuters' *Torts (California Civil Practice Series)*. He has also been a regularly contributing staff writer for multiple audio / video and home theater magazines. When not practicing law or writing, Mr. Kahn enjoys spending time with his family and does community work through Kiwanis International; sits as a Judge Pro-Tem in Ventura County; and serves as President of the Board of Directors of the Leonis Adobe Association, a non-profit educational group.

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Seminar Speakers

Lee A. Kantor, Esq., Partner
Hightower, Stratton, Novigrod, Kantor, West Palm Beach, FL

Lee was raised in the foothills of the Berkshire Mountains in Western Massachusetts. After graduating Cum Laude from the University of Massachusetts in Amherst, Lee went on to attend Loyola University New Orleans School of Law. He is a member of the Florida Bar and has been practicing trial law since 2005. Since joining Hightower, Stratton, Novigrod, Kantor, Lee has become an experienced trial attorney and has taken numerous cases to a successful jury verdict. Lee has been named as a SuperLaywer Rising Star for the defense of his corporate clients in bodily injury, trucking, construction defect and hospitality cases. Lee is the managing partner of the West Palm Beach office of Hightower and is the chairman of the firm's Business Development committee. During the booms and busts of past decade, Lee has defended his construction clients, both contractors and developers against claims of latent defect, construction site injury and contractual dispute. Additionally, Lee is the vice chair of the Construction Board of Appeals for the Village of Wellington. He enjoys giving back to the community in which his wife grew up and has warmly adopted him as one of its own.

Ken Kasdan, Esq., Senior Partner
Kasdan LippSmith Weber Turner LLP, Irvine, CA

Ken Kasdan is considered one of the nation's leading construction defect authorities who has achieved more than a billion dollars in settlements for his clients in the Western United States. He has practiced law for forty years and is the senior partner with Kasdan LippSmith Weber Turner LLP, established in 1992 where Kasdan is the founding and managing partner. Kasdan has been at the forefront of construction defect litigation with complex issues involving corrosion of building components, sulfate attack damage to concrete, soil subsidences, water intrusion, and wind-related damage. As a result of extensive litigation and multiple million-dollar verdicts and settlements, the construction industry has modified many of its procedures resulting in better, stronger and more durable concrete used through the Western United States. An important outcome for all. Well known in the national legal profession and a sought-after speaker on construction defect litigation, Kasdan is a member of the American Bar Association and the State Bars of California, Arizona, New Mexico and Hawaii, as well as the Consumer Attorneys of California (CAOC) and construction-related associations such as the American Concrete Institute (ACI) and the International Code Council (ICC). Among his many professional activities, Kasdan is a member in multiple states of the Community Associations Institute (CAI) and the Educational Community for Homeowners (ECHO). Kasdan earned his J.D. law degree from the State University of New York, at Buffalo, and a Bachelor of Arts degree, Cum Laude, from Bernard M. Baruch College of the City University of New York. Kasdan has been licensed to practice in California since 1976. Kasdan is rated AV-Preeminent by Martindale-Hubble, the highest rating achievable for both judicial skill and ethics. Since 2009 to the present, he has been selected for inclusion as a Southern California SuperLawyer.

Diane Kelly, Specialty Claims Consultant
Liberty Mutual Insurance Company, CA

Diane Kelly is a Specialty Claims Consultant for Liberty Mutual Insurance Company in the Southern California area. Diane is responsible for claims handling of serious and catastrophic claims in the National Market Division of Liberty Mutual. She has been with Liberty for over 39 years and has experience handling general liability, worker's compensation and property claims. Diane has held a variety of positions within Liberty Mutual's claims organization and currently handles defective construction claims across the country. Diane is a graduate of Cal State Fullerton.

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Seminar Speakers

Larry Kent, Esq., Founder
The Law Offices of Larry Kent, Long Beach, CA

Larry Kent founded the Law Offices of Larry Kent in 1998. The majority of the firm's practice involves the representation of owners of custom single-family homes. Graduating from University of California, Berkeley in 1983, Larry obtained his J. D. from Loyola Law School in 1986. He has been a speaker at seminars sponsored by West Coast Casualty, Lorman, MC Consultants, LiMa Solutions, the Southern California Defense Counsel, and the Building Industry Association. In addition, Larry has acted as an expert witness in multiple construction defect and legal malpractice cases and has served as a mediator in several single-family construction defect cases.

Keith D. Koeller, Esq. Founding Partner
Koeller, Nebeker, Carlson & Haluck LLP, Irvine, CA

Mr. Koeller is the founding partner of Koeller, Nebeker, Carlson & Haluck LLP. For the last 36 years, Mr. Koeller has focused his practice on the representation of developers and general both residential and commercial construction litigation. Mr. Koeller has handled significant claims concerning construction defect, construction delay, inverse condemnation, nuisance, bodily injury, and wrongful death. The firm currently has approximately 85 attorneys with offices in California, Nevada, Arizona and Florida. Mr. Koeller is AV-rated by Martindale-Hubbell. He is a Past Chair of the Orange County Bar Association, Construction Law Section. He has been named a Southern California Super Lawyer each year from 2009-2018. In 2003, he was awarded the Larry Syhre Commitment to Service Award at the West Coast Casualty Construction Defect Conference. Also, in 2009, he was awarded the prestigious Judge Jerrold Oliver Commitment to Excellence Award. Mr. Koeller has been an innovator in the development of alternative strategies for the resolution of construction defect claims and is a frequent speaker at leading industry seminars concerning important topics impacting construction litigation. Mr. Koeller and his wife have raised five children, served their church, coached numerous youth athletic teams, and enjoyed countless opportunities to serve others in their community

Kory Kruckenberg, Principal
California Construction Resolutions, Carlsbad, CA

Kory Kruckenberg has been in construction trades since 1981. He started working for his father as a finish carpenter and was "Offered up" to help in any and all trades. Kory's father felt that "Hands on" was the only way for him to get the full experience of the trades. Quickly moving through the ranks he began supervising crews on production homes at the age of 17. Mr. Kruckenberg received his general contractors' license in 1990 and founded K.K. West Contractors. Mr. Kruckenberg has been full time in the building trades for 37 years. He is still building custom homes and is directly involved in many post litigation repairs across the state of California. California Construction Resolutions was started by Mr. Kruckenberg in late 2006 and performs work in the litigation support field. California Construction Resolutions has been involved in over 400 cases representing homeowners, developers, sub-contractors, home owners' associations and many real estate non discloser cases. As an expert witness, Mr. Kruckenberg has testified in over 20 trials and binding arbitrations. He has been deposed 45 + times and attended countless mediations for the purpose of settlement.

Seminar Speakers

Hon. Sue Kurita, Judge
County Court at Law #6, El Paso, TX

Judge M. Sue Kurita is the presiding judge of El Paso County Court at Law Number Six since its creation in 1998. Prior to 1998, Judge Kurita served as a Municipal for the City of El Paso for 9 years, including 4 years as the Presiding Judge. Judge Kurita has served on the boards of Judicial Section of the State Bar of Texas, and on the National Association of Women Judges. She was elected Vice-President of the National Association for Women Judges and also served as the Chair for the New Judges Program for NAWJ. In 2010, the Texas Supreme Court appointed Judge Kurita to the State Commission for Judicial Conduct, where served as Vice-Chair from 2013-2015. In 2014, the Texas Supreme Court appointed Judge Kurita to the 9 member Grievance Oversight Committee. Judge Kurita was an official U.S. delegate to the 2004 Latin America Seminar on the 1980 Hague Convention Child Abduction Treaty. Judge Kurita was named the 2015 Outstanding Jurist by the American Board of Trial Advocates. Judge Kurita is an adjunct professor for Park University and Excelsior College, teaching military personnel and their families. She was named 2015 outstanding faculty member by Excelsior College. Judge Kurita received the inaugural 2013 Daniel H. Benson Public Service Award from The Texas Tech University School of Law Alumni Association. Judge Kurita is committed to furthering legal and judicial education. She is serving on the Texas Center for the Judiciary Curriculum Committee and is a frequent speaker at seminars including the National College on Judicial Conduct and Ethics; the Texas Association of Counties West Coast Casualty Construction Defect Seminar. Judge Kurita is a graduate of the University of Texas at El Paso (BA); Webster University; and Texas Tech University School of Law. Additionally, Judge Kurita is a graduate of the Defense Language Institute completing the Modern Greek Language Course. Judge Kurita has received certification in Criminal Law and Civil Law from the Texas Center for the Judiciary, Judicial College. Judge Kurita is certified as a Mediator and Arbitrator. Judge Kurita is one of the 100 women featured in JoAnne Gordon's recently published book "100 Happy Women at Work". Judge Kurita has received the City of El Paso Conquistador Award; and was named a Woman Trailblazer by the El Paso Bar Association.

Jim Kurkhill, Attorney and Litigation Consultant
Law Offices of Jim Kurkhill, Long Beach CA

Jim Kurkhill has concentrated his 25-year law practice on all aspects of construction law, including contract drafting, construction defect, project delay and change order disputes involving both commercial and residential projects. He has litigated construction cases from all perspectives, representing owners, developers, general contractors and design professionals with an emphasis on the resolution of complex and multiparty disputes. Mr. Kurkhill also serves as a consultant to other law firms assisting in developing case themes and presenting tech-heavy cases. He is a frequent speaker on a variety of topics, including how technology is changing the way lawyers practice, and managing & presenting complex construction cases. Mr. Kurkhill graduated with a B.S. in Optics from the School of Engineering and Applied Science at the University of Rochester, Rochester, NY in 1983. Prior to becoming an attorney, Mr. Kurkhill worked for seven years as an engineer in the laser industry. He received his J.D. from Pepperdine University in 1993.

Jill J. Lifter, Esq., Shareholder
Ryan & Lifter, San Ramon, CA

Jill J. Lifter is a shareholder of Ryan & Lifter in San Ramon, California and has been with the firm since January of 1986. She is AV rated by Martindale Hubbell. Ms. Lifter obtained her B.A. in Economics, *cum laude*, from the University of California, Los Angeles in 1982 and her J.D. from the University of Southern California in 1985. She is a member of the State Bar of California, the State Bar of Nevada, the Association of Defense Counsel of Northern California and Nevada (ADCNCN), and the Defense Research Institute. Ms. Lifter is the chair of the ADCNCN Construction Substantive Law Committee and also serves on its amicus committee, focusing on briefs and letters addressing construction law issues. Ms. Lifter's practice includes the defense of developers and general contractors, with primary emphasis on the defense of subcontractors, in construction defect cases. Ms. Lifter has tried several cases. She has published articles addressing construction defect issues in the *Defense Comment* magazine and has been a panelist for a number of presentations sponsored by The Association of Defense Counsel of Northern California and Nevada, the American Bar Association, Mealey's, Lorman, and the National Business Institute. Ms. Lifter received the ADCNCN's President's Award for Dedicated and Distinguished Service to the Association in 2017.

Seminar Speakers

Thomas Lether, Esq. Principal and Managing Shareholder
Lether & Associates, PLLC., Seattle, WA

Thomas Lether is the Owner and Managing Shareholder of Lether & Associates, PLLC. He has built his business with a simple approach: efficiency, client service, and results. Mr. Lether's primary clients include international and national insurance companies, smaller insurers and independent adjusting firms. He also represents contractors, property owners, and business owners. His practice predominantly involves complex insurance coverage disputes and extra-contractual claims. Mr. Lether is also involved in construction defect cases and has tried several to successful jury verdicts. His construction litigation background includes first party property claims, third party claims, and claims for contribution. Mr. Lether also serves as an appraiser and mediator and is a frequent lecturer on insurance related topics. Mr. Lether is licensed in the States of Washington, Oregon, Idaho, Alaska and in the Ninth Circuit Court of Appeals and the Federal Courts for the State of Washington, Oregon, Idaho, Alaska and Colorado. He has appeared in the majority of the Western States on a pro hoc vice basis, and provides coverage advice nationally and internationally. He is a licensed U.S. Merchant Marine Officer and is qualified to serve as an expert in maritime matters. Mr. Lether is a graduate of the University of Puget Sound and the University of Puget Sound Law School.

Steve Lokus, Western Regional Vice President, Casualty Claims
The Navigators Group, Inc., Irvine, CA

Steve Lokus has been with Navigators since 2012 where he is the Claims Manager of the Southern California Construction Defect unit which handles construction defects nationwide. He has handled and managed various claims including large commercial general liability claims on a primary and excess layer, claims within large SIRs and wrap policies with a focus on coverage, liability, risk transfer and litigation management. Prior to Navigators, Mr. Lokus was a Construction Defect Claims Supervisor at Fireman's Fund Insurance Company and Branch Manager for West Coast Casualty Service, Inc. He is a current member and corporate officer of the Construction Defect Claim Managers Association as well as a member of the Claims and Litigation Management Alliance (CLM).

John Lupfer, Esq. Director of Claims, Claims Counsel
Suffolk Construction Company.

John Lupfer is the Director of Claims, Claims Counsel at Suffolk Construction Company. Suffolk is one of the most successful privately held building contractors in the country. With annual revenue of $2.5 billion, Suffolk provides preconstruction, construction management, design-build and general contracting services to clients in the healthcare, science and technology, education, federal government and commercial sectors. Engineering News-Record ranked Suffolk #27 on its 2016 national list of "Top 400 Contractors." At Suffolk, John oversees a team of adjusters supervising a broad range of national claims. These claims arise out of numerous lines of coverage including general liability, workers compensation, pollution, professional liability, subcontractor default insurance, builder's risk, auto, and various wrap-up insurance programs. Prior to joining Suffolk, John worked at AIG managing complex, high exposure construction defect and coverage claims.

Julia W. Manganaro, Complex Claims Specialist
Navigators Insurance Company, Irvine, Ca

Julia has been promoted to cases with higher exposure and increased coverage and venue complexities. Julia a member of the new OCIP/WRAP Department, handling all lines of cases. She handles all aspects of investigation, evaluation, negotiation and settlement in Navigator's CD Unit. Her responsibilities include setting reserves, creating typed and detailed reports both for internal record and Large Loss Reports for supervisors and management. Computer skills in Excel, Access, MS Word, MS Office and Lotus Notes. Julia attends and proactively participates in all aspects of litigation such as MSC's etc. She is licensed in and handling claims in 18 states, in addition to California, Washington, Oregon, Nevada & Arizona. Julia has developed a familiarity with the CD industry including knowing and working with many judges / mediators, experts and defense counsel.

Seminar Speakers

Edward J. McKinnon, President
Claims Resource Management, Inc., Acton, CA

Ed McKinnon is President of Claims Resource Management, Inc., which he founded in 1988. He has forty-nine plus years of professional experience in the insurance industry. Ed attended University of Maryland and Merritt College. He is a member of IACP, formerly the Excess/Surplus Lines Claims Association, of which he is a Past President and former Board Member. Ed is also a Registered Professional Adjuster and an ARIAS U.S. Certified Arbitrator. He is currently a member of the Federation of Insurance & Corporate Counsel, having served as Chair, Vice Chair and Committee and Faculty Member. Ed has participated as a Panelist and/or Speaker on numerous panels and has published articles in various claims and defense periodicals. Ed has been retained as an Expert Witness in insurance related disputes in California and across the country.

Patrick J. Mendes, Esq., Partner
Tyson & Mendes, La Jolla, CA

Pat Mendes is a San Diego native. He is a graduate of the University of California, San Diego (B.A., *cum laude*, 1992) and the University of San Diego School of Law (J.D., *magna cum laude*, 1995). He has practiced law in San Diego since graduating from law school, obtaining considerable litigation experience with a national defense firm. In that capacity, he led the construction and insurance groups as a San Diego office partner. He co-founded Tyson & Mendes in 2002. At Tyson & Mendes, his specialty practice areas include construction, insurance coverage and professional liability. He has over 20 years' experience representing subcontractors and design professionals in construction defect and construction related claims.

Mark McGivern, CEO
The CCA Group, New York, NY

Mr. McGivern is the CEO of The CCA Group, a national consulting firm that provides Architectural, Engineering, and Construction services related to design, forensics, troubled projects, and litigation. Over the past 20 years, Mark has provided expert testimony in hundreds of construction defect cases nationwide in State, Federal and Arbitration Venues related to construction practices, standard of care, costs, scheduling, and safety. Prior to co-founding CCA in 1990, Mark spent 13 years working in design/build, working his way up from field operations, to managing mid to large scale commercial and residential projects. He has been a featured speaker, and a panelist at numerous construction conferences around the US. He has been interviewed on Nightline, Good Morning America, and various local programs regarding residential construction defects issues. Mr. McGivern resides in New York City.

Joseph R. Miele, Jr. Esq., Partner
Kaufman Dolowich & Voluck, LLP, Fort Lauderdale, FL

Mr. Miele began his career twenty five years ago when admitted to the New Jersey Bar in 1991. He first worked as a Home Office Supervisor for AIG in New York overseeing Environmental and Toxic Tort coverage litigation on behalf of member companies nationally. He was admitted to the New York Bar in 1992 and the District of Columbia Bar in 1994. Following his tenure at AIG Mr. Miele entered private practice as a coverage and "bad faith" associate. Mr. Miele relocated to Florida and was admitted to the Florida Bar in 2000. Throughout his entire career, Mr. Miele has concentrated in representing insurers in complex coverage and claim handling disputes. He has particular expertise in Construction Defect, First Party, Environmental/Toxic Tort and Employment Liability coverage and "bad faith" claims. Mr. Miele has appeared in hundreds of insurance coverage and "bad faith" claim handling proceedings in both the trial court and on appeal. He also represents insurers in Department of Insurance investigations. Mr. Miele frequently lectures and counsels insurers on insurance coverage law and proper claim handling practices. He received his Juris Doctorate degree from New York Law School in 1991 and a Bachelor of Science in Business Administration from Seton Hall University in 1987.

Seminar Speakers

Anthony L. Miscioscia, Esq., Partner
White and Williams, Philadelphia, PA

Anthony Miscioscia has a broad range of experience in complex insurance coverage, bad faith and commercial litigation matters. He is a knowledgeable and experienced coverage attorney and litigator who provides cost-effective, proactive advice to clients in the hopes of avoiding or minimizing litigation, and tenaciously represents clients in suit when needed. Having nearly 25 years representing major property and casualty insurers and smaller regional insurance companies on a national and regional basis, insurance company clients look to Tony for advice on a number of complex and emerging issues, including advertising injury/intellectual property, construction defect, legal, accounting and other professional liability, food contamination/product recall, environmental liability, educator's legal liability, employment discrimination, and employee benefits coverage and bad faith claims. As a counselor, Tony advises his clients concerning their rights and obligations with respect to a variety of claims and different types of liability insurance policies, assists clients in evaluating and mediating claims, and identifies potential additional sources of recovery and/or contribution for defense or indemnity that may be owed to a particular insured. When insurers find themselves at odds with their insureds, claimants and/or other carriers, insurers count on Tony to zealously represent their rights and interests in various state and federal courts, as well as in private arbitrations and mediations. Tony regularly defends insurance clients against bad faith, breach of contract and declaratory judgment claims, as well as represents clients in commencing and prosecuting affirmative actions for declaratory relief, reimbursement and/or contribution. Tony also represents insurance company clients in intervention proceedings, allowing the insurers to have a say in shaping the jury verdict sheet or jury interrogatories that may lead to a verdict against an insured –so that the insurer can better allocate any indemnity between potentially covered exposure and uncovered amounts. In addition to representing clients in the insurance industry, Tony also represents commercial clients in litigation and arbitration involving business and commercial disputes.

Phyllis Modlin, Claims Manager
Markel, Woodland Hills, CA

Phyllis Modlin is a Claims Manager with Markel in Woodland Hills, California. Ms. Modlin received her B.A. degree from University of California at Santa Barbara and her J.D. degree from University of California, Hastings College of the Law. She manages a unit handling construction claims under both primary and excess policies on a nationwide basis. She also serves as a claims advocate to underwriting for risk assessment, program and business development. Ms. Modlin is proficient in all aspects of claims handling and management, including damage, liability and coverage issues, reserving, risk transfer, auditing, litigation management and expense control measures.

Andrew Morgan, Esq., Partner
Borton Petrini, LLP., Bakersfield, CA

Andrew Morgan is a partner at Borton Petrini, LLP. He specializes in defending homebuilders, general contractors and subcontractors in complex construction defect litigation. He is the attorney for the builder in the California Supreme Court case *McMillin Albany v. Superior Court*. Mr. Morgan briefed and argued the case both at the Fifth District Court of Appeal and at the California Supreme Court. In addition to his appellate and construction defect practices, Andrew also practices general business litigation, and has significant experience prosecuting and defending contract, partnership, shareholder, employment, trade secret and land-sue disputes.

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Seminar Speakers

Tracy Myers, AIA, NCARB, GC, RRO, LEED AP, Senior Architect
Lombard Consulting Service, Huntington Beach, CA

Tracy Myers is a senior architect and general contractor with over 25 years of broad experience in architectural design, project management, construction administration, forensics, and property loss consulting. She specializes in expert witness testimony related to architectural and general construction issues, personal injury defect and accident investigation, building envelope investigation and repair including waterproofing, roofing and fenestration, property loss evaluations, code upgrade reviews, peer review and quality assurance services. Ms. Myers has provided forensic and consulting expertise on a variety of project types including single and multi-family residential, industrial, health care, hospitality, office, commercial and shopping centers. She has provided deposition and arbitration testimony, participated in mediations and joint expert exchanges, directed field investigations, prepared reports and repair scopes, analyzed construction defect allegations, and performed standard of care evaluations. She has also served as architect of record on repair/reconstruction projects.

Paul Nolan, Esq., Managing Partner,
Wood, Smith, Henning & Berman, LLP, Rancho Cucamonga, CA

Paul Nolan is a litigation attorney with 20 years of experience in all facets of litigation. He is the managing partner of the Rancho Cucamonga office of Wood, Smith, Henning & Berman. His practice involves a range of complex litigation, with specialization in the areas of construction, general liability, premises liability, transportation, and business litigation. Paul's experience in these various areas of the law have allowed him to develop practical solutions and recommendations for clients in all litigation forums, including litigation prevention and risk management. An experienced trial lawyer, Paul is also adept in all aspects of dispute resolution, including mediation and arbitration, and is widely recognized by national and global developers and contractors, including Fortune 500 companies, for his results.

William Noonan, North America Construction Industry Leader
Willis Towers Watson,

William (Bill) Noonan is the North America Construction Industry Leader and leads the National Construction Practice for Willis Towers Watson. Prior to this position Bill was the Executive Vice President and Construction Practice Leader for the Willis Towers Watson Atlantic and South Region. Bill provides strategic account oversight and serves as a resource to many clients throughout North America. Bill is often a featured speaker at many industry events and was the winner of the IRMI "Words of Wisdom" award in 2014. Prior to Willis Towers Watson, Bill worked for an ENR Top 20 Construction Management firm as the Sr. Vice President of Risk Management and prior to this as a Regional Director for an ENR Top 5 Construction Management firm. Bill has spent a good amount of time in the large residential condominium space and provides advice to owners, developers, and builders regarding the exposure on these projects. He has been able to take his experience resolving large complex construction defect claims to build better contract and risk strategies at the start of projects.

Rosemary K. Nunn, Esq., Partner
Gordon & Rees LLP, Irvine, CA

Rosemary Nunn has twenty years of experience as a commercial litigator with a specialty in construction law. Ms. Nunn has represented owners, developers, design professionals, contractors and subcontractors on numerous and varied public and private projects. She counsels clients through every aspect from contracting to litigation, including: early assessment and minimization of liability exposure and risk; cost-effective dispute resolution; project counseling to work through claims and disputed change order requests; strategy development for crafting a winning defense or prosecution; negotiating payment on projects with distressed parties, funding or bankrupt entities; and litigating cases through resolution via mediation, arbitration, or trial.Ms. Nunn has extensive experience in multi-party litigations enabling her to act as a key liaison between clients, opposing counsel, public entities and officials, various experts, and joint defense or prosecution teams.

Seminar Speakers

James J. Orland, Esq. Principal
Orland Law Group, Manhattan Beach, CA

James J. Orland received a Bachelor of Arts degree in both Political Science and Spanish in 1989 from the College of the Holy Cross. He received his Juris Doctorate from Loyola Law School in 1992 and was admitted to the California Bar in December of that same year. Mr. Orland is also admitted to practice in Federal District Court and is a member of the United State Court of Federal Claims. Mr. Orland is also a member of the Utah State Bar. Mr. Orland has extensive experience representing developers, general contractors, homeowners, manufacturers and subcontractors in complex construction defect litigation matters. Mr. Orland's area of practice also includes general liability, personal injury, products liability, business disputes and inverse condemnation. Mr. Orland has also successfully defended wrongful termination, wage and hour loss claims and trucking and transportation matters. He has handled litigation matters from their inception through trial and ultimately resolution on appeal. Mr. Orland is frequently a guest lecturer at national construction defect litigation seminars and has provided litigation training for attorneys and consultants in the construction defect field. Mr. Orland is a member of the Los Angeles County Bar Association, the South Bay Bar Association, and the Association of Southern California Defense Counsel. Mr. Orland is also a member of the American Board of Trial Advocates (ABOTA).

John Osorio, Esq, Chair
Marshall Dennehey Warner Coleman & Goggin, Philadelphia, PA

John serves as chair of the Architectural, Engineering & Construction Defect Litigation Practice Group at Marshall Dennehey Warner Coleman & Goggin. Over the past 20 years, he has handled more than 500 matters in the defense of architectural and engineering firms, general contractors, subcontractors, developers, and owners in litigation matters involving personal injury and property damage. John graduated from the University of Montana in 1979 with a Bachelor of Arts in history and political science. He then went on to receive his juris doctor from Southwestern University School of Law in Los Angeles, California.

Mark L. Parisi, Esq., Partner
White and Williams's, Philadelphia PA

Mark is a partner in White and Williams's Litigation Dept., located principally in the Philadelphia office. Mark is a member of the firm's Construction and Surety Practice Group. Mark's practice gravitated very early on to construction litigation. At first, he worked mostly on construction accident cases. Later, he developed proficiency in construction defect litigation which is now his main focus. Clients call upon Mark to handle significant matters coast to coast – 17 states and counting. He has extensive experience in EIFS and conventional stucco litigation, moisture intrusion cases, mold cases and matters involving all manner of structural issues, concrete issues and sinking buildings relative to both commercial and residential construction. His thorough understanding of construction contracting issues, the mechanics of construction and project management, and construction law enables him to handle litigation involving the entire universe of construction defect and construction accident claims. Mark represents commercial and residential owners, general contractors, construction managers, engineers and architects, subcontractors and construction material manufacturers and suppliers.

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Seminar Speakers

John Podesta, Esq. Partner
Wilson, Elser, Moskowitz, Edelman and Dicker LLP, San Francisco CA

John Podesta is a partner with Wilson, Elser, Moskowitz, Edelman and Dicker in their San Francisco office. In his 25 year legal career, he has engaged in national trial counsel, mediation and litigation management in state and federal courts throughout California and in Nevada, Colorado, Oregon and Washington. John focuses his practice in the areas of insurance coverage and bad faith, business litigation, land development and general civil litigation. His command of the business cycle, from drafting contracts and agreements to risk management and insurance advisory to construction and wrap-up matters, to insurance recovery and contribution matters, makes him uniquely situated for construction defect related insurance issues and "outside of the box" resolution strategies for policyholders and insurers.

Paloma Ramirez, Esq., Senior Counsel
Tyson & Mendes, LLP, San Diego, CA

Paloma Ramirez has specialized in the defense of general contractors, subcontractors and materials suppliers in construction defect and other construction related claims for over 15 years. As an aggressive litigator and a savvy negotiator, Ms. Ramirez has achieved extremely favorable settlements in hundreds of claims, ranging from minimal exposure to exposure in the millions. Ms. Ramirez is a 2001 graduate of the Southwestern University School of Law where she was on the Board of Governors for the Moot Court Honors Program. She completed her undergraduate studies at UCLA in 1996 with a Bachelor of Arts degree in Sociology.

Scott D. Rembold, Esq. Founding Partner
Rembold Hirschman, Coral Gables, FL

Scott D. Rembold is a founding partner of Rembold Hirschman, an insurance, construction, and business litigation firm with offices in Miami, West Palm Beach, and Naples, Florida. Mr. Rembold focuses his practice primarily on the construction industry, representing contractors and subcontractors both directly and through their insurers as assigned defense counsel. Mr. Rembold and his firm also have extensive experience handling general liability claims on behalf of insureds, as well as complex commercial litigation matters. Mr. Rembold has also served as outside general counsel for the South Florida Associated General Contractors and the American Society of Professional Estimators. Mr. Rembold is AV® Preeminent rated by Martindale-Hubbell, and has been named a Top Rated Lawyer in Construction Law by American Lawyer Media, a Top Attorney by the South Florida Legal Guide, "Legal Elite" by Florida Trend magazine, and has been named on the list of the Top 100 Lawyers in Florida by SuperLawyers in both 2016 and 2017. Mr. Rembold is Board Certified in Construction Law by the Florida Bar and earned the Certified Litigation Management Professional (CLMP) designation.

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Seminar Speakers

Elizabeth K. Rhode, Esq., Partner
Gillaspy and Rhode, PLLC, Portland, OR

Ms. Rhode's practice is focused on complex litigation with an emphasis on construction defect, property damage, product liability, personal injury and other insurance defense work. For the last ten plus years, she has represented developers, general contractors, design professionals and subcontractors in matters before the Superior Courts and Arbitration Services throughout Washington and Oregon. She has extensive experience in disputes involving multi-family, single family, and commercial properties and has handled multiple cases involving earth movement and subterranean water sources. Ms. Rhode has been a Partner since May 2013 and manages the firm's Portland office. Ms. Rhode is licensed and actively practicing in the states of Washington and Oregon and in the United States District Court for Oregon. Additionally, she is the Professional Education Programming Chair for the Portland branch of the National Association of Women in Construction. Ms. Rhode has a BS in civil engineering, which enhances her ability to work with clients, counsel, and experts on legal and technical matters. Her JD was earned at Seattle University School of Law.

Karen Rice, Vice President - Head of Construction Claims Operations
XL Catlin, Los Angeles, CA

Karen Rice is the Head of Construction Claims, Americas for XL Catlin out of Los Angeles, CA. She supports several business units, including Construction, Excess Casualty, and Surplus Lines. Prior to joining XL in 2011 she was the National Construction Defect Claim Manager for OneBeacon Insurance (OBI), and the AVP of National Construction Defect claims and Western States ACE Risk Management claims with ACE USA. Ms. Rice has sat on the DRI Construction Law Steering Committee for the past several years, and is on the Construction Advisory Board for CLM. She is also on the advisory board for ALFA International Construction Committee and has been a frequent lecturer at various Construction and Insurance Law seminars throughout the country, including Defense Research Institute, Association of Southern California Defense Counsel, West Coast Casualty Annual Construction Defect Seminar, HB Litigation Construction Law, and the American Bar Association. Ms. Rice earned her Bachelors degree from University of California at Santa Barbara and her Masters in Business Administration from the University of LaVerne.

Mary Rowe, Construction Defect Claims Manager
Markel, Red Bank, NJ

Mary Rowe is one of the Construction Defect Claims Managers for Markel Corp where she manages a department that handles all Construction Defect Claims nationwide. Markel has CD examiners in California, Virginia, Arizona, Deerfield and New Jersey that report to her. She has held a number of claims management positions for the last 30 years.

Jack Rubin, Esq., Senior Associate
Newmeyer & Dillion LLP., Newport Beach, CA

Jack Rubin is a senior associate with Newmeyer & Dillion LLP. His practice is largely focused on representing homebuilders, developers, and general contractors in complex, multi-party construction defect and insurance disputes. Mr. Rubin has experience handling a broad spectrum of construct defect litigation matters in a variety of different insurance contexts. He specializes in finding creative solutions to meet his client's unique goals for each case, including through effective use of the prelitigation procedures in the Right to Repair Act and Calderon Act.

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Seminar Speakers

Hon. Nancy M. Saitta (ret), Mediator, arbitrator, special master, consultant, private judge
ARM, Las Vegas, NV

Nancy Saitta is a former Justice of the Nevada Supreme Court having served as a member of the judiciary for 20 years. She began her judicial career in 1996 when she was appointed as a Las Vegas Municipal Court Judge. Two years later, she was elected a judge in the 8th Judicial District Court. During this time, she created the specialized Complex Litigation Division for streamlined case management of construction defect and other significant matters. Her work received national recognition. Justice Saitta was elected to the Supreme Court and served as Chief Justice from 2011 to 2012 and then retired from public service in 2016. She also served as co-chair of the Commission on Statewide Juvenile Justice Reform and chaired the Nevada Court Improvement Program. Prior to taking the bench, Justice Saitta was a senior deputy attorney general where she served as the Children's Advocate for the State of Nevada. Her commitment to children has permeated through her entire career and still remains a focus today. Her efforts benefiting children has won her recognition and national awards. In addition to being an attorney and judge, Justice Saitta has embraced her role as a teacher throughout much of her adult life. In 2016, Justice Saitta retired from public service to focus on developing a private ADR practice with a focus on complex matters.

Ed Schmitt, Esq. Partner
Koeller, Nebeker, Carlson & Haluck LLP, Irvine, CA

Mr. Schmitt enjoys the challenges of assisting clients achieve solutions to complex problems within the circumstances of the clients' goals in the marketplace and the constantly evolving statutory and case law. Hard work and creativity are necessary to keep all factors in mind while working toward solutions that protect the clients' immediate interests in litigated matters and complement the long-term vision clients may have with the business relationships they value. Mr. Schmitt maintains a varied practice, which includes construction law (primarily the defense of general contractors and developers), contracts, torts, insurance and general civil matters. Mr. Schmitt is a frequent speaker at seminars involving construction practice. He trained as a mediator through the Strauss Institute at Pepperdine University. Prior to attending law school, Mr. Schmitt worked in the sport fishing business in southern California. He has resided in the Dana Point-San Juan Capistrano portion of south Orange County for the entirety of his 34 year legal career and has served for many years on the boards of the homeowners associations where his family has resided. He is a member of the Association of Southern California Defense counsel and the Ocean Institute of Dana Point, In his time away from the practice, Mr. Schmitt enjoys coaching youth activities, political humor, boating, camping and shooting sports. He enjoys fishing all types of water. He finds special rewards in teaching kids about the art and responsibility of outdoor recreation and preserving the resources that allow us to enjoy our California environment.

Todd Schweitzer, Assistant Vice President
Zurich American Insurance, San Diego, CA

Todd Schweitzer is the Assistant Vice President and is responsible for the management of Major Case and Professional Liability claims as part of Zurich American Insurance Company's Latent and Environmental Claims group. Prior to joining Zurich in July 2008, he worked for Travelers for nineteen years serving in multiple managerial and technical capacities. His professional experience over the last twenty nine years includes both handling and managing claims involving construction defect, professional liability, general liability, products liability, premises liability, auto, and medical malpractice exposures. He has extensive litigation management and legal audit experience. Mr. Schweitzer has lectured extensively on various construction, insurance and claim related topics to attorneys, construction professionals, agents, brokers and insurance industry professionals, including The Association of Southern California Defense Counsel, West Coast Casualty Construction Defect Conference, Defense Research Institute, Utah Association of General Contractors, CLM, Willis Construction Risk Conference and the MC2 Construction Defect Conference. He received his B.A. in Finance with a minor in Accounting from Western Connecticut State University (1987) and the Chartered Property Casualty Underwriter (CPCU) designation (1995). At the 2009 West Coast Casualty Conference, he received the Larry Syhre Commitment to Service Award. He is a current member of the Construction Defect Claim Managers Association and the CLM Construction Advisory Board.

Seminar Speakers

Richard Seely, Esq.
Skane Wilcox, LLP, Los Angeles, CA

Rick Seely is an attorney with 20 years of experience representing various contractors, subcontractors and engineering professionals throughout California. Favorable verdicts, defense awards, proper settlements, and timely reports have all occurred under Rick's representation of his clients. Rick recently successfully defended a general contractor in a construction defect jury trial; and obtained a defense award for a subcontractor in a complex construction defect arbitration. Rick is a returning moderator and speaker at this seminar, as he moderated the "Occupy Crawford" presentation in 2012; presided over the discussion panel for "Zero Dark Subcontractor" in 2013; and helmed the "Guardians of the Subcontractor Galaxy" panel in 2015. He is a proud alumnus of U.C. Riverside, the Mighty Highlanders.

Jay Russell Sever, Esq. Partner
Phelps Dunbar, LLP, New Orleans, LA

Jay Russell Sever is a partner in the Insurance and Reinsurance group of Phelps Dunbar. He is also the Practice Coordinator for the Insurance and Reinsurance group in the New Orleans office. He serves as local, regional and national coverage counsel for both foreign and domestic insurance companies. He counsels clients, manages disputes and tries cases involving a wide variety of insurance coverage issues, including matters arising from bad faith, construction defect claims, third-party liability claims, first-party claims, professional liability claims, crane and rigging claims, racing and competitive sport claims, entertainment claims, transportation claims, environmental claims, general and toxic tort claims, advertising, copyright and trademark claims, media liability claims, multiple-year trigger and allocation issues, marine liability claims, Louisiana direct action claims and numerous others. In addition to handling cases in Louisiana and California courts in which he is admitted, Jay also has acted as lead counsel in cases pending in Alabama, Florida, Georgia, Illinois, Indiana, Kentucky, Mississippi, New Jersey, New York, North Carolina, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Virginia and Washington. Jay's practice, both litigation and counseling, involves attorneys from all of Phelps Dunbar's offices in the Gulf South and, where necessary, local counsel in states throughout the United States.

Honorable Ronald L. Styn, Judge
San Diego Superior Court, San Diego, CA

Honorable Ronald L. Styn was appointed to the San Diego Superior Court in April 2000. For the last fifteen years he has been in an Independent Calendar Department handling civil cases. He handles all of the construction defect cases filed in San Diego as well as every other kind of civil case. Judge Styn graduated from the University of Redlands and Stanford Law School where he was on the Board of Editors of the Stanford Law Review. After Law School he clerked for the Honorable James M. Carter, United States District Judge, worked as a trial attorney for the Department of Health, Education and Welfare, Food and Drug Division and was an Assistant Professor at the University of Kentucky College of Law. Returning to San Diego in 1969 he was in private practice doing business and real estate litigation until he was appointed to the Superior Court. He is an original Master of the Welsh Inn of the American Inns of Court and served as its President from 2002 to 2008. He also was an original member of the Board of Governors of the Association of Business Trial Lawyers, San Diego and served as its President.

Seminar Speakers

Hon. Peter B. Swann, Vice Chief Judge
Arizona Court of Appeals

Honorable Peter B. Swann was appointed to the Arizona Court of Appeals in 2008, and currently serves as Vice Chief Judge. From 2003-2008 he was a judge of the Maricopa County Superior Court, where he served in the Civil and Family Departments. From 2006-2008, he served as Associate Civil Presiding Judge and helped develop the court's electronic filing system. As an attorney in private practice in Phoenix at Steptoe & Johnson, LLP, he represented clients in commercial and constitutional litigation and commercial transactions. Judge Swann received his law degree from University of Maryland Law School, where he graduated first in his class in 1991. After serving as a law clerk to the Hon. Norman P. Ramsey in the United States District Court for the District of Maryland, he became a member of the State Bar of Arizona, receiving the highest score on the Arizona bar exam. He served six years on the Ethics Committee of the State Bar of Arizona, has served for the past 10 years on the Committee on the Rules of Civil Procedure and now serves on its Professionalism Committee. In 2013 and 2014, Judge Swann served on a committee tasked with rewriting the Arizona Rules of Civil Appellate Procedure, and in 2015 and 2016 served on the Supreme Court's Civil Rules Restyling Task Force. In 2016 and 2017, he served on the Supreme Court's Civil Justice Reform Comission. In 2008, Judge Swann was named "Judge of the Year" by the Phoenix Chapter of the Arizona Board of Trial Advocates. In 2016, Judge Swann was named "Judge of the Year" by the Arizona Supreme Court. Judge Swann frequently serves as a mediator in both appellate and trial court matters.

John Thompson, Vice President, Branch Manager
HDI-Gerling America Insurance Company, Glendale, CA

John Thompson, a California native, began his insurance career in 1982 with AIG, followed by 13 years with CIGNA Property and Casualty. John joined Gerling America Insurance Company in 1999 and in 2007 the company merged with "Haftpflichtverband der Deutschen Industrie" and is now HDI Global Insurance Company, with US headquarters in Chicago, Illinois. HDI Global provides insurance solutions for medium to large commercial and industrial clients with complex risks around the world. Mr. Thompson is currently a Vice President and is the Branch Manager in the Glendale, California office. Mr. Thompson supervises product liability, general liability, toxic tort, transportation, habitation, workers compensation and property damage claims, in all of the states. John holds multiple licenses as required by the different State Insurance Departments and is involved with overseeing the Special Investigation Unit. Mr. Thompson was a past recipient of the Larry Syhre Award for claims handling. Mr. Thompson has also been invited to speak at numerous seminars on a variety of topics.

Linda Tonkovich, Large Loss Specialist
Gallagher Bassett Services, Inc., Aliso Viejo, CA.

Linda Tonkovich is a Large Loss Specialist for Arch Insurance at Gallagher Bassett Services, Inc. in Aliso Viejo, CA. She is responsible for the handling of large, complex construction defect claims for major contractors across the United States. In addition to commercial and residential construction claims, her experience over the past thirty-four years includes handling claims and coverage issues involving General Liability, Products Liability, Professional Liability, Errors and Omissions, Employment Practices and Intellectual Property exposures. Prior to Gallagher Bassett, her work experience was at OneBeacon, Fireman's Fund and Aetna Casualty. She is the current Chair of the Speakers and Topics Committee for the Annual West Coast Casualty Construction Defect Seminar. She also is the current Treasurer for the Construction Defect Claim Managers Association (CDCMA). She earned her bachelor's degree at California State University, Fullerton. She holds active adjusting licenses in 34 states.

Seminar Speakers

Sheila Totorp, Esq., Partner
Clausen Miller, Irvine, CA

Sheila Totorp is a partner at Clausen Miller in Irvine. She has over 15 years of wide-ranging litigation experience defending construction professionals, businesses and insurance companies throughout California. The last five years of Sheila's practice has been focused on defending contractors and subcontractors in construction defect litigation. From the claim process, through mediation, arbitration and trial, Sheila strategically evaluates each case to ensure her clients' needs are met. She recently received a favorable jury verdict in defense of her client in a 3-week construction defect trial and successfully obtained summary judgment in favor of her client, a construction manager. Sheila graduated from San Diego State University and received her Juris Doctor from Southwestern University School of Law.

Wilson Townsend, Vice President of Claims
The RiverStone Group, Manchester, NH

Wilson Townsend is a Vice President of Claims of The RiverStone Group ("RiverStone"). RiverStone is a provider of RiskSmart Run-Off solutions and a member of Fairfax Financial Holdings. Over a thirty year career in claims including 19 years in management, Mr. Townsend has handled or managed most commercial general liability lines of business including, Construction Defect ("CD"), Commercial Auto, Errors & Omissions ("E&O"), and Directors and Officers claims, as well as primary and excess workers' compensation claims. Over the last 17 years at RiverStone he has served in several management roles including the direct supervision of claim professionals, as a Technical Claim Manager, and as a manager with responsibility for multiple units handling multiple lines of business. Mr. Townsend has lead and managed profitable acquisitions, served as Business Lead a two year business and technology transformation initiative, and remains involved in strategic corporate initiatives addressing risk and loss mitigation. A 1987 graduate of University of Massachusetts at Amherst Mr. Townsend earned a B.A. in Political Science. He also earned a Senior Claims Law Designation (SCLA) from the American Educational Institute.

Jon Turigliatto, Esq., Partner
Chapman, Glucksman, Dean, Roeb and Barger, LLP, Los Angeles, CA

Mr. Turigliatto is a Partner with Chapman, Glucksman, Dean, Roeb & Barger. He received his undergraduate degree in political science from the University of California, Irvine in 1989. He earned his Juris Doctor degree from Southern Methodist University School of Law in 1993. He was an extern law clerk to the Honorable A. Andrew Hauk, United States District Court for the Central District of California, in 1992. Mr. Turigliatto is admitted to the State Bar of California, United States District Court for the Northern and Central Districts of California, United States Court of Appeal for the Ninth Circuit, and United States Supreme Court. His practice focuses on the representation of the developers and general contractors in complex multi-party construction litigation, products liability, and commercial/business litigation. He also counsels owners and contractors in the drafting and negotiation of construction agreements. Mr. Turigliatto has trial, arbitration and mediation experience. He is a contributor to Chapman, Glucksman, Dean, Roeb & Barger's National Construction Risk Management Handbook. He has been a speaker and author on issues related to construction and real estate, including events sponsored by West Coast Casualty, the Association of Southern California Defense Counsel, Quality Built, and Lorman. He enjoys spending time with his family and supporting his children's high school soccer and sailing teams.

Seminar Speakers

Barry Vaughan, Esq., Mediator and Arbitrator
IVAMS Mediation & Arbitration Service, Rancho Cucamonga, CA

Barry Vaughan serves as a neutral with IVAMS Arbitration & Mediation Services based in Rancho Cucamonga, California. A graduate of the University of Chicago Law School, Barry has over 32 years' experience as a practicing attorney, during which time he represented both plaintiffs and defendants in hundreds of complex construction defect cases. He is an experienced trial and appellate lawyer, with several reported appellate decisions to his credit. Since opening his mediation practice in 2014, he has successfully resolved a wide variety of litigated cases including but not limited to construction defect disputes. This will be Barry's 14th year as a speaker at West Coast Casualty.

Joseph Vogel, Claims Director, Construction Defect Claims
Chubb, San Francisco, CA

Joseph Vogel is a claims director with Chubb Insurance Company's construction defect claims group. He is responsible for managing and resolving claims with large exposure throughout the United States. Joseph has extensive experience evaluating coverage under general liability policies, including practice policies, project policies, and policies issued as part of a controlled insurance program. Prior to joining Chubb in 2016, Joseph practiced law in California as a coverage attorney representing insurers in coverage disputes and litigation.

Bruce Wick, Director of Risk Management
CALPASC, Redlands, CA

With over 25 years of risk management experience, Bruce Wick is an industry leader and educator on issues critical to the construction industry. His expertise in the areas of workers' compensation, Cal/OSHA, construction defect, general liability and workplace safety make him a frequently sought presenter throughout California. His most recent seminars cover topics such as SB 800, Cal/OSHA and safety programs as well as claims handling for general liability and workers' compensation. Mr. Wick currently serves as Director of Risk Management for the California Professional Association of Specialty Contractors (CALPASC), an association of 500 specialty contractors and suppliers for the construction industry in California. Additionally, he sits on several Cal/OSHA advisory committees and has been instrumental in the area of improved protection against falls on construction sites.

J. Lee Wright, Assistant Vice President
Arch Insurance

Lee Wright is an Assistant Vice President at Arch Insurance and responsible for the company's construction defect claims operations. He currently sits on CLM's Construction Advisory Board and is a past Dean of the Claims College School of Construction Claims. He is also a past President of the Construction Defect Claim Manager Association. He founded and manages the Construction Defect Claims & Coverage Group on Linked which currently has more than forty five hundred members from around the world. He has thirty plus years of experience focusing on large, complex litigation files involving products, transportation and construction risks and has overseen national claims programs for self-insureds and foreign insurers. He has acted as a Regional Training Coordinator for a major insurer, is an approved CE instructor in several states and conducts seminars and classes on insurance coverage and risk transfer issues. Lee has a B.S. in Liberal Studies from Middle Tennessee State University as well as having earned the Certified Litigation Management Professional, Associate in Management, Master Certified Special Arbitrator, Certified Claims Professional and Construction Risk and Insurance Specialist designations.

Seminar Speakers

Chelsea L. Zwart, Esq.
Chapman, Glucksman, Dean, Roeb & Barger, Los Angeles, CA

Ms. Zwart grew up in Sonoma County, California where she worked for her family's construction company. She graduated from UCLA with a Bachelor of Arts in Sociology in 2010 and earned a Certificate in Construction Management from UCLA Extension in 2011. Ms. Zwart began working at Chapman, Glucksman, Dean, Roeb & Barger in 2014. In 2015, she earned a Juris Doctor with a Concentration in Civil Litigation from Loyola Law School and was admitted to the State Bar of California. Ms. Zwart regularly authors articles on trending topics for inclusion in CGDRB's publications and is heavily involved in the annual production of CGDRB's National Construction Risk Management Handbook and the creation of various continuing education presentations on Green/LEED, Right to Repair Statutes, and other significant construction topics. She has presented on various topics including Medical Liens, Conditional Policy Limits Demands, Automobile Dealership Errors and Omissions. She also has had articles published in AmWINS, the Los Angeles Daily Journal, and the Construction Defect Journal. She also still volunteers as an Alumni Mentor for the Loyola Law School Young Lawyer's Program.

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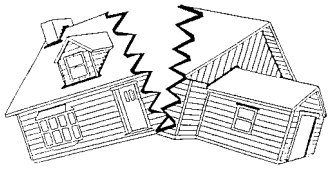

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May 16th, 17th and 18th 2018
The Disneyland Resort Hotel
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It is with great pleasure that West Coast Casualty, the Speakers and Topics Committee, our speakers, vendors and guests of this year's seminar applaud the generosity, kind spirit and good nature of the following organizations who have supported West Coast Casualty's Buy A Banner Support A Charity program by giving so generously and whose banners hang in the halls of the seminar today.

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Mr. Bremer is a founding member and Senior Partner of Bremer Whyte Brown & O'Meara, LLP, a full-service law firm with nine full-service offices throughout the Western US. Keith has been identified by the well-recognized Los Angeles Daily Journal as one of California's top 100 Attorneys. He is a top 50 attorney in Orange County and has also been named as one of America's top 100 attorneys. He is a member of the prestigious American Board of Trial Advocates (ABOTA), he is an AV-rated attorney by Martindale-Hubbell and voted Super Lawyer on multiple occasions.

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The CCA Group is proud to be the 2018 Construction Defect Seminar Lunch sponsor again this year and it is our pleasure to announce that Mark McGivern, CEO of The CCA Group, will be speaking at the conference on Wednesday, May 16th from 3:30 PM – 4:30 PM: **East Coast Meets West Coast – Hot Construction Defect Issues and Coverage Cases from the Other Coast** along with Anthony Miscioscia, Esq. and Mark Parisi, Esq.

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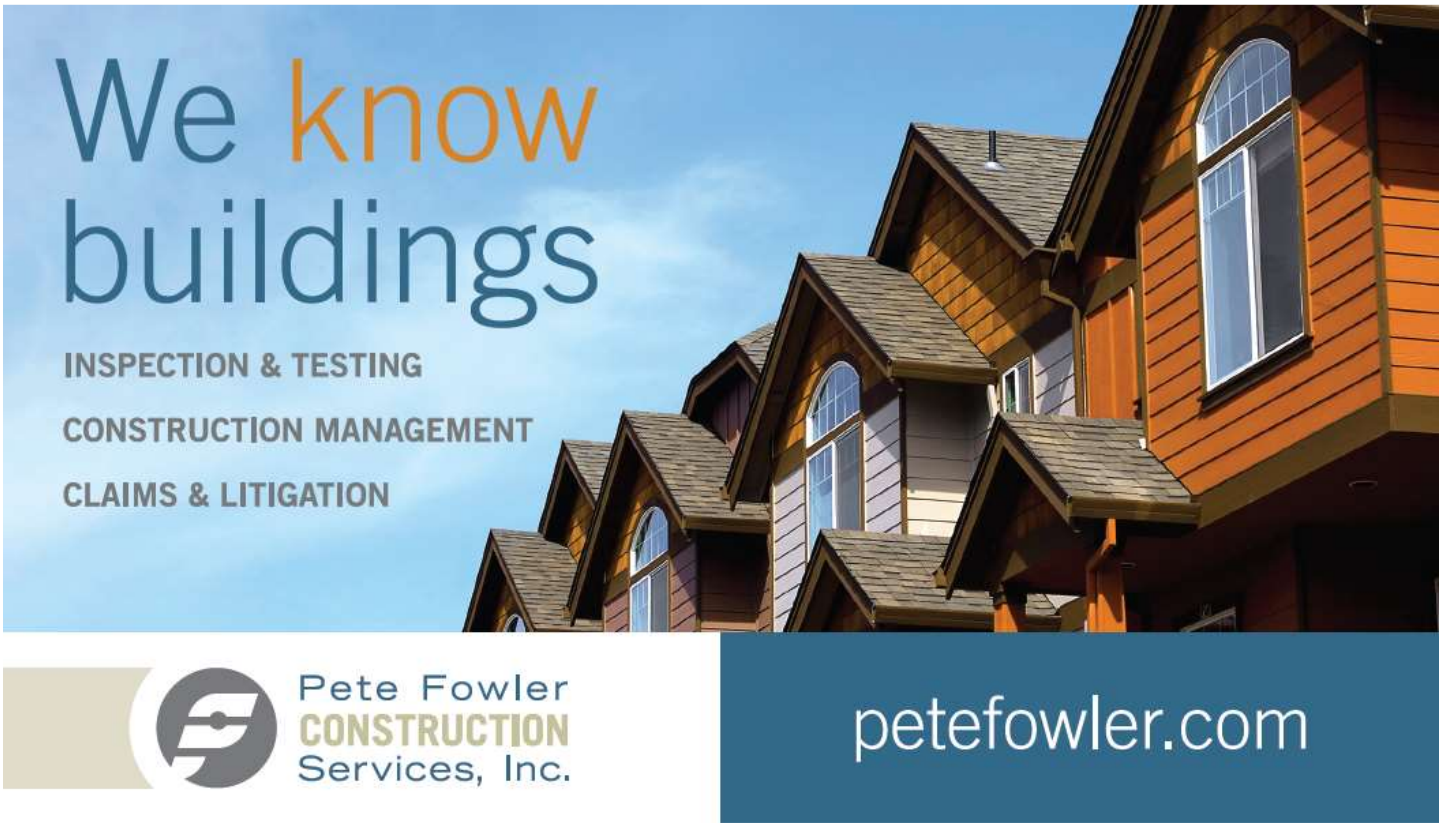

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Section 1.

West Coast Casualty's
Construction Defect Seminar
May 16th 17th and 18th, 2018

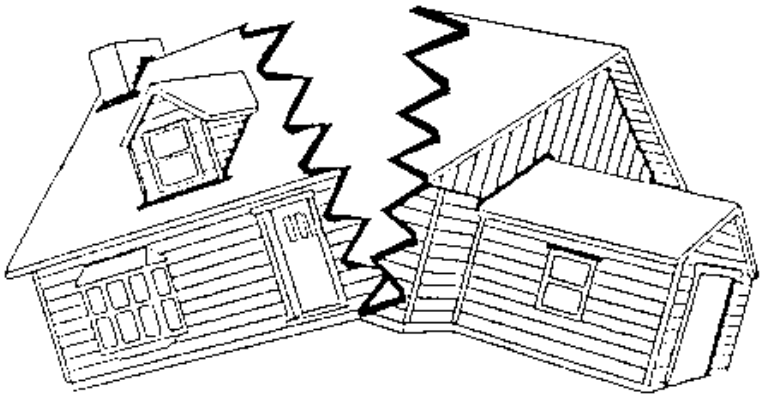
Grand Ballroom

Wednesday May 16th 2018
1:00 PM – 2:00 PM

Course Title:
Struggles and Successes of the Past 25 Years

Brian Kahn, Esq., Hon. Nancy Saitta (ret), Joseph Vogel, John Osorio, Esq., Wilson Townsend, Ross Feinberg, Esq. and Chelsea Zwart, Esq.

Struggles and Successes of the Past 25 Years



By

Brian D. Kahn, Esq.
Chapman, Glucksman, Dean, Roeb & Barger

Justice Nancy Saitta, retired
Advanced Resolution Management (ARM)

Ross Feinberg, Esq.
JAMS

Wilson Townsend
RiverStone TPA Services

Joseph Vogel
CHUBB

John H. Osorio, Esq.
Marshall, Dennehey, Warner, Coleman & Goggin

Chelsea L. Zwart, Esq.
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INTRODUCTION

The construction defect legal community has witnessed a myriad of changes over last two decades. Legislation in a multitude of States has attempted to streamline the claims process. Risk transfer has evolved as more and more builders have procured market driven policies. Trials have taken place helping to define the gap between the benefits of resolution and the risks of a jury verdict. Finally, there is less trust and a mitigated level of professional courtesy throughout the industry.

Legislation

Predominantly referenced as 'Right To Repair Statutes', states throughout the country codified the construction defect process. The common goal among these legislative bodies was to provide builders with an opportunity to cure the defects alleged by homeowners and homeowner's associations alike.

These statutes have, as one would expect, met with mixed reviews both in theory and in practice. The largest hurdle to progress has been the stringent timelines set forth in these statutes. Unless the property owner and builder stipulated to increasing the legislative timeline mandates, it was virtually impossible to comply with these new statutes. Furthermore, the definition of what is and is not a construction defect has muddied the waters with subjective criteria.

Finally, legislative mandates have, in certain jurisdictions, given way to common law theories and remedies. The end result is that we face an intersection of legislation and common law for counsel and the Judiciary to interpret.

Risk Transfer

The industry has never been so diverse when it comes to risk transfer. While many builders have purchased Owner Controlled Insurance Programs ('OCIPs') or Contractor Controlled Insurance Programs ('CCIPs'), others have continued to rely on contractual protection. Specifically, the pendulum has swung back and forth varying between builders absorbing 100 percent of the claims to builders relying on subcontractors both to fund any settlement or verdict and, further, to fund the developer's fees and costs.

Time was that builders paid approximately half of the settlements relying on subcontractors to pay the remaining 50%.

Soon builders were relying upon subs to pay more than half of settlements. Then, by virtue of case law and subcontracts with specific indemnification language, builders were able to see subcontractors pay 100 percent of any settlement or verdict.

The final stage has seen subcontractors paying both indemnity and defense for fees and costs incurred by the builders.

Thus, the variance has never been larger then it is today.

Where we see an 'OCIP'/ 'CCIP' policy, it is the builders either whose carriers or, in the case of a large 'OCIP' / 'CCIP' SIR, the builders themselves, fund settlements and judgments.

Conversely, where there is no wrap or 'OCIP' / 'CCIP' policy in place, builders are turning to the subcontractors to fund both indemnity and defense. Never before have we had such a diverse set of parameters to deal with when trying to resolve a construction defect lawsuit.

Trial

Once there was a time that the phrase "99 percent of construction defect cases settle" was common place across the industry. In truth, it was closer to 99.9%.

However, due to issues involving the true definition of legislative verbiage as to the meaning of "construction defect" and those of contractual indemnification terms, builders have taken more and more cases to trial. The result has been mixed as one might imagine.

In addition to trials, more and more cases, whether by property owners or community associations have found their way to arbitration.

The common denominator to every one of these trials or arbitrations has been one of great expense. Expense for attorneys and experts in addition to large expenditures for the actual process of arbitrations.

Many of the cases have been tried not with respect to a Plaintiff's indemnity claim but rather as to the obligation to provide a defense and allocations among parties for defense fees.

Professional Courtesy

Put simply, we have become more litigious over the last twenty years. Through the late 1980's and the majority of the 1990's, counsel worked closely together to resolve complex construction defect cases. Through a great level of detail, trust and case coordination, we witnessed cases being resolved in a process over the course of nine months.

Plaintiffs brought their claims, mediator's negotiated a set amount of inspections and testing, experts met to resolve differences and the parties negotiated resolution.

This process included an agreed upon level of extrapolation and a sharing of data in all respects.

There was an inherent trust between many, if not all, of the parties with a neutral consistently involved in the process.

However, in the last ten years, in many instances, the trust level has eroded and for a myriad of reasons.

Plaintiffs' claims are thought to be amplified on a regular basis. Builders and subcontractors are at odds with everything from scope of work to liability.

Finally, more and more insurance companies find each other in litigation over everything from coverage to liability.

Any given case can morph into a trial on the merits combined with a contemporaneous action related to coverage.

In sum, we have seen many changes over the last twenty years. However, a majority of these changes are actually reversions to the litigation world of the 1980's. The current level of litigation in all aspects of the construction defect world may well be necessary to bring back the days of professional collegiality. That said, it is time for the process to once again be streamlined with an eye toward shared responsibilities. It is up to Plaintiffs' counsel to be cognizant of their claims, builder's counsel to be cognizant of their rights and obligations, subcontractor counsel to be cognizant of their role and all involved to be cognizant of the fact that, as an industry, we are better when we work together.

SIGNIFICANT INSURANCE COVERAGE CHANGES FOR CONSTRUCTION DEFECT CLAIMS

1. Move to Broad Form language in the 1986 Commercial General Liability policy which provided completed operations coverage.

2. Change of the drafting committees of ISO to more policyholder oriented forms than previous committees.

    a. The above essentially resulted in the broadening of coverage across the policy.

3. Coverage for construction defect claims was also expanded pursuant to decisions such as *Montrose.*

    a. Continuous trigger of coverage under multiple policies so that, again, there is a broadening of coverage with multiple carriers on the risk.

4. Defective construction causing damage treated as an "Occurrence" in most states. Most states trending in this direction by way of case law or statute resulting in the broadening of coverage and overall increase in construction defect claims in other states.

5. The Rise and Fall (and Rise?) of Additional Insured Obligations.

6. Implementation of More Sophisticated/Complex Insurance Programs in response to broadening of coverage, increase in overall losses and to accommodate larger insureds.

    a. OCIPs/CCIPs and other wrap programs developed to consolidate the defense and handling of claims. "We are in it together."

    b. Large Self Insured Retention programs developed such that the insured also has skin in the game with regard to large construction defect claims.

c. Fully Fronted Policies / Burning Limits Policies also in response to the significant costs associated with construction defect claims.

d. Insurance Companies responding with endorsements that limit coverage for construction defect claims (i.e. Residential Work Exclusions (with certain carve outs), Work performed in certain States excluded from coverage, Continuous and Progressive Damages Exclusions, Prior-Work Exclusion, Anti-Stacking Endorsements).

SIGNIFICANT CLAIMS HANDLING CHANGES FOR CONSTRUCTION DEFECT CLAIMS

1. Overall Impact of the Internet and Social Media.

    a. Beneficial in locating insureds given claims materialize well after construction has been completed.

    b. Assist with immediately investigating the project details, news articles, photos, history, prior complaints and overall value of the property at issue.

    c. Beneficial in evaluating timing of damages (i.e. rainfall events).

    d. Educate yourself as to the parties on the service list, insureds and brokers.

2. Information Management Has Changed Significantly.

    a. Drop Box and similar applications permit sharing of large documents.

    b. Law Firm/Vendor Management has been streamlined with new claims handling software.

3. Striving for Early Resolution in Appropriate Settings to Avoid Costly Litigation.

    a. With OCIPs/CCIPs and/or burning limits policies it makes a lot of sense to see if an early resolution is possible in order to save costs and given all other insurance likely has wrap exclusions.

    b. In those non-wrap cases where there is a lot of different insurers involved, setting up insurance coverage mediations to address coverage issues early on.

    c. In many cases insureds are agreeing to simply make repairs to cap the damages.

    d. Special/Project Specific Arbitration Boards.

    e. Get the opposing experts together early on with the mediator to try and find common ground.

OVER THE PAST 25 YEARS, THE CONSTRUCTION DEFECT COMMUNITY HAS CREATED ITS OWN COTTAGE INDUSTRY

1. Numerous Construction Defect experts operating on a nationwide basis and developing new methods for testing.

2. Vendors handling defense sharing agreements/AI payments among several carriers.

3. Contract document review attorneys (i.e. Relativity) given the sheer volume of documents to review in this electronic age.

4. Licensed drone pilots to provide images/photos of high rise projects.

5. Claim advocates for brokers/ TPA's.

CONSTRUCTION DEFECT TRENDS

1. Moving from large single family homes cases with several plaintiffs to Condominium Association cases with a single plaintiff.

2. Overall Increase in commercial, public works and mixed use projects. (i.e. condominium projects with commercial spaces; airports; freeways; auto dealerships; timeshares; apartments; prisons; schools; water parks etc.)

    a. Creating new issues (i.e. standing, date(s) of completion, number of occurrences; loss of use).

3. More aggressive pursuit of product suppliers and manufacturers.

4. Still a lot of OCIP/CCIP policies and project specific polices.

5. CD cases more often than not ordered to mediation and sometimes several mediations occur (with sessions lasting 2-3 days).

6. The Court is more involved in case management as they are starting to understand that CD is its own beast and cases are complex/contain many parties.

    a. Case Management Orders can assist with efficiency, but there may be complications with revisions to timelines because unexpected delays, events, new parties, etc.

E-Discovery

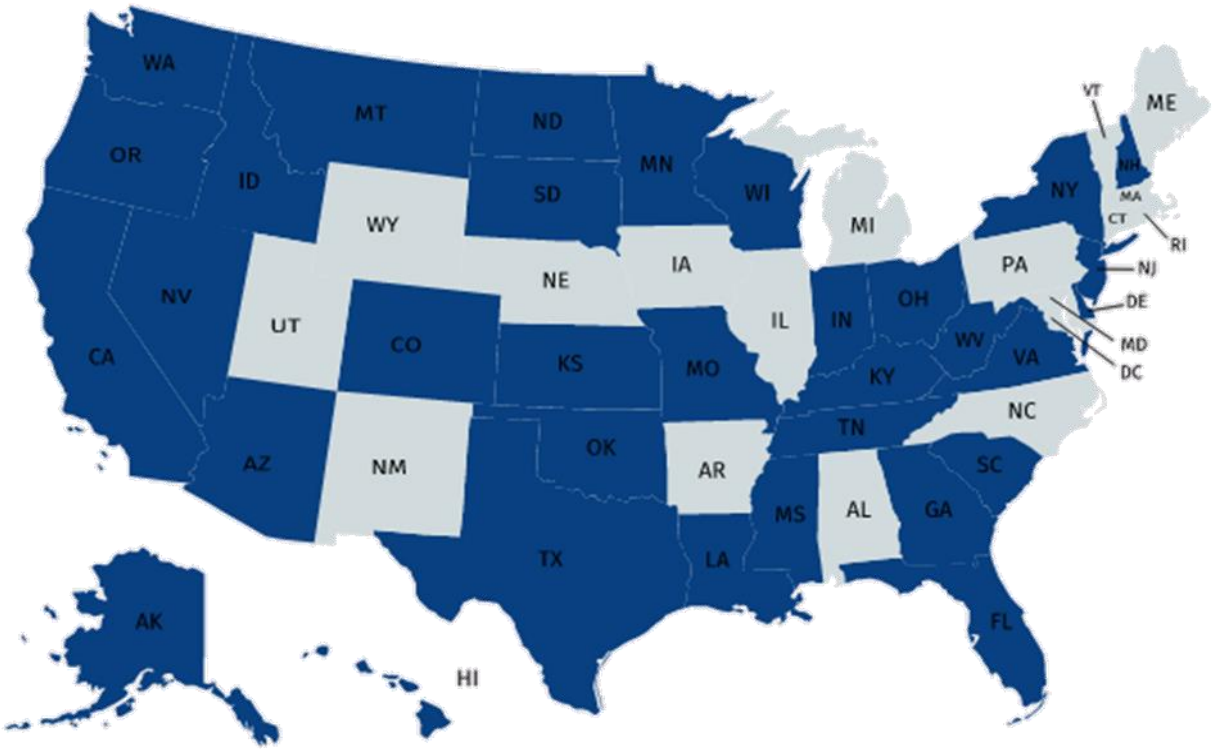
- Then
  - No electronic discovery
  - Physically reviewed boxes of documents
  - Cost = time spent to review & copies
- Now
  - Issues relating to e-discovery
    - More inadvertent disclosure
    - Cost of gathering data / getting data into usable form can be significant
    - May require lengthy meet and confer with opposing counsel before docs are even produced
    - If the demand doesn't identify native format, what do you do?
    - Concern with metadata scrub
    - Some programs no longer exist
    - Being able to search through thousands of digital documents is function is helpful
    - Can tag a single document with multiple descriptors (e.g., privileged & re: plumbing)
    - Need carrier authority to retain vendors
    - Issues with Dropbox and other links expire
    - Making sure proper protocol is followed to protect sensitive information
      - Vetting vendors
      - Using secure transfer method
  - The timeframe to do doc review has basically remained unchanged
- E-Mail Generally
  - Then: receive a letter, review the letter, draft a couple versions of reply letter, mail letter… rinse & repeat
  - Now: Expectation of immediate turn around
    - Potentially quicker resolution of issues
    - The dreaded "reply all" can create a number of problems
    - E-mails tend to be less formal and at times, less thought is put into the content
    - Pressing "send" before cooling down
    - Essentially on-call 24/7
  - Clients
    - May not realize interoffice emails are discoverable if there ends up being a problem post-project
      - Send the "we messed up big time" email that you then have to produce and strategize around
    - Digital data (not necessarily just email) documenting mistakes during construction that may be minor but get blown out of proportion because the camera caught it so someone else should have
      - Issue might come up with 24/7 (or close to it) recording of construction
- Documents in general

- We will always have clients that "discover" portions of the job file months into litigation
- For the most part, contractors have been retaining more records because they are electronically stored
    - What happens if the client gets a new computer system?
- Making sure the client understands all the potential locations documents might exist in is important to make sure a thorough search is performed.
    - Storage, email, server, cloud, etc.

Right to Repair Statutes

A majority of the states have some type of notice and right to repair requirements for construction defect litigation. While only a few of these provisions existed prior to 1996, a number of states added provisions in quick succession beginning in 2001.

Generally, these laws permit a builder to address a homeowner's claimed defects and attempt to make curative repairs in order to avoid litigation. The basic premise is that giving the builder notice of a defect and an opportunity to repair the defect will promote cooperation between the builder and owner, give the builder an opportunity to avoid litigation, and provide the owner with the ability to achieve satisfaction without having to pursue a lawsuit.



Has Right to Right Laws

No Right to Repair Laws

Green / LEED Construction

The terms "green construction" and "LEED construction" are used more and more frequently as the pursuit of LEED certification becomes a customary objective from the outset of construction. The growing number of LEED certified buildings and green construction projects makes it imperative that all parties involved in the construction process have a basic working knowledge of the particular risks specific to sustainable construction.

The following definitions are simplified versions of the definitions defined and incorporated throughout the American Institute of Architects (AIA) Sustainable Project (SP) model contract documents:

- **Sustainable Objective:** the Owner's goal of incorporating Sustainable measures throughout the project to benefit the environment and occupants.

- **Sustainability Plan:** an overview of the project's Sustainable Measures that assigns a responsible party to each and describes the strategies and evaluation metrics for each.

- **Sustainability Documentation:** the documents required to obtain the Sustainable Objective.

- **Sustainability Certification:** the initial third-party certification (e.g., LEED) that is designated as part of the Sustainable Objective.

- **Sustainability Measure:** specific design or construction element or requirement that must be active to satisfy the Sustainable Objective.

Careful consideration in defining these contract terms is often of critical importance when the project fails to obtain certification or performance as expected.

There are five rating systems that address multiple project types: (1) Building Design and Construction, (2) Interior Design and Construction, (3) Building Operations and Maintenance, (4) Neighborhood Development, and (5) Home.

Points are earned in a combination of credit categories, including: Innovation & Design, Location & Linkages, Sustainable Sites, Water Efficiency, Energy & Atmosphere, Materials & Resources, Indoor Environmental Quality, and Awareness & Education.

The number of points a project earns under these rating systems determines the level of certification. There are four LEED certification levels – (1) Certified, (2) Silver, (3) Gold, and (4) Platinum.

Impact of Green / LEED Construction

Currently, there is no universally accepted standard for what qualifies as green or sustainable building. There also is a lack of case law surrounding the area. As a result of evolving standards and an increase in demands on builders and subcontractors, there is a greater likelihood that deviation from the original design may occur. The lack of a clear standard of care opens the door for greater liability to subcontractors and exposure to the developer. Additionally, new, unknown products can create issues both during and post-construction if they ultimately do not perform as expected or are not properly maintained by the owner. Therefore, green project contracts must clearly address scope of work, liabilities, coverage, applicable regulations, and indicate which party has responsibility for and ownership over the certification document. It is also important that builders do not guarantee certification or overstate assurances for energy reductions, water usage, or tax benefits.

Section 2.

West Coast Casualty's
Construction Defect Seminar
May 16th 17th and 18th, 2018

Grand Ballroom

Wednesday May 16th 2018
2:00 PM – 3:00 PM

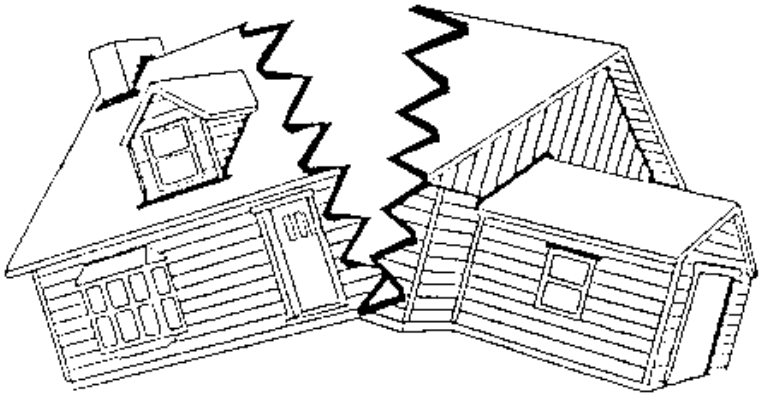
Course Title:

Unwrapped and Unraveled - An insightful (or inciteful?) play at the changing nature of the relationships between the parties in a wrap program who thought the wrap was supposed to take care of everything

Adrienne Cohen, Esq., Hon. Rex Heeseman (Ret.), David Harris Esq.,
Mathew Adler, Ed Schmidt Esq. and Tim Earl Esq.,

25TH ANNIVERSARY

1993 - 2018



Wednesday, May 16th, 2018

2:00 PM – 3:00 PM Unwrapped and Unraveled

Matthew Adler
XL Caitlin

Adrienne Cohen, Esq.
The Law Offices of Adrienne Cohen

Tim Earl, Esq.
Sullivan Hill

David A. Harris, Esq.
Santana & Vierra

Hon. Rex Heeseman (Ret.)
JAMS ADR

Ed Schmidt, Esq.

Koeller, Nebeker, Carlson & Haluck, LLP

Summary of Leading Wrap Cases

A. Wrap-Up Exclusions

D.R. Horton Los Angeles Holding Co., Inc. v. American Safety Indemnity Co.
2012 WL 33070 (S.D. Cal., 2012).

Wrap Exclusions in grader's policies did not bar a duty of defense to an additional insured residential developer from grader's own insurer where grader's own insurer failed to produce evidence that grader was enrolled in the residential developer's OCIP and that grader's work was covered by the OCIP.

B. Wrap Up "Other Insurance Clause" Cases

National Union Fire Ins. Co. of Pittsburgh, Pa. v. American Foreign Insurance Company
2006 WL 4757339 (C.D. Cal., 2006)

OCIP umbrella/excess insurer entitled to equitable indemnity from non-OCIP Insurer based upon application of equitable principles. Court relied heavily on contractor's contract language which did not limit the applicability of contractor's non-OCIP insurance which stated "Any portrayal of insurance policy coverage, terms, and conditions contained in this contract is informational, and is not a binding interpretation of coverage or conditions of the actual policies," and the insured enrolling in the OCIP was required to "make modifications to [its] existing insurance program to prevent duplicate insurance coverage or cost."

Westchester Surplus Lines Insurance Company v. Liberty Mutual Ins. Co.
2018 WL 1014603 (N.D. Cal., 2018)

Primary OCIP insurer not entitled to equitable contribution from primary non-OCIP insurer based upon "other Insurance" clauses making the OCIP insurer primary. Among other things, the court looked at the fact that the OCIP policy was specifically purchased for the project that was the subject of the underlying litigation: "The cost of the Westchester Policy premium was deducted from the payments Tractel was due under the contract. Accordingly, Tractel is entitled to enjoy the benefits of an OCIP."

C. Self-Insured Retention Exhaustion.

Axis Surplus Ins. Co. v. Glencoe Ins. Ltd.
204 Cal. App. 4th 1214 (2012)

Non-OCIP insurer entitled to equitable contribution from OCIP insurer for defense expenses when insured satisfied OCIP SIR at the time of settlement. When an insured has tendered a claim to the nonparticipating insurer, the nonparticipating insurer's duty to defend is subject to the insured satisfying an SIR, and the insured satisfies the SIR as payment of a settlement of which the nonparticipating insurer was aware, the timing of the insured's payment of the SIR does not prevent

the settling insurer from establishing the nonparticipating insurer's legal obligation to cover the underlying claim.

D. Broker Negligence

Pacific Rim Mechanical Contractors, Inc. v. Aon Risk Ins. Services West, Inc.,
203 Cal. App. 4th 1278 (2012).

Retail insurance broker that placed a residential OCIP for contractor group participating in the construction of a high-rise condominium project not liable for failing to notify enrolled subcontractor of OCIP insurer's insolvency shortly after completion of the construction project because the broker owed no duty to notify the insured of the OCIP carrier's insolvency. The Court of Appeal in Pacific Rim noted that: "PacRim seeks to impose upon brokers a new legal duty of notification after the policy has been procured, to an insured that has a certificate of insurance, of the insolvency of an insurance company. That duty, as explained in *Kotlar*, under Insurance Code section 677.2 rests with the insurer." Pacific Rim Mechanical Contractors, Inc., 203 Cal. App. 4th at 1284.

AXIS SURPLUS INSURANCE COMPANY, Plaintiff and Respondent,

v.

GLENCOE INSURANCE LTD., Defendant and Appellant.

No. D058963.

April 11, 2012.

Axis Surplus Insurance Company and Glencoe Insurance Ltd. provided general liability insurance in favor of Pacifica Pointe L.P. Pacifica was sued in a construction defect suit and tendered claims to both Axis and Glencoe. Axis agreed to defend Pacifica subject to a reservation of rights. Glencoe declined the tender, but monitored the construction defect suit and asked Pacifica to inform it once it satisfied the self-insured retention (SIR) under the Glencoe policy.

Pacifica and Axis paid a total of $1 million to settle the construction defect suit. Although Glencoe refused to participate in the settlement, it approved of Pacifica contributing its SIR ($250,000) as part of the settlement, which Pacifica did.

After settling the construction defect suit, Axis sued Glencoe for declaratory relief and equitable contribution to recover at least a portion of the $750,000 it paid in settlement. After a bench trial, the court found in favor of Axis and allocated a 60/40 split of Axis's settlement payment to the advantage of Axis.

Glencoe appeals, claiming the court committed reversible error in finding Axis proved a potential for coverage under the Glencoe policy. In addition, Glencoe argues the court abused its discretion in allocating the amounts of contribution. We affirm.

FACTUAL AND PROCEDURAL HISTORY

The Construction Defect Litigation

In September 2004, Pacifica purchased the Carmel Pointe apartments. It subsequently converted the apartments to condominiums, and in turn, sold the condominiums to individual owners. A homeowners' association called the Carmel Pointe Homeowners Association (Association) then was created. The Association filed a 3 construction defect suit against Pacifica. The Association brought claims for breach of warranties, negligence, nuisance, negligent misrepresentation, and intentional misrepresentation arising out of the condominium conversion project at Carmel Pointe.

The Tenders

Based on the construction defect suit, Pacifica tendered a claim to Axis. Axis provided insurance coverage to Pacifica through a general liability insurance policy issued to the Commercial Industrial Building Owners Alliance, Inc. (CIBA) under policy number ELP712476-05 from March 31, 2005 to March 31, 2006. The policy contained a $500,000 "per occurrence" SIR that was subject to an aggregate and was satisfied by the payment of claims unrelated to the construction defect suit. Axis also provided insurance coverage to Pacifica through a second policy issued to CIBA as policy number ELP700696-04 from March 31, 2004 to March 31, 2005. This policy also had a $500,000 "per occurrence" SIR that was subject to an aggregate and was satisfied by the payment of claims unrelated to the underlying litigation.

The Axis policies provided primary coverage with limits of liability of $5 million and $10 million and with defense expense outside the limit of liability. The Axis policies contained an "other insurance" clause, which provided for the sharing of a loss with a coinsurer by equal shares if the coinsurer also provides for sharing by equal shares. The Axis policies provided coverage for liability for property damage caused by an occurrence during their

respective terms. The policies defined property damage as physical damage to tangible property caused by an occurrence or loss of use of property not physically damaged caused by an occurrence.

Axis accepted Pacifica's tender subject to a reservation of rights. Axis originally provided Pacifica with a defense under Axis policy no. ELP700696-04. However, the policy limits were exhausted in May 2008 as a result of unrelated claims. Axis then provided Pacifica with a defense under policy no. ELP712476-05. Axis paid $118,624.50 in attorney fees and costs on behalf of Pacifica in the construction defect suit.

Pacifica also tendered a claim to Glencoe. Glencoe issued a wrap-up/owner controlled insurance policy (no. CL-10586-00) to Pacifica specifically for the Carmel Pointe construction project with a policy period from September 2, 2004 through September 2, 2007. The Glencoe policy had a $5 million limit per occurrence and in the aggregate. The Glencoe policy provided coverage for property damage defined as physical damage to tangible property caused by an occurrence after the retroactive date of the policy prior to expiration of the extended reporting period. The retroactive date of the Glencoe policy is September 2, 2004, and the extended reporting period expires September 2, 2017.

The Glencoe policy contained an SIR in the amount of $250,000. The policy stated Glencoe had no duty to investigate or defend any claim until Pacifica satisfied the SIR. It also contained an "other insurance" provision similar to the one found in the Axis policy.

Glencoe did not accept Pacifica's tender, but instead, reserved its rights under its policy and requested that Pacifica provide evidence that it had satisfied the SIR.

The Settlement of the Construction Defect Suit

Although Glencoe declined to defend Pacifica, the construction defect suit progressed with Axis providing Pacifica's defense. The Association produced a preliminary defects list with a total cost of repair of $13,976,250, which included relocation costs and acoustical claims.

On October 22, 2008, the Association made a $1 million settlement demand on Pacifica, which would expire on November 14, 2008. Pacifica and the Association agreed to extend the expiration of the settlement to December 17, 2008.

In response to the Association's settlement demand, Pacifica sent experts to Carmel Pointe to evaluate defects and deficiencies and prepare a preliminary scope and cost of repair. Pacifica instructed its experts to identify all potential defects and not just those defects claimed by the Association. The experts created a preliminary repair estimate totaling $1,466,747.50. Pacifica's cost of repair did not include the Association's acoustical claims or relocation costs.

On November 3, 2008, Pacifica advised Glencoe about the Association's $1 million settlement demand. Before the end of November 2008, Glencoe was advised of the preliminary cost of repairs calculated by Pacifica's experts.

On December 16, 2008, the day before the settlement demand was to expire, Glencoe responded to Pacifica's request for approval of the settlement. Glencoe stated in part: "It is our understanding that JPI West Coast [the

original owner/developer of Carmel Pointe], as well as its direct and additional insurers are of the opinion that the information available at this time is insufficient to warrant contribution towards settlement. We share that concern when asked to fund a settlement without their contribution. We also have a concern with respect to the unorthodox manner of negotiation and settlement as well as the effective scope of the settlement negotiated on an expedited basis. [¶] . . . [¶] Axis' most recent demand for contribution requires an analysis of causation and damage which the current information available does not allow. The current deadline imposed by the [Association] does not allow [Glencoe] to fully evaluate this matter. We have inquired about an extension of time to respond to the settlement. We have been advised that an extension is not likely to be provided. We renew our request for an extension. Accordingly, while we lack sufficient information to agree to fund a settlement at this time, we will not object to Pacifica contributing its SIR to a settlement funded by Axis up to the proposed $1,000,000."

Glencoe also did not agree the settlement was for a covered loss.

On December 22, 2008, the Association and Pacifica entered into a written settlement agreement. On December 30, 2008, Axis issued a check to the Association for $750,000 as partial payment of the settlement. Eight days later, Pacifica issued a check to the Association for $250,000 toward funding the settlement and satisfying the $250,000 SIR under the Glencoe policy.

The Suit for Equitable Contribution

On August 11, 2009, Axis filed an action against Glencoe alleging causes of action for declaratory relief and equitable contribution. The first cause of action for declaratory relief sought a declaration from the court that the Glencoe policy applied to the construction defect suit and Glencoe was obligated for an equitable share of the defense costs and settlement Axis paid to resolve it. The second cause of action for equitable contribution sought an award of damages representing an equitable contribution from Glencoe toward the defense costs and settlement Axis paid.

The parties decided that trial would be submitted to the court on an agreed record consisting of stipulated facts, documents, and excerpts of deposition transcripts. In its trial brief, Axis conceded it was not making any claim for reimbursement of the defense costs it paid on behalf of Pacifica in the construction defect suit. Accordingly, the trial court only needed to decide whether the Glencoe policy potentially covered Pacifica in the construction defect suit, and if so, determine Glencoe's equitable contribution to the $750,000 settlement that Axis paid to resolve it.

Along with their trial briefs and exhibits, Axis and Glencoe filed separate proposed statements of decision. After careful consideration of all evidence and the arguments of parties, the trial court filed its statement of decision. There is no indication in the record that either party objected to the court's statement of decision.

The court determined Axis had met its burden of proof to establish a claim for equitable contribution with regard to the $750,000 Axis paid to settle the construction defect suit on behalf of Pacifica. The court then concluded that a 60/40 split of the $750,000 settlement payment in favor of Axis was the most equitable result. Therefore, Axis was awarded $450,000 as damages against Glencoe.

Glencoe timely appealed.

DISCUSSION

Equitable contribution is available to apportion a loss among several insurers when each of those insurers is " ' "obligated to indemnify or defend the same loss or claim, and one insurer has paid more than its share of the loss or defended the action without any participation by the others." . . . "The purpose of this rule of equity is to 8 accomplish substantial justice by equalizing the common burden shared by coinsurers, and to prevent one insurer from profiting at the expense of others." ' " (Safeco Ins. Co. of America v. Superior Court (2006) 140 Cal.App.4th 874, 879 (Safeco), quoting Maryland Casualty Co. v. Nationwide Mutual Ins. Co. (2000) 81 Cal.App.4th 1082, 1089.)

In this appeal, Glencoe raises two issues. First, it contends the court erred in finding Axis met its burden of proving there was potential for coverage under the Glencoe policy. Second, it asserts the court abused its discretion by failing to apportion Axis's $750,000 settlement payment using the equal shares method called for in the "other insurance" clauses in the Glencoe and Axis policies. We reject both of these contentions.

I

THE COURT PROPERLY FOUND THAT AXIS MET ITS BURDEN OF PROOF

A. Standard of Review

The parties disagree on the appropriate standard of review for the first issue Glencoe raises. Without any authority, Axis argues we apply an abuse of discretion standard. Axis is incorrect.

Citing Waller v. Truck Ins. Exchange, Inc. (1995) 11 Cal.4th 1 at page 18, Glencoe asserts we should apply a de novo standard because we are deciding whether an insurer has a duty to defend. Waller involved the interpretation of an insurance policy and whether it covered economic losses that cause emotional distress. (Ibid.) Here, the interpretation of the Glencoe policy is not disputed. That said, to the extent we need to interpret any of the Glencoe policy, we agree with Glencoe that we should apply a de 9 novo standard because there was no extrinsic evidence presented at trial, and thus no factual dispute as to its meaning. (Powerine Oil Co., Inc. v. Superior Court (2005) 37 Cal.4th 377, 390; AIU Ins. Co. v. Superior Court (1990) 51 Cal.3d 807, 818.)

The trial in this matter, however, involved more than the court interpreting Glencoe's policy. Nevertheless, Glencoe argues we also apply a de novo standard when the trial court decides questions of law based on stipulated facts. (Nguyen v. Calhoun (2003) 105 Cal.App.4th 428, 437.) This is not the correct standard on the record before us. The trial court considered the parties' respective trial briefs, an agreed upon record, and proposed statements of decisions submitted by each party. The agreed upon record included stipulated facts plus exhibits and deposition testimony. As such, the court did not merely decide questions of law based on stipulated facts, and a de novo standard is inappropriate.

Instead, the application of the Glencoe policy language involves disputed facts or inferences drawn from undisputed facts. We therefore review the trial court's findings for substantial evidence. "We begin with the presumption that the record contains evidence to uphold every finding of fact and appellant has the burden to

demonstrate there is no substantial evidence to support the findings under attack. [Citation.] ' "When a finding of fact is attacked on the ground that there is not any substantial evidence to sustain it, the power of an appellate court begins and ends with the determination as to whether there is any substantial evidence contradicted or uncontradicted which will support the finding of fact." [Citations.]' " (North American Capacity Ins. Co. v. Claremont Liability Ins. Co. 10 (2009) 177 Cal.App.4th 272, 285, italics omitted; citing Foreman & Clark Corp. v. Fallon (1971) 3 Cal.3d 875, 881.)

In addition, we review the trial court's implied factual findings for substantial evidence. "Under the doctrine of implied findings, the reviewing court must infer, following a bench trial, that the trial court impliedly made every factual finding necessary to support its decision. . . . The appellant also must bring ambiguities and omissions in the factual findings of the statement of decision to the trial court's attention. If the appellant fails to do so, the reviewing court will infer the trial court made every implied factual finding necessary to uphold its decision, even on issues not addressed in the statement of decision. The question then becomes whether substantial evidence supports the implied factual findings." (Fladeboe v. American Isuzu Motors Inc. (2007) 150 Cal.App.4th 42, 48.) In this case, as Glencoe " 'did not raise any objections to the statement of decision[, we] are required to presume the trial court made all findings necessary to support the judgment.' " (Id. at p. 60, quoting Sammis v. Stafford (1996) 48 Cal.App.4th 1935, 1942.)

B. Payment of the SIR

In an action for equitable contribution by a settling insurer against a nonparticipating insurer, the settling insurer has met its burden of proof when it makes a prima facie showing of potential coverage under the nonparticipating insurer's policy. (Safeco, supra, 140 Cal.App.4th at p. 877.) The settling insurer does not have to prove actual coverage. (Id. at p. 879.) After the settling insurer has satisfied its burden of 11 proof, the burden shifts to the nonparticipating insurer to prove an absence of actual coverage under its policy. (Ibid.)

Here, the court found Axis satisfied its burden of proof in proving the potential of coverage under the Glencoe policy. Glencoe, however, argues the court erred because the evidence is insufficient. Specifically, Glencoe asserts, under Safeco, supra, 140 Cal.App.4th 874, Axis had to prove Pacifica's $250,000 payment was for covered "property damage" as defined in the Glencoe policy. Glencoe therefore insists not only does Axis have to show that Pacifica paid $250,000 to satisfy its SIR, but it must show that this payment only applied to covered property damage. We disagree.

Pacifica paid the $250,000 as part of a settlement. By settling, the parties forgo their right to have liability "established" by a trier of fact, and the settlement "becomes presumptive evidence of the [insured's] liability and the amount thereof, which presumption is subject to being overcome by proof. [Citation.] . . . 'A contrary rule would make the right to settle meaningless. . . .' " (Phoenix Ins. Co. v. United States Fire Ins. Co. (1987) 189 Cal.App.3d 1511, 1526-1527 (Phoenix Ins. Co.) [equitable indemnity action]; Isaacson v. California Ins. Guarantee Assn. (1988) 44 Cal.3d 775, 791-792 [same presumption when insured settles a claim, then sues insurer to recover the amount of the settlement].) While none of these cases address the precise issue before us, we see no reason why the rule in Phoenix Ins. Co., supra, 189 Cal.App.3d at pages 1526-1527, which was cited with approval in Safeco, supra, 140 Cal.App.4th at page 880, would not apply to Pacifica's payment of its SIR as part of a settlement.

By settling, the parties avoid the cost and uncertainty of litigation. The settlement and the amount of the settlement are thus presumptive evidence of the insurer's liability and the amount of liability. (See Safeco, supra, 140 Cal.App.4th at p. 880, citing Phoenix Ins. Co., supra, 189 Cal.App.3d at pp. 1526-1527.) In other words, the settlement is presumed to be made for only damages covered under the applicable policy. Because the settlement here included the insured's payment of the SIR, the SIR shares the presumptive effect of the settlement as well, and Axis had no obligation to prove the SIR applied only to "covered property damage" as defined in the Glencoe policy. Further, Glencoe specifically approved Pacifica's payment of its SIR toward settlement. To apply a different rule to payment of an SIR as part of a settlement would undermine the benefits of settlement.1

C. The Timing of Pacifica's Satisfaction of the SIR

Glencoe also asserts the court erred in finding Axis satisfied its burden of proof because Axis did not and cannot establish Glencoe had a legal obligation to provide a defense prior to the date of settlement. (See Safeco, supra, 140 Cal.App.4th at p. 879.) Glencoe argues its legal obligation to provide Pacifica with a defense in the construction defect suit could only be triggered after Pacifica satisfied the SIR. Pacifica and the Association entered into their settlement agreement on December 22, 2008. To fund a portion of the settlement, Axis issued a check in the amount of $750,000 to the Association on December 30, 2008. Pacifica then issued a check in the amount of $250,000 to fund the remainder of the settlement on January 7, 2009. Thus, Glencoe argues the earliest Axis could show a potential for coverage under the Glencoe policy was on January 7, 2009, after the parties entered into a settlement agreement. As such, Glencoe insists Axis cannot satisfy its burden of proof under Safeco, supra, at page 879. We are not persuaded.

Glencoe accurately cites Safeco, among other reasons, for the general rule: "In an action by an insurer to obtain contribution from a coinsurer, the inquiry is whether the nonparticipating coinsurer 'had a legal obligation . . . to provide [a] defense [or] indemnity coverage for the . . . claim or action prior to [the date of settlement],' and the burden is on the party claiming coverage to show that a coverage obligation arose or existed under the coinsurer's policy." (Safeco, supra, 140 Cal.App.4th at p. 879, citing American Continental Ins. Co. v. American Casualty Co. (2001) 86 Cal.App.4th 929, 938 (American Continental), original italics.) The purpose of this rule is to ensure courts will not order a coinsurer to contribute to a loss that it had no obligation to pay under the terms of its policy. (See Safeco, supra, 140 Cal.App.4th at p. 879; American Continental, supra, at pp. 937-938.) Here, Glencoe argues it could not have an obligation prior to the settlement of the construction defect suit because Pacifica only satisfied its SIR in paying a portion of the settlement. It does not argue it never received notice of the suit, the action giving rise to Pacifica's tender (the Carmel Pointe construction project) was outside the scope of the Glencoe policy, or its insured was not a named defendant in the 14 construction defect suit. Glencoe's argument thus concerns the timing of its obligation to indemnify rather than the absolute absence of any obligation whatsoever. This distinction becomes critical when we explore the origin of the legal obligation rule cited in Safeco, supra, at page 879 and American Continental, supra, at page 938.

In Safeco, supra, 140 Cal.App.4th 874, the court did not address the timing of when an insurer has a legal obligation to an insured. Thus, except for the general rule regarding a coinsurer's legal obligation to provide coverage, Safeco provides us little guidance. We thus turn to American Continental, supra, 86 Cal.App.4th 929, on which Safeco relies, to better understand the origination of the subject rule.

In American Continental, the court addressed whether multiple insurers had an obligation to a common insured. (American Continental, supra, 86 Cal.App.4th at p. 937.) The plaintiff sued a hospital and four doctors for medical malpractice. (Id. at p. 934.) During a deposition, a nurse, who tended to the plaintiff while she was at the hospital, admitted she failed to do certain essential tasks. (Ibid.) The plaintiff, however, never named the nurse as a defendant or served her in the action. (Ibid.)

The hospital tendered its defense to its insurer, American Continental, which undertook its defense. (American Continental, supra, 86 Cal.App.4th at p. 934.) American Continental negotiated a settlement on behalf of the hospital and its employees (which included the nurse). (Ibid.) Prior to negotiating the settlement, American Continental discovered the nurse was personally insured by American Casualty. American Continental demanded American Casualty participate in the defense and settlement of the action. American Casualty refused. (Ibid.) After settling the matter, 15 American Continental sued American Casualty for, among other things, equitable contribution. (Id. at p. 935.) American Casualty demurred to the complaint, arguing no obligation to provide coverage had arisen. The trial court sustained the demurrer without leave to amend. (Ibid.)

The Court of Appeal affirmed the trial court's judgment and concluded American Casualty's obligation to provide coverage did not arise. (American Continental, supra, 86 Cal.App.4th at p. 933.) It held "that where an insurer was never under any legal obligation to provide coverage under a policy of liability insurance, that insurer may not be required to contribute to the defense or indemnity costs which may have been incurred by a second insurer in defending and settling an action . . . from the negligent acts of a common insured who was not named as a defendant in said suit and against whom no claim of negligence was ever made." (Id. at p. 933.) The court noted the nurse was not sued and never became legally obligated to pay any amount to the plaintiff, which would have triggered coverage under her policy. (Id. at pp. 938-939.) The court stressed the failure of the plaintiff to sue the nurse or make any claim against her was a dispositive fact distinguishing the "case from all other California cases applying the equitable contribution doctrine." (Id. at p. 941.) Further, the court acknowledged the "novel facts" involved in the case. (Id. at p. 933.)

While American Continental and the instant action both involve claims between primary insurers for equitable contribution, the similarity between the cases ends there. Unlike in American Continental, here the insured (Pacifica) was a named defendant and tendered claims to both primary insurers (Axis and Glencoe). Although Glencoe did not 16 agree to defend Pacifica, it reserved its rights under its policy, requested Pacifica provide evidence that it had satisfied the SIR, and monitored the construction defect suit. Further, Glencoe claimed to lack sufficient information to agree to fund any settlement, but it did "not object to Pacifica contributing its SIR to a settlement funded by Axis up to the proposed $1,000,000." American Continental simply is inapposite to the instant matter.

In addition, the cases on which American Continental relied to reach its holding do not address the issue before us. The cases the court cited in American Continental, supra, 86 Cal.App.4th at page 938 where the courts declined to enforce an insurer's contribution claim did not involve the timing of the satisfaction of an SIR. (See Old Republic Ins. Co. v. Superior Court (1998) 66 Cal.App.4th 128, 154, disapproved on another ground in Vandenberg v. Superior Court (1999) 21 Cal.4th 815, 841, fn. 13 [loss paid by plaintiff insurer not covered under policy of defendant insurer because it was contract liability not tort liability]; Great American West, Inc. v. Safeco Ins. (1991) 226 Cal.App.3d 1145, 1152-1153 [loss payment was made to insured by plaintiff insurer more than

four years after the expiration of the one-year time limit in defendant insurer's policy; thus, any claim under defendant's policy was unenforceable]; United Pacific Ins. Co. v. Hanover Ins. Co. (1990) 217 Cal.App.3d 925, 939 [even though paid by plaintiff insurer, the loss was not covered under any of the policies issued by the multiple insurers involved].)

Glencoe cites two other cases that involve the satisfaction of an SIR: Clarendon America Ins. Co. v. North American Capacity Ins. Co. (2010) 186 Cal.App.4th 556 (Clarendon) and Forecast Homes v. Steadfast Ins. Co. (2010) 181 Cal.App.4th 1466 17 (Forecast).2 Neither case, however, is helpful with the issue before us. Clarendon concerns the interpretation of an insurer's policy and whether the SIR applied to one claim or each of the eight houses involved in the claim. (See Clarendon, supra, 186 Cal.App.4th at p. 564.) Forecast involves the interpretation of an insurer's policy and whether an additional insured could satisfy the named insured's SIR. (See Forecast, supra, 181 Cal.App.4th at pp. 1476-1484.)

None of the authority cited by Glencoe deals directly with the timing of the payment of the SIR in the context of a settlement in determining if an insurer's legal obligation to provide coverage existed. For its part, Axis does not even bother to address Glencoe's argument. Our independent research failed to uncover any case dealing with facts analogous to those before us. Thus, we are faced with a novel issue.

Like the court in Safeco, supra, 140 Cal.app.4th at page 879, we accept the rule set forth in American Continental, supra, 86 Cal.App.4th at page 938: A critical inquiry in any action for equitable contribution between insurers is whether the nonparticipating coinsurer had a legal obligation to provide a defense or indemnity coverage for the claim this was a consistent flaw throughout Axis's respondent's brief. 18 prior to the settlement of a claim. In applying this rule to the facts before us, however, we keep in mind that an equitable contribution claim between coinsurers is not based upon contract, but instead involves " 'equitable principles designed to accomplish ultimate justice in the bearing of a specific burden.' " (Signal Companies, Inc. v. Harbor Ins Co. (1980) 27 Cal.3d 359, 369.)

" 'California follows the general rule that an insurer that discharges a common obligation of another insurer may seek contribution from the second insurer. [Citations.] The insurers' "respective obligations flow from equitable principles designed to accomplish ultimate justice in the bearing of a specific burden." [Citation.] No specific rule governs this area of the law. Courts should consider the nature of the claim, the relation of the insured to the insurers, the particulars of each policy and any other equitable considerations. [Citation.]' " (Fire Ins. Exchange v. American States Ins. Co. (1995) 39 Cal.App.4th 653, 664, citing Northern Ins. Co. of New York v. Allied Mut. Ins. (9th Cir. 1992) 955 F.2d 1353, 1360.) In other words, in an equitable contribution action, a court reviews the applicable facts and policies and decides what is fair between the potential coinsurers. Of course, if one insurer never had an obligation to provide coverage, it would be extremely unfair to enforce a contribution action. (See American Continental, supra, 86 Cal.App.4th at p. 938.) This is not the case here.

The Glencoe policy specifically insured Pacifica for its construction project at Carmel Pointe. Pacifica was sued for alleged construction defects arising out of the Carmel Pointe project. Pacifica tendered its claim to Glencoe. Glencoe did not agree to defend, but instead, monitored the litigation and requested to be informed when Pacifica 19 satisfied its SIR. During his deposition, a Glencoe representative acknowledged potential coverage existed assuming the SIR was satisfied. Pacifica did not satisfy the SIR until it contributed to the settlement of

the construction defect suit because Axis, a coinsurer, was defending Pacifica. While Glencoe did not agree to contribute to the settlement, it specifically approved of Pacifica's payment of its SIR as part of the settlement. Thus, this is not a case where Glencoe had no notice of the claim or settlement. (See American Internat. Specialty Ins. Co. v. Continental Casualty Ins. Co. (2006) 142 Cal.App.4th 1342, 1366.) In addition, the trial court found "Glencoe never made any effort to secure the authority necessary to settle, or contribute to the settlement of the [construction defect suit] even though the insured was facing a time-sensitive settlement opportunity."

To allow Glencoe to defeat an equitable contribution claim merely based on the timing of the payment of the SIR would award Glencoe for its inaction and work an injustice. Glencoe appears to have been hiding behind the SIR requirement in its policy, gambling that Pacifica would not satisfy it because Axis was providing Pacifica with a defense in the construction defect suit. We decline to adopt a rule sanctioning such gamesmanship.

In short, the unique facts of this case warrant that we create a limited exception to the rule enunciated in Safeco, supra, 140 Cal.App.4th at page 879 and American Continental, supra, 86 Cal.App.4th at page 938 regarding the timing of an insurer's legal obligation to provide coverage. When the insured has tendered a claim to the nonparticipating insurer, the nonparticipating insurer's duty to defend is subject to the insured satisfying an SIR, and the insured satisfies the SIR as payment of a settlement of 20 which the nonparticipating insurer was aware, the timing of the insured's payment of the SIR does not prevent the settling insurer from establishing the nonparticipating insurer's legal obligation to cover the underlying claim. To apply a more rigid rule in this matter would undermine the equity inherent in an equitable contribution action. (See Maryland Casualty Co. v. Nationwide Mutual Ins. Co. (2000) 81 Cal.App.4th 1082, 1093 [the purpose of a claim for equitable contribution "is to accomplish substantial justice by equalizing the common burden shared by coinsurers, and to prevent one insurer from profiting at the expense of others."].)

D. Substantial Evidence Supports the Court's Judgment

Glencoe also challenges the court's finding that Axis proved at least $1 million of covered property damage. Glencoe's challenge, however, is misguided.4 We are not concerned with the amount of property damage Axis proved at trial. Axis did not have to prove actual coverage, just the potential for coverage under the Glencoe policy. (See Safeco, supra, 140 Cal.App.4th at p. 879.) We conclude substantial evidence supports the court's finding that Axis had shown a prima facie case of potential coverage under the Glencoe policy.

Pacifica was a named insured under the Glencoe policy, which specifically covered Pacifica's construction project at Carmel Pointe. The underlying litigation arose out of alleged construction defects at Carmel Pointe. Based on the construction defect suit, Pacifica tendered claims to both Axis and Glencoe. Axis accepted Pacifica's tender subject to a reservation of rights. Glencoe reserved its rights under its policy and requested Pacifica provide evidence that it had satisfied the SIR.

Although Glencoe did not agree to defend Pacifica, it monitored the construction defect suit. Indeed, a Glencoe representative testified during his deposition that Glencoe was monitoring the underlying litigation because there existed the potential for coverage if Pacifica satisfied its SIR. Glencoe argues its representative's deposition testimony does not constitute an admission that Glencoe owed a duty to defend Pacifica in the underlying

litigation. We, however, do not see anywhere in the record where the court made this finding based on the deposition testimony. Instead, we agree with the court that the testimony established Glencoe viewed the satisfaction of the $250,000 as the key trigger to potential coverage under the policy: "Q. And during that entire time, Glencoe was monitoring the file because it understood that there was at least a potential for coverage under its policy for the claims being asserted in the underlying action; correct? "A. That's a fair statement provided the SIR is satisfied." The Association made a $1 million settlement demand. Pacifica then sent experts to evaluate the defects and deficiencies at the project. Their preliminary cost of repair was $1,466,747.50. The Association's preliminary cost of repair was $13,976,250. Although Glencoe did not agree to contribute to any settlement, it informed Pacifica it did "not object to Pacifica contributing its SIR to a settlement funded by Axis up to the proposed $1,000,000." Moreover, the court found that Glencoe did nothing to obtain authority to contribute to the settlement of the construction defect suit.

Pacifica then settled the underlying litigation for $1 million. Axis paid $750,000 of the settlement, and Pacifica contributed $250,000.

Despite this abundance of evidence, Glencoe claims that certain evidence in the record (primarily Axis's expert reports) cannot establish covered damages of any amount. Again, Glencoe confuses Axis's burden of proof. Axis does not have to prove actual coverage under the Glencoe policy, just the potential of coverage. (See Safeco, supra, 140 Cal.app.4th at p. 879.) Thus, Axis did not have to establish covered damages of any amount, but merely that the claims in the construction defect suit were potentially covered under the Glencoe suit. (Id. at p. 877.) We agree with the court that it did so. Indeed, we struggle to contemplate a stronger case showing potential coverage under a policy than the one before us.

Because we are satisfied substantial evidence supports the court's finding that Axis satisfied its burden of proof, the burden switched to Glencoe to prove an absence of actual coverage. (See Safeco, supra, 140 Cal.App.4th at p. 881.) Here, Glencoe does not argue the court erred in finding it did not satisfy its burden. Nor could it. There is no indication that Glencoe ever inspected the Carmel Pointe project or talked to any party or counsel involved in the construction defect suit. Indeed, Glencoe's expert witness admitted he had not been to the Carmel Pointe project, was not sure where the project 23 was located, and had not taken any pictures of the project. He further testified that he was not retained to evaluate what was "property damage," and he did not know how that term was defined in the Glencoe policy. Simply put, there is nothing in the record that would even allow Glencoe to begin to prove actual coverage did not exist.

II THE COURT DID NOT ABUSE ITS DISCRETION IN ALLOCATING LIABILITY

Glencoe insists the court abused its discretion in allocating liability because it did not apportion liability using the equal shares method found in the "other insurance" clauses in the Glencoe and Axis policies. Both the Axis and Glencoe policies contain substantially similar "other insurance" provisions. These provisions state the respective insurer will share with other primary insurance on an equal basis so long as the other insurer also allows contribution on an equal share basis. Glencoe concedes it and Axis are both primary insurers. Based on these facts, Glencoe asserts the court could not use equity to override the terms of the policies and should have allocated contribution equally between Axis and Glencoe. We disagree.

We review the trial court's ultimate equitable determination in allocating liability among the responsible insurers for abuse of discretion. (Scottsdale Ins. Co. v. Century Surety Co. (2010) 182 Cal.App.4th 1023, 1033; Hartford Casualty Ins. Co. v. Travelers Indemnity Co. (2003) 110 Cal.App.4th 710, 724.) An abuse of discretion occurs when, in light of applicable law and considering all relevant circumstances, the court's ruling exceeds the bounds of reason. (Shamblin v. Brattain (1988) 44 Cal.3d 474, 478-479 (Shamblin); Denham v. Superior Court (1970) 2 Cal.3d 557, 566.)

When a trial court is required to evaluate claims for equitable contribution among multiple liability insurers, each insuring the same insured on the same claim, the trial court exercises its discretion and weighs the equities seeking to attain distributive justice and equity among the mutually liable insurers. (Fireman's Fund Ins. Co. v. Maryland Casualty Co. (1998) 65 Cal.App.4th 1279, 1293 (Fireman's Fund).) The court may consider numerous factors in making its determination, including the nature of the underlying claim, the relationship of the insured to the various insurers, the particulars of each policy, and any other equitable considerations. (Truck Ins. Exchange v. Unigard Ins. Co. (2000) 79 Cal.App.4th 966, 974 (Truck).)

Here, the court carefully considered the relationship between Pacifica and both Axis and Glencoe, the terms of the Glencoe policy (including policy limits), and time on risk (the Glencoe policy was issued for three years and the Axis policies were issued for two years). The court specifically noted it was "balancing all the pertinent factors including the greater time on risk and limits by Glencoe with the co-insurance provisions in both policies and the facts and circumstances regarding the covered claims in each carrier's policies and the participation in the settlement by Axis. . . ."

Glencoe does not argue the court improperly considered these factors, misinterpreted the Glencoe policy, or failed to consider other factors. Instead, Glencoe asserts the court could only allocate liability equally under the "other insurance" provisions in the Axis and Glencoe policies. Glencoe's position is contrary to established California law (see Fireman's Fund, supra, 65 Cal.App.4th at p. 1293; Truck, supra, 79 Cal.App.4th at p. 974), and we decline to create a new rule on the record before us.

The only authority Glencoe cites in support of its position is Hartford Casualty Ins. Co. v. Travelers Indemnity Co. (2003) 110 Cal.App.4th 710.) However, Hartford does not stand for the proposition urged by Glencoe: in allocating liability for a claim of equitable contribution, a trial court has no discretion to allocate liability beyond the terms of the primary insurers' respective policies if the policies contain substantially similar other insurance provisions. In fact, Hartford did not deal with one primary insurer suing another primary insurer for equitable contribution. Instead, there, the primary insurer sued the excess insurer for equitable contribution and claimed the trial court erred by failing to ignore the "excess clause" in the excess insurer's policy and award contribution. (Id. at pp. 716, 724.) In affirming the trial court's decision, the Court of Appeal concluded the specific facts of the case did not warrant the use of equity to override the terms of the insurance policies in a dispute between a primary insurer and an excess insurer. (Id. at p. 727.) No analogous facts exist here.

Hartford therefore is not helpful. Here, the court's allocation of liability did not exceed the bounds of reason. (See Shamblin, supra, 44 Cal.3d at pp. 478-479.) We are satisfied the court did not abuse its discretion.

D.R. HORTON LOS ANGELES HOLDING CO., INC., Plaintiff,

v.

AMERICAN SAFETY INDEMNITY COMPANY, Defendant.

No. 10CV443 WQH (WMc).

Jan. 5, 2012.

D.R. HORTON LOS ANGELES HOLDING CO., INC.,
Plaintiff,
v.
AMERICAN SAFETY INDEMNITY COMPANY, Defendant.

No. 10CV443 WQH (WMc).
|
Jan. 5, 2012.

Attorneys and Law Firms

Scott W. Sonne, Thomas R. Proctor, Luce, Forward, Hamilton and Scripps LLP, San Diego, CA, for Plaintiff.

David S. Blau, Blau & Associates PC, Los Angeles, CA, for Defendant.

Opinion

ORDER

HAYES, District Judge.

*1 The matters before the Court are the Motion for Partial Summary Judgment filed by Plaintiff D.R. Horton (ECF No. 25) and the Motion for Summary Judgment, or Alternatively Partial Summary Judgment filed by Defendant American Safety Indemnity Company (ECF No. 33).

I. Procedural Background

This action arises out of an insurance dispute regarding coverage under four insurance policies (the "Policies") issued by Defendant American Safety Indemnity Company ("ASIC") to Ebensteiner Co. ("Ebensteiner").[1] The policies at issue in this litigation are: XGI 01–1261–003 ("03 policy") effective from August 1, 2001 through August 1, 2002; XGI 02–1261–004 ("04 policy") effective from August 1, 2002 through August 1; 2003, XGI 03–1261–005 ("05 policy") effective from August 1, 2003 through August 1, 2004; and ESL 0010410406 ("06 policy") effective from August 1, 2004 through August 1, 2005.

On January 15, 2010, Plaintiff D.R. Horton Los Angeles Holding Co ., Inc. ("D.R.Horton") filed a Complaint against ASIC which was removed to this Court. (ECF No. 1). The Complaint alleges that D.R. Horton was engaged in a real estate development project named Canyon Gate ("Canyon Gate") and that D.R. Horton entered into a subcontractor agreement with Ebensteiner for grading work on the project. *Id.* at 10. The Complaint alleges that Ebensteiner purchased general liability insurance policies from ASIC and named D .R. Horton as an additional insured and third-party beneficiary of ASIC's obligations to Ebensteiner. *Id.* at 10–11.

The Complaint alleges that D.R. Horton received several notices to builder and several complaints and cross-complaints were filed against D.R. Horton in the following cases: *Chang O. Kim, et al. v. City of Santa Clarita, et al.,* Los Angeles Superior Court Case No. BC407614 (the *"Kim* case"), *Canyon Gate Maint. Ass'n v. City of Santa Clarita, et al.,* Los Angeles Superior Court Case No. BC415663 (the *"Canyon Gate* case"), and *Warrick, et al. v. City of Santa Clarita, et al.,* Los Angeles Superior Court Case No. PC046442 (the *"Warrick* case") (collectively "the underlying actions"). The Complaint alleges that D.R. Horton made claims for benefits under the policies regarding the underlying actions and that ASIC declined coverage and refused to defendant D.R. Horton.

D.R. Horton asserts a claim for breach of contract and breach of the implied covenant of good faith and fair dealings against ASIC for failure to provide D.R. Horton with a defense in the underlying actions, for withholding or delaying payments, for failing to properly investigate D.R. Horton's claims, and for refusing and failing to respond to D.R. Horton's request for benefits and coverage. D.R. Horton also seeks declaratory relief "that [ASIC is] obligated to defend and indemnify [D.R. Horton] under said Policies; and, [t]hat [ASIC is] obligated to pay for the cost of [D.R. Horton's] defense in [the underlying actions] and to pay expenses and other settlement costs in connection with [the underlying actions]." *Id.* at 14.

*2 On April 12, 2010, ASIC filed an Answer. (ECF No. 4). On October 22, 2010, ASIC filed a Counterclaim against D.R. Horton asserting a claim for declaratory relief. ASIC asserts that there is no potential coverage for Ebensteiner and that there is no potential coverage for Plaintiff D.R. Horton as an additional insured. (ECF No. 17).

On April 6, 2011, D.R. Horton filed a Motion for Partial

Summary Judgment. (ECF No. 25). On May 2, 2011, ASIC filed an Opposition. (ECF No. 41). On May 9, 2011, D.R. Horton filed a Reply. (ECF No. 42). On May 20, 2011, D.R. Horton filed a Request for Judicial Notice in Support of its Motion for Partial Summary Judgment. (ECF No. 44).

On April 15, 2011, ASIC filed a Motion for Summary Judgment, or Alternatively Partial Summary Judgment. (ECF No. 33). On May 2, 2011, D.R. Horton filed an Opposition (ECF Nos. 39–40). On May 9, 2011, ASIC filed a Reply. (ECF No. 43).

On May 20, 2011, D.R. Horton filed a Request for Judicial Notice. (ECF No. 44). On May 23, 2011, ASIC filed an Opposition. (ECF No. 45).

On May 27, 2011, the Court heard oral argument on the motions. (ECF No. 46).

On August 31, 2011, ASIC filed a Supplemental Brief.[2] (ECF No. 54). On September 14, 2011, D.R. Horton filed an Opposition to the Supplemental Brief. (ECF No. 55).

II. Factual Background

The 03 policy was issued by ASIC to Ebensteiner and covered the period from August 1, 2001 through August 1, 2002. (03 Policy, ECF No. 35–2 at 2). On March 4, 2002, Ebensteiner began performing grading work at the Canyon Gate project. (ASIC Stmt. of Undisputed Facts, ECF No. 33–2 at 3; Compl. ECF No. 1 at 10).

The 04 policy was issued by ASIC to Ebensteiner and covered the period from August 1, 2002 through August 1, 2003. (04 Policy, ECF No. 35–3 at 2).

On January 23, 2003, "certain owners of pre-existing single-family homes in a subdivision which was located ... adjacent to the Canyon Gate development ... instituted lawsuits against three D.R. Horton entities consolidated as [*Fessler*]." (ASIC Stmt. of Undisputed Facts, ECF No. 33–2 at 7; *see also Fessler* Compl. ECF No. 33–9 at 10). "The *Fessler* homeowners alleged damage to their homes due to the grading operations of Ebensteiner for D.R. Horton while grading the adjacent Canyon Gate project." (ASIC Stmt. of Undisputed Facts, ECF No. 33–2 at 7–8). "[T]he homeowners in the *Fessler* action alleged 'property damage' to their homes took place in 2002, commencing during the [03] policy [ASIC] issued to Ebensteiner." *Id.* at 8.

The 05 policy was issued by ASIC to Ebensteiner and covered the period from August 1, 2003 through August 1, 2004. (05 Policy, ECF No. 35–4 at 2).

During the course of the *Fessler* litigation, ASIC received Ebensteiner's job file which "reflected rough grading daily reports through May 2003." (Decl. Jean Fisher, ASIC attorney, ECF No. 35 at 4 ¶ 12). During the course of the *Fessler* litigation, ASIC received the Deposition of Jim Jordan who stated that construction of homes could not have begun at the Canyon Gate project until after May 2003 when the final tract map was approved. (Decl. Jean Fisher, ASIC attorney, ECF No. 35 at 4 ¶ 12; Depo. Jim Jordan, City of Santa Clarita, ECF No. 35–6 at 2, 5–6).

*3 "After May 2003, [D.R. Horton] obtained various bids for the grading of the Canyon Gate lots." (ASIC Stmt. of Undisputed Facts, ECF No. 41–2 at 28). Ebensteiner was selected to perform the additional work.

The 06 policy was issued by ASIC to Ebensteiner and covered the period from August 1, 2004 through August 1, 2005. (06 Policy, ECF No. 25–10 at 2).

In October 2007, "ASIC paid for the defense of its Named Insured, Ebensteiner, and three D.R. Horton entities as purported 'additional insureds' under Ebensteiner's [03 policy]" to settle the *Fessler* litigation. (ASIC Stmt. of Undisputed Facts, ECF No. 33–2 at 8; Settlement Agmt., ECF No. 35–5 at 2).

On November 9, 2007, June Ebensteiner provided a Declaration to ASIC which stated: "The Ebensteiner Co. and the Ebensteiner Family Trust ceased to do business and had no ongoing operations as of July 31, 2004 [the end of the 05 policy period], and was not conducting business ...." (Decl. June Ebensteiner, ECF No. 35–7 at 2). On November 6, 2008, ASIC and June Ebensteiner entered into an agreement with ASIC to rescind the 06 policy. (ASIC letter, ECF No. 35–8 at 2–4, ASIC 2045–07).

On February 27, 2009, the complaint in the *Kim* case, one of the underlying actions, was filed. (*Kim* Compl., ECF No. 25–12 at 123). The *Kim* plaintiffs are homeowners within the Canyon Gate project who allege that between March 6, 2002 and January 2003, "multiple backcut failures, earth movement, and fissures and cracks in the ground surface occurred during the implementation of the unapproved design change for the shear keys by D.R. Horton, its subcontractors and engineers. During this entire time, D.R. Horton and its grading subcontractor were performing grading of the Canyon Gate project and

extension of Golden Valley Road without approval from the City and doing so at 'their own risk.' " *Id.* at 138. The *Kim* plaintiffs allege that monitors "showed significant movement along the slide planes of these landslides commenced almost immediately after D.R. Horton began the rough grading of Canyon Gate, which movement continues to the present date." *Id.* at 143. The *Kim* plaintiffs allege that "the geologic hazards ... substantially interfered with the Plaintiffs use and enjoyment of their land." *Id.* at 161. The *Kim* plaintiffs allege: "As a direct, foreseeable and proximate result of said interference, Plaintiffs have incurred physical damage to their land, improvements and structures located on their residential real properties and/or a diminution-in-value of their residential properties as a result ...." *Id.* at 161–62.

On April 2, 2009, D.R. Horton tendered a request for coverage to ASIC based on the *Kim* case. (D.R. Horton letter, ECF No. 25–12 at 198).

On June 11, 2009, the complaint in the *Canyon Gate* case was filed on behalf of a homeowner's association for the Canyon Gate project. The Complaint asserted essentially the same facts and claims as asserted in the *Kim* case. (*Canyon Gate* Compl., ECF No. 25–13 at 2). The *Canyon Gate* case also asserts a claim of private nuisance against D.R. Horton and other builders and stated that: "As a direct, foreseeable and proximate result of said interference, [Plaintiff has] incurred physical damage to its Common Areas." *Id.* at 34.

*4 On September 22, 2009, the complaint in the *Warrick* case was filed asserting essentially the same facts and claims as asserted in the *Kim* case. (*Warrick* Compl., ECF No. 25–13 at 61). The *Warrick* plaintiffs are homeowners within the Canyon Gate project who assert a claim of private nuisance against D.R. Horton and other builders and allege: "As a direct, foreseeable and proximate result of said interference, [Plaintiffs] have incurred physical damage to their land, improvements and structures located on their residential real properties and/or a diminution-in-value of their residential properties." *Id.* at 93.

On October 1, 2009, D.R. Horton tendered a request upon ASIC for coverage regarding the *Kim, Canyon Gate,* and *Warrick* cases which "concern[ed] the grading and soils stabilization work performed during construction of [the Canyon Gate project]." (D.R. Horton letter, ECF No. 25–13 at 130). D.R. Horton provided copies of several notices to builder received by D.R. Horton from November 14, 2008 through June 5, 2009 as well as copies of the *Kim, Canyon Gate,* and *Warrick* complaints. *Id.* at 130–31.

The insurance policies at issue provide coverage as follows:

> We 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. We will have the right and duty to defend the insured against any suit' seeking those damages. However, we will have no duty to defend the insured against any 'suit' seeking damages for 'bodily injury' or 'property damage' to which this insurance does not apply....
>
> This insurance applies to 'bodily injury' and 'property damage' only if:
>
> (1) The 'bodily injury' or 'property damage' is caused by an 'occurrence' that takes place in the 'coverage territory'; and
>
> (2) The 'bodily injury' or 'property damage' occurs during the policy period.

(03 Policy, ECF No. 25–8 at 28; 04–05 Policies, ECF No. 25–9 at 4, 66; 06 Policy, ECF No. 25–10 at 4).

The term "property damage" is defined as:

> a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
>
> b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the 'occurrence' that caused it.

(03 Policy, ECF No. 25–8 at 40; 04–05 Policies, ECF No. 25–9 at 16, 78; 06 Policy, ECF No. 25–10 at 16). The term "occurrence" is defined as: " 'Occurrence' means an accident, including continuous or repeated exposure to substantially the same general harmful conditions." (03 Policy, ECF No. 25–8 at 39; 04–05 Policies, ECF No. 25–9 at 15, 77; 06 Policy, ECF No. 25–10 at 20).

On October 29, 2009, ASIC issued a letter to D.R. Horton declining D.R. Horton's request for coverage under the policies. The letter stated that ASIC had "evaluated the job file of the named insured to reaffirm that all of its work was concluded May 13, 2003 ...." (ASIC letter, ECF

No. 35–9 at 3). The letter states that ASIC was "not aware of any ... tangible property existing at the plaintiffs' lots during [the 04 policy], and we are informed construction occurred at Canyon Gate after 8/01/03 [during the 05 policy]." *Id.* The letter states:

> *5 In regard to [the 03 policy], there is no potential for 'property damage' claimed by plaintiffs as there was no 'property damage' existing on the lots during the policy period. The homes at issue in the new lawsuit were not started until after the expiration of [the 03 policy] and therefore, there is no potential for covered 'property damage' under this policy.

Id. at 5.

The letter stated that the 98 10 additional insured endorsement required a project to be "on file" but "a review of the underwriting file shows no indication of this project on file...." *Id.* at 8. The letter stated:

> As this Additional Insured Endorsement applies to on-going operations only, and the claim filed by the homeowners is for completed operations, there would be no Additional Insured coverage for this claim.... Further, the coverage was intended to provide additional insured coverage for liability arising out of or relating to the Named Insured's sole negligence whereas the complaint of *Kim et. al.* does not pertain to the sole negligence of Ebensteiner Co. While DR Horton may have qualified as an additional insured on the [03] policy issued to Ebensteiner during its work to cover the claims in the *Fessler* matter, there is no coverage available for this claim involving completed operations. In comparison, there is no additional insured coverage available to DR Horton for these claims involving 'property damage' which potentially first arose at a time when Ebensteiner's operations were completed and were not ongoing.

Id. The letter does not address coverage under the 06 policy.

III. Contentions of the Parties

D.R. Horton contends that it is an additional insured under two endorsements to the 03, 04, 05, and 06 policies. D.R. Horton contends that ASIC improperly relied on policy exclusions to deny coverage and to refuse to defend D.R. Horton. D.R. Horton contends that the damage alleged in the underlying litigation was not Ebensteiner's work product. D.R. Horton contends that the damage alleged in the underlying litigation occurred during Ebensteiner's ongoing operations. D.R. Horton contends that the damage alleged in the underlying litigation may have arisen out of Ebensteiner's sole negligence. D.R. Horton contends that D.R. Horton's wrap policies do not apply to this case.

D.R. Horton further contends that the 03 policy limits were not exhausted by ASIC's payment of $1,000,000 to settle the *Fessler* suit. D.R. Horton contends that Ebensteiner performed work during the 06 policy period and that the rescission of the 06 policy was barred as a matter of law. D.R. Horton contends that ASIC's duty to defend began when D.R. Horton provided ASIC with a notice to builder. D.R. Horton contends that it has asserted a valid claim of bad faith.

ASIC contends that D.R. Horton was not an additional insured under the 03, 04, 05, and 06 policies. Even if D.R. Horton was an additional insured, ASIC contends that the work product exclusions eliminate coverage because the property damage arose from Ebensteiner's work. ASIC contends that the ongoing operations restriction eliminates coverage in this case because the property damage alleged in the underlying litigation arose from completed operations. ASIC contends that the sole negligence restriction eliminates coverage in this case because the underlying actions do not allege damage that arose out of Ebensteiner's sole negligence. ASIC contends that the wrap policy provision eliminates coverage in this case because D.R. Horton has not tendered a request to other insurers under the wrap policies.

*6 ASIC further contends that the 03 policy was

exhausted by ASIC's payment of $1,000,000 to settle the *Fessler* suit and that the 06 policy was properly rescinded. ASIC contends that a notice to builder did not trigger the duty to defend. ASIC contends that D.R. Horton's bad faith claim fails as a matter of law and that D.R. Horton's declaratory relief claim is redundant.

IV. Discussion

Summary judgment is appropriate if there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law. *See* FED. R. CIV. P. 56(c). The moving party has the initial burden of demonstrating that summary judgment is proper. *See Adickes v. S.H. Kress & Co.,* 398 U.S. 144, 152, 90 S.Ct. 1598, 26 L.Ed.2d 142 (1970). The burden then shifts to the opposing party to provide admissible evidence beyond the pleadings to show that summary judgment is not appropriate. *See Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 324, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). "In considering a motion for summary judgment, the court may not weigh the evidence or make credibility determinations, and is required to draw all inferences in a light most favorable to the non-moving party." *Freeman v. Arpaio,* 125 F.3d 732, 735 (9th Cir.1997); *see also Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 256, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986).

To avoid summary judgment, the nonmovant must designate which specific facts show that there is a genuine issue for trial. *See Anderson,* 477 U.S. at 256; *Harper v. Wallingford,* 877 F.2d 728, 731 (9th Cir.1989). A "material" fact is one that is relevant to an element of a claim or defense and whose existence might affect the outcome of the suit. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.,* 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). The materiality of a fact is thus determined by the substantive law governing the claim or defense. *See Anderson,* 477 U.S. at 252; *Celotex,* 477 U.S. at 322; *Taylor v. List,* 880 F.2d 1040, 1045 (9th Cir.1989).

Generally, "interpretation of an insurance policy is a question of law." *Waller v. Truck Ins. Exchange, Inc.,* 11 Cal.4th 1, 18, 44 Cal.Rptr.2d 370, 900 P.2d 619 (1995). "insurance policies are contracts to which ordinary rules of contractual interpretation apply." *Maryland Casualty Co. v. Nationwide Ins. Co.,* 65 Cal.App.4th 21, 28, 76 Cal.Rptr.2d 113 (1998). The court should "look first to the language of the contract in order to ascertain its plain meaning ...." *Waller,* 11 Cal.4th at 18, 44 Cal.Rptr.2d 370, 900 P.2d 619. "A policy provision is ambiguous when it is capable of two or more constructions both of which are reasonable." *Id.* (quotations omitted). "Any ambiguous terms are resolved in the insureds' favor, consistent with the insureds' reasonable expectations." *Kazi v. State Farm Fire and Cas. Co.,* 24 Cal.4th 871, 879, 103 Cal.Rptr.2d 1, 15 P.3d 223 (2001).

"An insurer must defend any action that asserts a claim potentially seeking damages within the coverage of the policy." *Maryland Casualty Co.,* 65 Cal.App.4th at 32, 76 Cal.Rptr.2d 113 (quoting *Montrose Chemical Corp. v.Super. Ct.,* 6 Cal.4th 287, 295 n. 3, 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153 (1993)); *see also Buss v. Superior Court,* 16 Cal.4th 35, 46 n. 10, 65 Cal.Rptr.2d 366, 939 P.2d 766 (1997) (holding that the duty to defend is dependent on "at least potential coverage."). "[T]he duty to defend may exist even where coverage is in doubt and ultimately does not develop ...." *Kazi,* 24 Cal.4th at 879, 103 Cal.Rptr.2d 1, 15 P.3d 223; *see also Quan v. Truck Ins. Exchange,* 67 Cal.App.4th 583, 79 Cal.Rptr.2d 134 (1998) (explaining that because interpretation of an insurance policy is a question of law based on the contract "writings or memos by insurance company personnel venturing their opinions as to whether a defense should be afforded do not constitute 'admissions' of a defense duty."). "[F]or an insurer, the existence of a duty to defend turns not upon the ultimate adjudication of coverage under its policy of insurance, but upon those facts known by the insurer at the inception of a third party lawsuit." *Montrose,* 4 Cal.4th at 295, 14 Cal.Rptr.2d 418, 841 P.2d 938 (internal citations and quotations omitted). "[T]he duty to defend, although broad, is not unlimited; it is measured by the nature and kinds of risks covered by the policy." *Waller,* 11 Cal.4th at 19, 44 Cal.Rptr.2d 370, 900 P.2d 619. "[W]here there is no potential for coverage, there is no duty to defend." *Infinet Marketing Services, Inc. v. American Motorist Ins. Co.,* 150 Cal.App.4th 168, 177, 58 Cal.Rptr.3d 92 (2007); *see also Hudson Ins. Co. v. Colony Ins. Co.,* 624 F.3d 1264, 1268 (9th Cir.2010) (holding that the duty to defend does not exist where there is no legal theory or facts in the underlying complaint to potentially give rise to coverage) (citing *Gunderson v. Fire Insurance Exchange,* 37 Cal.App.4th 1106, 44 Cal.Rptr.2d 272 (1995)).

*7 Accordingly, "[i]n resolving the question of whether a duty to defend exists ... the insurer has a higher burden than the insured." *American States Ins. Co. v. Progressive Cas. Ins. Co.,* 180 Cal.App.4th 18, 27, 102 Cal.Rptr.3d 591 (Cal.App.2009). " '[T]he insured need only show that the underlying claim may fall within policy coverage; the

insurer must prove it cannot'; the insurer, in other words, must present undisputed facts that eliminate any possibility of coverage." *Id.* (emphasis and citations omitted).

A. Additional Insured

i. Additional Insured Endorsement 20 10

D.R. Horton contends that there was "at least a potential" that it was an additional insured under the 03 and 04 policies pursuant to 20 10 endorsements on the grounds that: (1) Ebensteiner's broker, Baccarella Insurance Services ("Baccarella"), issued Certificates of Insurance stating that D.R. Horton was additional insured under the 03 and 04 policies, and (2) ASIC was aware that Baccarella issued Certificates of Insurance and specifically authorized Baccarella to do so. (ECF No. 25–1 at 18).

ASIC contends that D.R. Horton was not an additional insured under any 20 10 endorsements on the grounds that the policies did not contain 20 10 endorsements and the purported endorsements that D .R. Horton has produced were created by Ebensteiner's agent Baccarella, not ASIC. ASIC contends that the 20 10 endorsements from Ebensteiner's agent Baccarella to D.R. Horton were unauthorized and were not approved by ASIC. ASIC contends that it cannot be liable for the acts of Bacarella as an "ostensible agent" on the grounds that it did not authorize or provide apparent authority to Baccarella to act as an agent of ASIC. (ECF No. 43 at 10).

D.R. Horton has submitted a Certificate of Liability Insurance issued by Ebensteiner's agent Baccarella to Ebensteiner for the 03 policy which states: "RE: Canyon Gate ... [D.R. Horton is] hereby named as additional insured per CG2010 (11–85) attached." (ECF No. 25–10 at 61). D.R. Horton has also submitted a Certificate of Liability Insurance issued by Ebensteiner's agent Baccarella to Ebensteiner for the 04 policy which states: "RE: Canyon Gate ... [D.R. Horton is] added as additional insured only as their interest may appear per CG2010 (11–85)." (ECF No. 25–10 at 63). D .R. Horton has also submitted the 20 10 additional insured endorsement form issued by Ebensteiner's agent Baccarella. *Id.* at 64–65, 102 Cal.Rptr.3d 591.

ASIC has submitted a quote for insurance dated July 17, 2002, on "American Safety Insurance Services, Inc." letterhead from Frank Dunne, ASIC's Underwriter, to Jack Smith of "Brown & Riding," ASIC's surplus line producer, regarding "Insurance Proposal for Ebensteiner Company" which states the terms of the insurance. (ECF No. 35–12 at 2). The quote allows for the enhancement of "additional Insured Wording where required by written contract and as per [ASIC] Additional Insured Endorsements."[3] *Id.* at 3, 102 Cal.Rptr.3d 591. The quote contains a section titled "Warranties/Requirements" which states:

> *8 The company has granted the Producer named above the authority to issue certificates of insurance on behalf of the Named Insured. However, in no event does such producer have the authority to issue certificates of insurance which include any addition to or modification of the policy terms and conditions, or to add any additional insureds and/or change any term, condition, provision of the policy unless such changes or modifications are first approved by policy endorsement issued by the company and signed by an officer.
> *Id.*

D.R. Horton has submitted a fax dated July 22, 2002, on "American Safety Insurance Services, Inc" letterhead, from Candy Woodward, Assistant Underwriter for ASIC, to Jack Smith of "Brown & Riding," ASIC's surplus line producer, with the subject line "Ebensteiner Company" which states: "I spoke with Frank [ASIC's Underwriter] this morning concerning the CG2010's on this account. He said that he didn't have a problem with 15–20 of them but anymore than that he would have to look into .... I noticed the list has many more than that so I don't know what can be done with such a large list." (ECF No. 25–10 at 67). ASIC has submitted a letter dated July 18, 2002, from "Ron Arody for Jack Smith" of Brown & Riding, ASIC's surplus line producer, regarding Ebensteiner Co. which states: "Attached please find a copy of the list of Additional Insureds regarding the GC 20 10 11/85 on the current policy." (ECF No. 35–16 at 4). The list includes 39 additional insureds. D.R. Horton does not appear on that list.

ASIC has submitted a letter dated July 28, 2003, from Kelly Nguyen of Brown & Riding, ASIC's surplus line producer, to Frank Dunn, ASIC's Underwriter, which states:

> Last year you have (sic) agreed to provide CG 2010 1185 on certain projects. Some of those projects are ongoing and we need to continue with the CG2010 1185 on the renewed policy. Please

> endorse the policy to provide CG2010 1185 for those ongoing projects. An updated list of those projects is attached.

(ECF No. 35–17 at 2). The attached list includes 39 additional insureds. D.R. Horton does not appear on that list.

ASIC has submitted a quote for insurance dated August 13, 2003 regarding the 05 policy which states:

> The company has granted the Producer named above the authority to issue certificates of insurance on behalf of the Named Insured. However, in no event does such producer have the authority to issue certificates of insurance which include any addition to or modification of the policy terms and conditions, or to add any additional insureds and/or change any term, condition, provision of the policy unless such changes or modifications are first approved by policy endorsement issued by the company and signed by an officer.

(ECF No. 35–13 at 4).

Under California law a principal may be liable for the acts of an "ostensible agent" where the following three elements are met: "(1) 'the person dealing with the agent must do so with belief in the agents authority and this belief must be a reasonable one,' (2) "such belief must be generated by some act or neglect of the principal sought to be charged,' and (3) 'the third person in relying on the agent's apparent authority must not be guilty of negligence.' " *Certain Underwriters at Lloyd's of London v. Am. Safety Ins. Servs., Inc.,* 702 F.Supp.2d 1169, 1173 (C.D.Cal.2010) (quoting *Mejia v. Community Hospital of San Bernardino,* 99 Cal.App.4th 1448, 1456, 122 Cal.Rptr.2d 233 (2002)); *see also Am. Cas. Co. of Reading, Penn. v. Krieger,* 181 F.3d 1113, 1121 (9th Cir.1999) (" 'An agency is ostensible when the principal intentionally, or by want of ordinary care, causes a third person to believe another to be his agent who is not really employed by him.' ") (quoting Cal. Civ.Code § 2300). Ostensible agency has been applied to the insurance context as existing "where the principal knows that the agent holds himself out as clothed with certain authority, and remains silent." *Preis v. Am. Indem. Co.,* 220 Cal.App.3d 752, 760, 269 Cal.Rptr. 617 (1990); *see also Am. Cas. Co. of Reading, Penn.,* 181 F.3d at1 121 (explaining that the principal is liable for the acts of another where it "intentionally or by want of ordinary care has caused or allowed [the third party] to believe the agent possesses such authority...."); *see also Alex Robertson Co. v. Imperial Casualty & Indemnity Co.,* 8 Cal.App.4th 338, 343–46, 10 Cal.Rptr.2d 165 (1992).

*9 In this case, the 03, 04, 05, and 06 policies issued by ASIC do not contain generic form 20 10 endorsements. The form 20 10 additional insured endorsements that D.R. Horton obtained regarding the 03 and 04 policies were provided by Ebensteiner, who had obtained them from Ebensteiner's agent Baccarella. ASIC limited the authority of its underwriter to offer certificates of insurance only in circumstances where any additional insured enhancement was first approved by ASIC and the approval was signed by an officer. ASIC's surplus line producer, Brown & Riding, issued certificates of insurance to a list of purported additional insureds; however, the list did include D.R. Horton or the Canyon Gate project. There is no evidence that ASIC was aware that Ebensteiner's agent Baccarella issued form 20 10 additional insured endorsements to D.R. Horton or that ASIC granted Ebensteiner's agent Baccarella authority to issue form 20 10 additional insured endorsements to D.R. Horton. The Court concludes that any belief that D.R. Horton may have had regarding its status as an additional insured pursuant to a form 20 10 endorsement was not "generated by some act or neglect of the principal sought to be charged [.]" *Certain Underwriters at Lloyd's of London,* 702 F.Supp.2d at 1173. Accordingly, any action against D.R. Horton could not assert a "claim potentially seeking damages within the coverage of the policy[ ]" pursuant to any 20 10 additional insured endorsement. *Montrose Chemical Corp.,* 6 Cal.4th at 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153. The record shows that ASIC did not have a duty to defend D.R. Horton under the policies pursuant to any 20 10 endorsements

ii. Additional Insured Endorsement 98 15

D.R. Horton contends that it "qualified, at least potentially, as an additional insured under the [98 15] endorsement" on the grounds that the subcontractor agreement between D.R. Horton and Ebensteiner required Ebensteiner to name D.R. Horton as an additional insured and the Canyon Gate project was on

file with ASIC. (ECF No. 25–1 at 18). D.R. Horton contends that ASIC has "acknowledged the on file requirement can be met by showing anything in writing that is contained in [ASIC's] own files indicating the project site was covered." (ECF No. 42 at 8). D.R. Horton contends that a waiver of subrogation form attached to the 03 policy shows that the Canyon Gate project was on file.

ASIC contends that D.R. Horton is not an additional insured pursuant to the 98 15 endorsement on the grounds that the Canyon Gate project was not on file with ASIC. ASIC contends that "[t]o be on file, there must be some indication of approval by the underwriter and/or within the policy that a project is covered." (ECF No. 41 at 21.) ASIC contends that the generic endorsements attached to the policies do not name D.R. Horton or the Canyon Gate project so the project was not on file.[4]

The 03, 04, 05, and 06 policies each contain a generic form 98 15 titled "Additional Insured" endorsement which states: "Name of person or organization: Those parties required to be named as an Additional Insured in a written contract with the Named Insured entered into prior to the loss or occurrence. Name of Project: Those projects on file with the Company." (ECF No. 25–8 at 27, 57; ECF No. 25–9 at 3, 33, 64, 95; ECF No. 25–10 at 3, 30).

*10 D.R. Horton has submitted the subcontract between D.R. Horton and Ebensteiner dated April 12, 2002, which required Ebensteiner provide D.R. Horton with a certificate of insurance that "name[s] D.R. Horton ... as an additional insured." (ECF No. 25–8 at 24). ASIC does not dispute that the subcontractor agreement between D.R. Horton and Ebensteiner required Ebensteiner to name D.R. Horton as an additional insured.

D.R. Horton has submitted a letter dated April 24, 2002, from ASIC to Brown & Riding stating, as the subject line "Ebensteiner Co. Endorsement ES 98 13 08 99 Attached to Policy ["03"]," and an "ASIC–ES 98 13 08 99 Endorsement—Waiver of Subrogation" form which lists the organization as D.R. Horton and the Canyon Gate project. (ECF No. 25–15 at 8–11). The waiver of subrogation form states: "In consideration of the payment of premiums, we [ASIC] waive our right to subrogation against the person or organization named above [D.R. Horton] in connection with the sole negligence of the Named Insured [Ebensteiner] in the performance of 'your work' on the project described below [Canyon Gate] ...." *Id.* at 11, 24 Cal.Rptr.2d 467, 861 P.2d 1153.

In this case, the policies each contain a form 98 15 additional insured endorsement which allow for additional insureds to be added to the policies. The policies provide for additional insurance coverage where the party is required to be named as an additional insured in a written contract with the named insured. The subcontractor agreement between D.R. Horton and Ebensteiner required Ebensteiner to name D.R. Horton as an additional insured under the insurance. The terms of the policies do not define "on file" within the meaning of form 98 15, which weighs in favor of coverage. *See Golden Eagle Ins. Co. v. Insurance Co. of the West,* 99 Cal.App.4th 837, 845, 121 Cal.Rptr.2d 682 (2002) ("Ambiguities in insurance contracts are generally construed in favor of coverage.") (citing *Ins. Co. v. Superior Court,* 51 Cal.3d 807, 822, 274 Cal.Rptr. 820, 799 P.2d 1253 (1990)). The Court finds that there is at least a factual dispute regarding whether the Canyon Gate project was "on file" with ASIC pursuant to the inclusion of the "ASIC—ES 98 13 08 99 Endorsement—Waiver of Subrogation" form in the 03 policy. *See Montrose Chemical Corp.,* 6 Cal.4th at 295 n. 3, 24 Cal.Rptr.2d 467, 861 P.2d 1153 (finding that there was a duty to defend although the parties factually disputed whether the plaintiff was a named insured under the policy). There is evidence in the record to support the finding that the Canyon Gate project was on file with ASIC within the meaning of the policies because the waiver of subrogation form identified D.R. Horton and related to work at the Canyon Gate project. The Court concludes that there was a potential for coverage and that ASIC had a duty to defend D.R. Horton as an additional insured pursuant to the 98 15 endorsements. *See Montrose Chemical Corp.,* 6 Cal.4th at 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153.[5]

B. 03 Policy Per Occurrence Limit

ASIC contends that there is no potential for coverage under the 03 policy because the policy was exhausted by the payment of the $1,000,000 per-occurrence limit in the *Fessler* suit. ASIC contends that it properly allocated the entire $1,000,000 payment to the 03 policy on the grounds that the policies contained a "deemer provision" that all damage which commenced prior to the inception of the policy is deemed to have occurred in any prior policy, and that the policies contained an exclusion for preexisting injuries. (ECF No. 41 at 28). ASIC contends that the allegations in the *Kim, Canyon Gate,* and *Warrick* cases do not raise a possibility of a second occurrence

under the 03 policy on the grounds that the damage alleged in the *Kim, Canyon Gate,* and *Warrick* complaints and the damage alleged in the *Fessler* suit are based on the same proximate cause: Ebensteiner's grading work at the Canyon Gate project. *See* (ECF No. 33 at 30).

*11 D.R. Horton contends that "ASIC has not eliminated the potential for coverage" on the grounds that ASIC had a duty to split the settlement in *Fessler* of $1,000,000, between the 03 and 04 policies instead of exhausting the 'per occurrence' limit for the 03 policy. (ECF No.25–1 at 23). D.R. Horton contends that the damages alleged in the *Fessler* suit arose during the 03 policy and continued into the 04 policy; therefore, ASIC's "implied covenant ... to give at least as much consideration to [D.R. Horton's] interests as [ASIC did] to its own[ ] ... required ASIC to split the settlement between [the 03 and 04] policies." *Id.* at 23, 24 Cal.Rptr.2d 467, 861 P.2d 1153. D.R. Horton contends that even if ASIC properly allocated the entire $1,000,000 payment to the 03 policy, the property damage alleged in the underlying litigation arose out of a different occurrence than the damage in the *Fessler* case because the damaged properties were located on a different slope. D.R. Horton contends that the 03 policy's aggregate limit of $2,000,000 is available, because the damage in the underlying litigation arose out of a separate occurrence.

It is undisputed that the homeowners in the *Fessler* action alleged that there was property damage to their homes beginning in 2002 and that the damage was ongoing. It is undisputed that ASIC paid $1,000,000 to settle the *Fessler* litigation.

The 03 and 04 policies provided $1,000,000 of coverage for each occurrence limited to a general aggregate total of $2,000,000 of coverage. (ECF No. 25–8 at 26, 62; ECF No. 25–9 at 2, 38). The 03 and 04 policies contain a provision that states: " 'Occurrence' means an accident, including continuous or repeated exposure to substantially the same general harmful conditions that happens during the term of this insurance." (ECF No. 25–8 at 39; ECF No. 25–9 at 15). The "Amended Definitions Endorsement—Occurrence or Duty to Defend" form attached to the 03 and 04 policies adds: " 'Property damage', 'bodily injury' or 'personal and advertising injury' which commenced prior to the effective date of this insurance will be deemed to have happened prior to, and not during, the term of this Insurance." (ECF No. 25–8 at 47; ECF No. 25–9 at 23). The "Pre-existing Injury or Damage Exclusion" form attached to the 03 and 04 policies state:

> This insurance does not apply to:
>
> 1. Any 'occurrence', incident or 'suit' whether known or unknown to any officer of the Named Insured:
>
> a. Which first occurred prior to the inception date of this policy ...; or
>
> b. Which is, or is alleged to be, in the process of occurring as of the inception date of this policy ... even if the 'occurrence' continues during this policy period.

(ECF No. 25–8 at 52; ECF No. 25–9 at 28).

The Court finds that the 03 and 04 policies allowed for ASIC to assign property damage that commenced in one term and continued into another term to the first term. The Court concludes that the 03 policy limit per occurrence has been exhausted. However, the 03 policy also provided an aggregate limit of $2,000,000 where there are separate occurrences.

*12 "The *number* of relevant occurrences for the purpose of interpreting the per occurrence limitation of liability is different from the question of *when* the relevant occurrence happens for the purpose of determining if there is coverage at all, or whether coverage should be allocated to a particular policy period." *Whittaker Corp. v. Allianz Underwriters, Inc.,* 11 Cal.App.4th 1236, 1242, 14 Cal.Rptr.2d 659 (1992). With regard to whether there is a single or multiple occurrences, the court looks to the "underlying proximate cause." *Id.* (citing *Appalachian Ins. Co. v. Liberty Mut. Ins. Co.,* 676 F.2d 56, 61 n. 11 (3rd Cir.1982)); *see also EOTT Energy Corp. v. Storebrand Internat. Ins. Co.,* 45 Cal.App.4th 565, 577–78, 52 Cal.Rptr.2d 894 (1996).

The 03 policy was effective from August 2001 through August 2002. At the time that ASIC denied tender of the defense in this case, ASIC had Ebensteiner's job file and job logs which ended in May 2003. ASIC had information regarding Ebensteiner's work during the 03 policy period which consisted of grading at the Canyon Gate project.

The *Fessler* complaint and the *Kim, Canyon Gate,* and *Warrick* complaints each allege damage caused by the grading work at the Canyon Gate project. To the extent that some of the damage alleged by the *Kim, Canyon Gate,* and *Warrick* plaintiffs occurred during the 03

policy, the damage would have arisen out of the same grading work that ASIC had already determined was an "occurrence" and had paid the $1,000,000 per occurrence policy limit. The damage alleged by the *Kim, Canyon Gate,* and *Warrick* plaintiffs arose out of the same proximate cause and does not constitute a second occurrence because the damaged property is located on a different slope. *See Whittaker Corp.,* 11 Cal.App.4th at 1242, 14 Cal.Rptr.2d 659 (holding that the number of occurrences under a policy is determined by the "underlying proximate case" of the injury).

The Court concludes that ASIC has presented undisputed facts and has eliminated any possibility of coverage under the 03 policy. *See American States Ins. Co.,* 180 Cal.App.4th at 27, 102 Cal.Rptr.3d 591. The Court concludes there was no potential for coverage and no duty to defend D.R. Horton under the 03 policy on the grounds that any action against D.R. Horton could not assert a "claim potentially seeking damages within the coverage of the policy." *Montrose Chemical Corp.,* 6 Cal.4th at 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153; *see also Whittaker Corp.,* 11 Cal.App.4th at 1242, 14 Cal.Rptr.2d 659.[6]

C. 06 Policy

D.R. Horton contends that Ebensteiner performed work during the 06 policy period as shown by certain change orders, a waiver, and an invoice dated in August 2004. D.R. Horton contends that "[a]t minimum ... there is a factual dispute about whether Ebensteiner was performing 'ongoing operations' during the 06 policy." (ECF No. 40 at 15).

ASIC contends that Ebensteiner "had no ongoing operations [during the 06 policy] to give rise to new accidents and exposures...." (ECF No. 41 at 29).

*13 D.R. Horton has submitted a daily log report dated August 2, 2004 which states: "[quantity] 4 inlet structures $150.00 each ... [quantity] 4 outlet structures $150.00 each ... 1 month rental and back flow device ... July 1–July 31 $1,000 ...." (ECF No. 25–11 at 67). D.R. Horton has submitted a change order dated August 4, 2004 and a change order dated August 11, 2004, from D.R. Horton to Ebensteiner authorizing certain work identified in daily log reports dated between June 2004 and July 2004 as well as the daily log report dated August 2, 2004. *Id.* at 69, 71, 14 Cal.Rptr.2d 659. D.R. Horton has submitted an invoice from Ebensteiner to D.R. Horton dated August 31, 2004. *Id.* at 77, 14 Cal.Rptr.2d 659. D.R. Horton has also submitted an "Unconditional Waiver and Release Upon Final Payment" dated January 7, 2005, stating that Ebensteiner had been paid by D.R. Horton for the work done at the Canyon Gate project. *Id.* at 79, 14 Cal.Rptr.2d 659.

The Court finds that D.R. Horton has failed to submit evidence to show that Ebensteiner performed work during the 06 policy period. The invoice and unconditional waiver and release upon final payment submitted by D.R. Horton do not show that Ebensteiner performed work after July 31, 2004. The daily log report dated August 2, 2004 records the use of materials and the "1 month rental" of a back flow device from "July 1–July 31 ...." (ECF No. 25–11 at 67). The change orders dated August 4 and 11, 2004 approve work performed between June 2004 and July 2004 and approve the daily log report dated August 2, 2004 for the rental of equipment in July 2004. The Court concludes that D.R. Horton has failed to carry its burden to show that there is no genuine issue as to any material fact and that D.R. Horton is entitled to a judgment as a matter of law that ASIC owed a duty to defend D.R. Horton under the 06 policy.[7] *See* FED. R. CIV. P. 56(c); *see also Adickes,* 398 U.S. at 152.

D. Exclusions for Property Damage Arising Out of "Your Work"

ASIC contends that the work product exclusions of j(5) and j(6) eliminate coverage for property damage arising from Ebensteiner's work from all policies. (ECF No. 33 at 20). ASIC contends that "Ebensteiner graded the entire site so the site is its work product and therefore is not covered." (ECF No. 43 at 2). ASIC asserts that the "subcontract agreement" between D.R. Horton and Ebensteiner shows that Ebensteiner's work encompassed the entire tracts because the subcontract agreement provides that the contract is for "rough grading" of tracts "48892, 48892–02." (ECF No. 25–8 at 2). ASIC asserts that a letter dated September 7, 2007, to ASIC from D.R. Horton shows that Ebensteiner's work encompassed the entire tracts because it states that Ebensteiner "conducted the grading of the Canyon Gate project." (ECF No. 25–12 at 2). ASIC also asserts that Ebensteiner's job file with entries dating from February 12, 2002 through March 4, 2003 shows that Ebensteiner performed rough grading work on the entire Canyon Gate project.[8] (ECF No. 25–10 at 69–116).

*14 D.R. Horton contends that ASIC had a duty to defend and that the work product exclusions do not eliminate potential coverage because they "only apply to the 'particular part' of the property on which the insured was working .... " (ECF No. 40 at 24). D.R. Horton contends that the damage, which consisted of cracking and fissures, may have occurred on portions of the property where Ebensteiner had not worked. D.R. Horton contends that the damage alleged relates to property that was not Ebensteiner's work product. D.R. Horton contends that to eliminate potential coverage under ASIC's interpretation of the j(5) and (6) exclusions, "ASIC must prove that Ebensteiner actually worked on all of the land that suffered damage." *Id.* at 19.

The insurance policies at issue provide for coverage as follows:

> We 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....
>
> This insurance applies to 'bodily injury' and 'property damage' only if:
>
> (1) The 'bodily injury' or 'property damage' is caused by an 'occurrence' that takes place in the 'coverage territory'; and
>
> (2) The 'bodily injury' or 'property damage' occurs during the policy period.

(ECF No. 25–8 at 28; ECF No. 25–9 at 4, 66; ECF No. 25–10 at 4).

The term "property damage" is defined as:

> a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
>
> b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the 'occurrence' that caused it.

(ECF No. 25–8 at 40; ECF No. 25–9 at 16, 78; ECF No. 25–10 at 16).

The policies contain work product exclusions j(5) and j(6) which state that there is no coverage for: " 'property damage' to ... (5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the 'property damage' arises out of those operations; or (6)[t]hat particular part of any property that must be restored, repaired, or replaced because 'your work' was incorrectly performed on it." (ECF No. 33–2 at 20–21).

The j(5) and j(6) exclusions "preclude coverage for deficiencies in the insured's work." *Clarendon Am. Ins. Co. v. Gen. Sec. Indem. Co. of Ariz.,* 193 Cal.App.4th 1311, 1325, 124 Cal.Rptr.3d 1 (2011) (explaining that defect and deficiencies in the insured's work would be excluded by j(5) and j(6)) (citation omitted). "Generally, liability policies ... are not designed to provide contractors and developers with coverage against claims *their work* is inferior or defective." *Maryland Casualty Co. v. Reeder,* 221 Cal.App.3d 961, 967, 270 Cal.Rptr. 719 (1990) (citation omitted) (emphasis aded). Work product exclusions such as those contained in exclusions j(5) and j(6) exclude "repair and replacement losses" and are intended to provide "incentive to exercise care in workmanship thereby reducing the risk that is covered." *Western Employers Ins. Co. v. Arciero & Sons, Inc.,* 146 Cal.App.3d 1027, 1031–32, 194 Cal.Rptr. 688 (1983) (quotation and citation omitted). "Rather, the effect of the policy is to make the contractor stand its own replacement and repair losses while the insurer takes the risk of injury to the property of others." *Id.* at 31, 194 Cal.Rptr. 688. "The risk intended to be insured is the possibility that the ... work of the insured, once relinquished or completed, will cause bodily injury or damage to property *other than to the product or completed work itself ...." Id.* (quotation and citation omitted) (emphasis added).

*15 In this case, the *Kim, Canyon Gate,* and *Warrick* plaintiffs are homeowners and landowners within the Canyon Gate project. The *Kim* plaintiffs allege that between March 6, 2002 through January 2003, "multiple backcut failures, earth movement, and fissures and cracks in the ground surface occurred during the implementation of the unapproved design change for the shear keys by D.R. Horton, its subcontractors and engineers." (ECF No. 25–12 at 138). The *Kim* plaintiffs allege that monitors were installed during the rough grading process which "showed significant movement along the slide planes of these landslides commenced almost immediately after D.R. Horton began the rough grading of Canyon Gate, which movement continues to the present date." *Id.* at 143, 194 Cal.Rptr. 688. The *Kim* plaintiffs allege that "the geologic hazards ... substantially

interfered with the Plaintiffs use and enjoyment of their land." *Id.* at 161, 194 Cal.Rptr. 688. The *Kim* plaintiffs allege that the interference with the use and enjoyment of their land is "indefinite and unreasonable, in that their properties have sustained permanent physical injury, measures taken in remediation of the current geological hazards are not likely to restore their property to its original market value, and the geologic conditions present an ongoing and significant risk of additional future harm." *Id.* The *Kim* plaintiffs allege: "As a direct, foreseeable and proximate result of said interference, Plaintiffs have incurred physical damage to their land, improvements and structures located on their residential real properties and/or a diminution-in-value of their residential properties as a result .... " *Id.* at 161–62, 194 Cal.Rptr. 688. The *Canyon Gate* plaintiff also asserts a claim of private nuisance against D.R. Horton and other builders and states that: "As a direct, foreseeable and proximate result of said interference, [Plaintiff has] incurred physical damage to its Common Areas." (ECF No. 25–13 at 34). The *Warrick* plaintiffs allege: "As a direct, foreseeable and proximate result of said interference, [Plaintiffs] have incurred physical damage to their land, improvements and structures located on their residential real properties and/or a diminution-in-value of their residential properties." *Id.* at 93, 194 Cal.Rptr. 688.

The *Kim, Canyon Gate,* and *Warrick* plaintiffs allege damage beyond the repair and replacement of the grading work. The *Kim, Canyon Gate,* and *Warrick* plaintiffs allege damage to their land and property caused by the grading work at the Canyon Gate project. A claim for repair of damage to land or property other than the grading work itself is not excluded by j(5) and j(6). There is a potential for coverage and the j(5) and j(6) work product exclusions did not eliminate a duty to defend.

Even if the Court presumed that the j(5) and j(6) exclusions preclude coverage for damage to land or property upon which Ebensteiner had performed any work, the Court does not conclude that ASIC has eliminated any possibility of coverage under the 04 and 05 policies. ASIC has failed to show that at the time it declined to provide a defense, ASIC relied upon information that showed that Ebensteiner had graded all of the land within the Canyon Gate project. The subcontractor agreement identified the location of work as tracts "48892, 48892–02." (ECF No. 25–8 at 2). However, the subcontractor agreement does not show that Ebensteiner graded the entire tracts. The letter dated September 7, 2007, to ASIC from D.R. Horton states that Ebensteiner "conducted the grading of the Canyon Gate project." (ECF No. 25–12 at 2). The letter describes the work done by Ebensteiner; the letter does not show that Ebensteiner performed work on the *entire* tracts. Finally, Ebensteiner's job file entries dating from February 12, 2002 through March 4, 2003 list material and equipment used as well as hours spent, but the job file entries do not show whether Ebensteiner performed work on the entire tracts.

*16 The Court finds that the *Kim, Canyon Gate,* and *Warrick* plaintiffs allege damage to their land and property other than the repair and replacement of the grading work by Ebensteiner. The Court finds that the *Kim, Canyon Gate,* and *Warrick* complaints assert claims potentially seeking to recover for damage to land or property located within the Canyon Gate project, but built on portions of the Canyon Gate project which Ebensteiner had not performed grading work. ASIC has failed to show that there was no "potential" that Ebensteiner's grading work caused damage to land or property which would not be excluded by j(5) and j(6). *Montrose Chemical Corp.,* 6 Cal.4th at 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153. At the time of the denial of coverage, the Court concludes that the j(5) and j(6) work product exclusions in the 04 and 05 policies did not eliminate a duty to defend. *See Kazi,* 24 Cal.4th at 879, 103 Cal.Rptr.2d 1, 15 P.3d 223.

E. Limitation of Coverage to "Ongoing Operations"

ASIC contends that the additional insured endorsements restrict coverage to Ebensteiner's ongoing operations which would only include liability that arises while Ebensteiner's work was in progress. ASIC contends that the underlying actions do not allege that damage occurred while Ebensteiner was performing grading work. ASIC contends that the underlying actions allege exclusively completed operations damages because they "seek damages from the sale of the completed homes and structures" purchased in 2005–2006. (ECF No. 33 at 25). ASIC contends that there was no potential for coverage for damage to homes under the 05 policy because "nothing ... could be built on any lot or other area of the project unless and until Ebensteiner's grading operations on that lot or area was completed." *Id.* ASIC further contends that there was no potential for coverage for damage to land under the 04 and 05 policies because "graded dirt" is not tangible property. (ECF No. 41 at 25).

D.R. Horton contends that the policies provide for coverage where the property damage in the underlying litigation occurred during the policy period. D.R. Horton contends that "the underlying complaints do not allege when the property damage occurred. Therefore, there was at least a potential that property damage occurred during each policy period." (ECF No. 25–1 at 20). D.R. Horton contends that there was a potential for coverage during each of the 04 and 05 policies on the grounds that damage could have occurred to the land during Ebensteiner's ongoing operations. D.R. Horton contends that there was also a potential for coverage under the 05 policy on the grounds that damage could have occurred to home which were built during Ebensteiner's ongoing operations.

The policies at issue state: "We will pay those sums that the insured becomes legally obligated to pay as damages because of ... 'property damage' to which this insurance applies ...." (ECF No. 33–2 at 10–11). The policies state: "This insurance applies to 'bodily injury' and 'property damage' only if: ... (2) the 'bodily injury' or 'property damage' occurs during the policy period." *Id.* The policies define "property damage" as "physical injury to tangible property, including all resulting loss of use of that property ...." *Id.* at 11–12. The 04 and 05 additional insured endorsements form 98 15 state: "This Endorsement applies only to *ongoing* operations performed by the Named Insured ...." (ECF No. 25–9 at 33, 95) (emphasis added).[9] Insurance policies which "expressly restrict coverage for an additional insured to the 'ongoing operations' of the named insured" ... "effectively preclude[s] application of the endorsement's coverage to completed operations losses." *Pardee Const. Co. v. Insurance Co. of the West,* 77 Cal.App.4th 1340, 1359 & n. 16, 92 Cal.Rptr.2d 443 (2000) (explaining that coverage restrictions to "your ongoing operations" restricts liability to "work in progress only").

*17 The California Supreme Court has held: " 'Tangible property' is not ambiguous, and coverage therefore does not turn on alternative meanings. Consistent with an insured's reasonable expectations, 'tangible property' refers to things that can be touched, seen, and smelled." *Kazi,* 24 Cal.4th at 880, 103 Cal.Rptr.2d 1, 15 P.3d 223 (distinguishing tangible property from an easement which is an intangible legal interest in real property). As discussed above, the *Kim, Canyon Gate,* and *Warrick* plaintiffs each allege damage to their "land" or "Common Areas." (ECF No. 25–12 at 161; ECF No. 25–13 at 2, 93).

With respect to the alleged damage to "graded dirt" or land during the 04 and 05 policies, the Court does not find, as a matter of law, that "graded dirt" or land is not tangible property. The *Kim, Canyon Gate,* and *Warrick* plaintiffs have alleged damage to their land which could have occurred during the 04 or 05 policy periods. The parties do not dispute that Ebensteiner was performing work at the Canyon Gate project during the 04 and 05 policies. ASIC has failed to show that at the time it denied D.R. Horton's tender, there was no "potential" that Ebensteiner's grading work could have damaged land on areas of the Canyon Gate project during the time in which Ebensteiner's work was ongoing in another part of the project. *Montrose Chemical Corp.,* 6 Cal.4th at 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153. The Court concludes that at the time of the denial of coverage the "ongoing operations" limitation of coverage did not eliminate a duty to defend. *See Kazi,* 24 Cal.4th at 879, 103 Cal.Rptr.2d 1, 15 P.3d 223.

With respect to the alleged damage to homes or property during the 05 policy, at the time that ASIC denied tender, ASIC stated that "we are informed construction occurred at Canyon Gate after 8/01/03 [during the 05 policy]," and that "homes in the 'Canyon Gate' development were completed starting in 'late 2004 [during the 06 policy].' " (ECF No. 35–9 at 3). The parties do not dispute that Ebensteiner was performing work at the Canyon Gate project during the 05 policy.

The *Kim, Canyon Gate,* and *Warrick* plaintiffs have alleged damage to their homes or property which could have occurred during the 05 policy period. The Court finds that ASIC has failed to show that at the time it denied D.R. Horton's tender, there was no "potential" that Ebensteiner's grading work could have damaged homes or property built on portions of the Canyon Gate project during the time in which Ebensteiner's work was ongoing in another part of the project. *Montrose Chemical Corp.,* 6 Cal.4th at 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153. The Court concludes that at the time of the denial of coverage the "ongoing operations" limitation of coverage did not eliminate a duty to defend. *See Kazi,* 24 Cal.4th at 879, 103 Cal.Rptr.2d 1, 15 P.3d 223.

F. Ebensteiner's Sole Negligence

ASIC contends that there is no coverage under the policies on the grounds that the underlying actions do not arise out of Ebensteiner's sole negligence. ASIC contends that "[f]rom a brief review of the first thirty

paragraphs of the underlying complaint, it is clear that the claims asserted against [D.R. Horton] are based on its own conduct, decisions and engineering shortcuts, and/or those geotechnical consultants who it retained (who are also sued)." (ECF No. 41 at 21).

*18 D.R. Horton contends that ASIC had a duty to defend it in the underlying actions on the grounds that ASIC has not "conclusively established that the property damage could not have arisen out of Ebensteiner's sole negligence." (ECF No. 25–1 at 26). D.R. Horton contends that ASIC did not determine who was negligent with respect to the grading prior to denying a defense in this case.

In this case, the forms 98 15 state: "Coverage under this Endorsement applies ... only for liability arising out of or relating to [Ebensteiner's] sole negligence ...." (ECF No. 25–8 at 27, 57; ECF No. 25–9 at 3, 33, 64, 95; ECF No. 25–10 at 3, 30). The *Kim* plaintiffs allege that "in an effort to reduce the cost of developing the Canyon Gate project, Zephyr, Draper, and D.R. Horton cut corners in the geotechnical engineering, design, grading and excavation for these tracts ...." (ECF No. 25–12 at 132). The *Kim* plaintiffs allege that on March 20, 2002, "D.R. Horton, its grading subcontractor and [its engineers] resumed rough grading on [a tract in the Canyon Gate project] despite the fact that the City had not approved their revised shear key design." *Id.* at 138, 103 Cal.Rptr.2d 1, 15 P.3d 223. The *Kim* plaintiffs allege: "As a direct, foreseeable and proximate result of said interference, Plaintiffs have incurred physical damage to their land, improvements and structures located on their residential real properties and/or a diminution-in-value of their residential properties as a result ...." *Id.* at 161–62, 103 Cal.Rptr.2d 1, 15 P.3d 223.

The *Canyon Gate* case asserts essentially the same facts and claims as asserted in the *Kim* case. (ECF No. 25–13 at 2). The *Canyon Gate* plaintiff alleges that: "As a direct, foreseeable and proximate result of said interference, [Plaintiff has] incurred physical damage to its Common Areas." *Id.* at 34, 103 Cal.Rptr.2d 1, 15 P.3d 223. The *Warrick* case asserts essentially the same facts and claims as asserted in the *Kim* case. (ECF No. 25–13 at 61). The *Warrick* plaintiffs allege: "As a direct, foreseeable and proximate result of said interference, [Plaintiffs] have incurred physical damage to their land, improvements and structures located on their residential real properties and/or a diminution-in-value of their residential properties." *Id.*

The *Kim, Canyon Gate,* and *Warrick* complaints allege damage to the plaintiff's homes and property resulting from the grading work performed at the Canyon Gate project. Ebensteiner performed the grading work at the Canyon Gate project. The Court finds that the *Kim, Canyon Gate,* and *Warrick* cases assert facts to show that the damage could have been caused by Ebensteiner's sole negligence. The Court finds that the *Kim, Canyon Gate,* and *Warrick* cases present a "legal theory or facts" that potentially give rise to coverage. *See Hudson Ins. Co.,* 624 F.3d at 1268 (citation omitted). The Court finds that ASIC has failed to show that at the time it denied D.R. Horton's tender, there was no "potential" that Ebensteiner's sole negligence gave rise to the damage allege in the underlying actions. *Montrose Chemical Corp.,* 6 Cal.4th at 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153.

G. Notice to Builder

*19 D.R. Horton asserts that ASIC's duty to defend began when D.R. Horton provided ASIC with a notice to builder on November 19, 2008. D.R. Horton contends that a California Civil Code section 910 notice to builder is a civil proceeding within the meaning of the policies coverage of "suits." (ECF No.25–1 at 28–29; ECF No. 40 at 28).

ASIC contends that at the time it declined to defend D.R. Horton based on the notice to builder, no case had held that a notice to builder was a legal proceeding. ASIC contends that later cases indicating that a notice to builder is a legal proceeding "were not and could not have been known or binding on ASIC in December 2008 ...." (ECF No. 41 at 29).

The policies in this case provide that ASIC has the duty to defend the insured against any suit seeking damages because of bodily injury or property damage to which the insurance policies apply. The policies state that: " 'Suit' means a civil proceeding in which damages because of ... 'property damage'... to which this insurance applies are alleged. 'Suit' includes: (a) An Arbitration proceeding ...; or (b) Any other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent." (ECF No. 25–9 at 16).

California Civil Code section 910 requires a claimant to provide written notice to a builder of any claimed violation and states that the notice: "[S]hall have the same force and effect as a notice of commencement of a

legal proceeding." Cal. Civ.Code § 910 (effective Jan. 1, 2003). In *Clarendon Am. Ins. Co. v. StarNet Ins. Co.,* 113 Cal.Rptr.3d 585 (Cal.App.2010), the California Court of Appeal found "as a matter of first impression" that a proceeding under the Caldren Act was an alternative dispute resolution proceeding as defined by the commercial general liability insurance policy. *Id.* at 586, *Clarendon Am. Ins. Co. v. Starnet Ins. Co.,* 117 Cal.Rptr.3d 613, 614, 242 P.3d 67 (Cal.2010) (granting the petition for review but deferring the matter pending the disposition of *Ameron Int'l Corp. v. Ins. Co. of the State of Penn. .,* 50 Cal.4th 1370, 118 Cal.Rptr.3d 95, 242 P.3d 1020 (Cal.2010)), *Clarendon Am. Ins. Co. v. Starnet Ins. Co.,* 121 Cal.Rptr.3d 879, 879, 248 P.3d 191 (Cal.2011) (dismissing review); *see also Ameron Int'l Corp.,* 50 Cal.4th at 1383, 118 Cal.Rptr.3d 95, 242 P.3d 1020 (holding as a matter of "first impression" that a federal adjudicative administrative agency board proceeding triggered the duty to defend where an insurance policy did not define the term "suit"). The Caldren Act is similar to California Civil Code section 910 because it requires a homeowners association to serve the respondent with a "Notice of Commencement of Legal Proceedings." Cal. Civ.Code § 1375.

At the time ASIC denied tender for the notices to builder, California Civil Code section 910 expressly stated that notices to builder: "[S]hall have the same force and effect as a notice of commencement of a legal proceeding." Cal. Civ.Code § 910. The Court finds that ASIC has failed to show that at the time it denied D.R. Horton's tender of the notices to builder, there was no "potential" for coverage. *Montrose Chemical Corp.,* 6 Cal.4th at 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153. The Court concludes that ASIC had a duty to defend D.R. Horton pursuant to the notices to builder.

H. Wrap Policies

*20 ASIC contends that it sought information from D.R. Horton regarding any wrap policies for the Canyon Gate Project since 2003. (ECF No. 54 at 2). ASIC contends that it has recently discovered that D.R. Horton has wrap policies which apply from March 1, 2003 through August 1, 2006. *Id.* ASIC contends that there is a wrap exclusion in the policies which applies to D.R. Horton. ASIC contends that coverage in this case is precluded on the grounds that tender to other insurance carriers is a condition precedent to coverage under the ASIC policies and the wrap policies issued to D.R. Horton "cover [D.R. Horton] in connection with claims regarding Canyon Gate...." *Id.* at 4, 24 Cal.Rptr.2d 467, 861 P.2d 1153.

D.R. Horton contends that the wrap policies do not apply to this case on the grounds that D.R. Horton was insured under the wrap policies; not Ebensteiner or Ebensteiner's work. D.R. Horton contends that this case relates only to liability arising out of Ebensteiner's work. In addition, D.R. Horton contends that "ASIC presents no evidence that [D.R. Horton] did not tender the claims to other insurers." (ECF No. 55 at 4). D.R. Horton contends that it was not required to disclose the wrap policies when ASIC requested the information during the *Fessler* litigation on the grounds that the wrap policies took effect after the *Fessler* complaint was filed and could not have possibly applied to the damage alleged in the *Fessler* litigation. D.R. Horton contends that even if the policies require D.R. Horton to tender the claim to other insurers, D.R. Horton was relieved of that duty because ASIC anticipatorily repudiated the policy by denying coverage; ASIC is estopped from enforcing the term because it failed to raise the issue while it was investigating the claim; the provision is an unenforceable "escape clause"; and the term is unenforceable on the grounds that it is not "conspicuous, plain, and clear." (ECF No. 55 at 5).

The 04, 05, and 06 policies contain a "Wrap-up Exclusion" which provides: "This insurance does not apply to *any work* insured under a consolidated (Wrap up) Insurance Program ...." (ECF No. 25–10 at 43; ECF No. 35–3 at 45; ECF No. 35–4 at 53) (emphasis added). The "Wrap-up" policies insure D.R. Horton, not Ebensteiner. (ECF No. 54–9 at 4 DRH 00874; 64 DRH 934; 124 DRH 994; 185 DRH 1055). The work at issue in this case is Ebensteiner's grading work.

The Court finds that ASIC has failed to show there was no "potential" for coverage on the grounds that the "Wrap-up" policy applies to D.R. Horton's work and this case involves Ebensteiner's work. *Montrose Chemical Corp.,* 6 Cal.4th at 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153. The Court concludes that at the time of the denial of coverage the "Wrap-up" policy did not eliminate a duty to defend.

I. Bad Faith and Punitive Damages

ASIC contends that D.R. Horton's bad faith claim fails as a matter of law because there was a genuine dispute regarding coverage. ASIC contends that even if ASIC is not entitled to summary judgment on D.R. Horton's bad faith claim, ASIC is entitled to partial summary judgment

on the request for punitive damages because ASIC had "more than reasonable support for its position." (ECF No. 33 at 35).

*21 D.R. Horton contends that bad faith is shown by ASIC's failure to investigate information indicating that Ebensteiner performed work during the 05 and 06 policies and by ASIC's failure to investigate the issue of Ebensteiner's sole negligence. D.R. Horton contends that ASIC's "after-the-fact changes to the policies, and its attempt to conceal how and when those changes were made, alone are sufficient to defeat summary judgment on the punitive damages claim." (ECF No. 40 at 30).

"The genuine issue rule in the context of bad faith claims allows a [trial] court to grant summary judgment when it is undisputed or indisputable that the basis for the insurer's denial of benefits was reasonable—for example, where even under the plaintiff's version of the facts there is a genuine issue as to the insurer's liability under California law." *Wilson v. 21st Century Ins. Co.,* 42 Cal.4th 713, 724, 68 Cal.Rptr.3d 746, 171 P.3d 1082 (Cal.2007) (citing *Amadeo v. Principal Mut. Life Ins. Co.,* 290 F.3d 1152, 1161–62 (9th Cir.2002)). "On the other hand, an insurer is not entitled to judgment as a matter of law where, viewing the facts in the light most favorable to the plaintiff, a jury could conclude that the insurer acted unreasonably." *Id.* "[A] bad faith claim should be dismissed on summary judgment if the defendant demonstrates that there was 'a genuine dispute as to coverage.' " *Feldman v. Allstate Insurance Co.,* 322 F.3d 660, 669 (9th Cir.2003) (citation omitted). However, an insurer is not relieved of its "obligation to thoroughly and fairly investigate, process, and evaluate the insured's claim." *Wilson,* 42 Cal.4th at 723, 68 Cal.Rptr.3d 746, 171 P.3d 1082.

In this case, D.R. Horton's claim of bad faith includes assertions that ASIC did not "thoroughly and fairly investigate, process, and evaluate the insured's claim." *See Wilson,* 42 Cal.4th at 723, 68 Cal.Rptr.3d 746, 171 P.3d 1082. D.R. Horton's claim for punitive damages includes assertions that ASIC belatedly attempted to revise the policies. The Court finds that, viewing the facts in the light most favorable to the D.R. Horton, there are disputed issues of fact regarding whether ASIC acted unreasonably and whether the evidence supports an award of punitive damages in this case. Accordingly, ASIC's Motion for Summary Judgment of D.R. Horton's bad faith and punitive damages claims is DENIED.

J. Declaratory Relief

ASIC contends that D.R. Horton's declaratory relief claim is "redundant." (ECF No. 33 at 35). D.R. Horton has not addressed this issue.

Declaratory relief is "unnecessary and superfluous" where "[t]he issues invoked in that cause of action already were fully engaged by other causes of action." *Hood v. Superior Court,* 33 Cal.App.4th 319, 324, 39 Cal.Rptr.2d 296 (1995). In this case, D.R. Horton has asserted three claims: (1) breach of the implied covenant of good faith and fair dealings for ASIC's failure to provide a defense in the underlying actions; (2) breach of contract for ASIC's failure to provide benefits under the contract; and (3) declaratory relief seeking judicial determination "(1) that Defendants are obligated to defend and indemnify D.R. Horton under said policies with respect to the [underlying actions]; and (2) that Defendants are obligated to pay for the cost of D.R. Horton's defense in the [underlying actions] and to pay expenses for repairs and other settlement costs in connection with the [underlying actions]." (ECF No. 1 at 15).

*22 The Court finds that the declaratory relief claim "unnecessary" on the grounds that the issues raised in the declaratory relief claim are fully raised in the other claims. *Hood,* 33 Cal.App.4th at 324, 39 Cal.Rptr.2d 296. ASIC's Motion for Summary Judgment is GRANTED as to the claim for declaratory relief.

V. Conclusion

IT IS HEREBY ORDERED that Plaintiff D.R. Horton's Motion for Partial Summary Judgment (ECF No. 25) is GRANTED as to Plaintiff D.R. Horton's claims that ASIC had a duty to defend D.R. Horton under the XGI 02–1261–004 and XGI 03–1261–005 policies in the *Chang O. Kim, et al. v. City of Santa Clarita, et al.,* Los Angeles Superior Court Case No. BC407614; *Canyon Gate Maint. Ass'n v. City of Santa Clarita, et al.,* Los Angeles Superior Court Case No. BC415663; and *Warrick, et al. v. City of Santa Clarita, et al.,* Los Angeles Superior Court Case No. PC046442 cases and related notices to builder and DENIED in all other respects. Defendant ASIC's Motion for Summary Judgment (ECF No. 33) is GRANTED as to Plaintiff D.R. Horton's third claim for declaratory relief and DENIED in all other respects.

All Citations

Footnotes

1 Ebensteiner Co. is not a party to this action.

2 In the Opposition, ASIC sought "more time to oppose outstanding discovery issues that may defeat this motion." (ECF No. 41 at 30). The parties were permitted to file supplemental briefing.

3 The policies each contain a blank 98 15 Additional Insured endorsement. The policies do not contain a blank 20 10 Additional Insured endorsement.

4 D.R. Horton contends that according to the terms of the *Fessler* settlement agreement, it is conclusively presumed to be true that D.R. Horton was named as an additional insured. The settlement agreement states that it was made: "[w]ithout admission by any party hereto of any liability, and for the purpose of settlement of the Action [ASIC] and [D.R. Horton] ... wish to settle existing claims ...." (ECF No. 25–11 at 125). The settlement agreement states: "American Safety issued policies, [03, 04] and XG–1021261–008 ... to Ebensteiner Co. which named [D.R. Horton] as an additional insured." *Id.*

California Evidence Code section 622 provides: "The facts recited in a written instrument are conclusively presumed to be true as between the parties thereto, or their successors in interest; but this rule does not apply to the recital of a consideration." Cal. Evid.Code § 622. In *People ex rel. Dept. of Public Works v. Forster,* 58 Cal.2d 257, 23 Cal.Rptr. 582, 373 P.2d 630 (1962), the court held that, "the declaration (in an offer of compromise) of facts involved in the controversy which are not mere concessions made for the purpose of such offer, but are statements of independent facts, are admissible against the party making them." *Id.* at 263, 23 Cal.Rptr. 582, 373 P.2d 630(quotation omitted). However, "[t]he rule of the *Forster* case is changed by [California Evidence Code section 1152(a)] because that rule prevents the complete candor between the parties that is most conducive to settlement." *Caira v. O er,* 126 Cal.App.4th 12, 33, 24 Cal.Rptr.3d 233 (2005); *see also* Cal. Evid.Code § 1152(a) ("Evidence ... [of] any conduct or statements made in negotiation [of settlement], is inadmissible to prove his or her liability for the loss or damage or any part of it.").

The Court finds that the settlement agreement was entered into for the purpose of settlement and the settlement agreement did not contain any admissions of liability. To the extent that there is a factual recital, the Court finds that it is a "mere concession[ ] made for the purpose of [settlement]" and inadmissible to prove ASIC's liability in this case. *See Forster,* 58 Cal.2d at 263, 23 Cal.Rptr. 582, 373 P.2d 630; Cal. Evid.Code § 1152(a).

5 D.R. Horton has also requested that the Court take judicial notice of a Declaration dated March 18, 2011 which was submitted by Jean Fisher, ASIC corporate claims counsel, in support of ASIC's motion for summary adjudication filed in *ASIC v. Admiral Insurance Co.,* Case No. 37–2010–00092157–CU–IC–CTL, Superior Court of California for the County of San Diego. Fisher states: "[D.R. Horton] which contracted with [Ebensteiner] qualified as an additional insured on [the 03 policy]." (ECF No. 44 at 6). Courts may take judicial notice of other courts' proceedings if they "directly relate to matters before the court." *Hayes v. Woodford,* 444 F.Supp.2d 1127, 1136–37 (S.D.Cal.2006); *see also United States ex rel. Robinson Rancheria Citizens Council v. Borneo, Inc.,* 971 F.2d 244, 248 (9th Cir.1992); Fed R. Evid. 210(b). D.R. Horton's request for judicial notice of the Fisher Declaration is GRANTED. However, the Court does not rely on the statements contained in the Fisher Declaration in reaching its decision in this Order. *See Quan v. Truck Ins. Exchange,* 67 Cal.App.4th 583, 602, 79 Cal.Rptr.2d 134 (1998) (explaining that because interpretation of an insurance policy is a question of law based on the contract "writings or memos by insurance company personnel venturing their opinions as to whether a defense should be afforded do not constitute 'admissions' of a defense duty.").

6 ASIC also seeks to apply the "per occurrence" limit across the policies. ASIC contends that the California Supreme Court is considering this issue. *See State v. Continental Ins. Co./(Employers Ins. of Wausau),* 91 Cal.Rptr.3d 106, 203 P.3d 425 (2009) (granting the petition for review by the Supreme Court of California). In this case, the policies provide: "The Limits of Insurance of this Coverage Part apply separately to each consecutive annual period ...." (ECF No. 35–2 at 11). The policies do not otherwise expressly apply the per occurrence limit across consecutive policies.

7 ASIC has not moved for summary judgment on the 06 policy. The issue remains pending. The Court makes no ruling on whether rescission of the 06 policy was proper.

8 ASIC also asserts that Ebensteiner's job file with entries dating from January through August 2, 2004, two change orders dated August 11 and 18, 2004, and a final billing statement dated August 31, 2004, as well as statements in the Deposition of Glen Longarini which was taken on February 24, 2011 show that Ebensteiner performed rough grading work on the entire Canyon Gate project. (ECF No. 28–11 at 2–77; 36–3 at 2). However, ASIC has failed to show that it was aware of this evidence at the time

it denied D.R. Horton's tender. As discussed above, "a duty to defend turns not upon the ultimate adjudication of coverage under its policy of insurance, but upon those facts known by the insurer at the inception of a third party lawsuit." *Montrose,* 4 Cal.4th at 295, 14 Cal.Rptr.2d 418, 841 P.2d 938.

9 D.R. Horton also contends that the word "ongoing" was not present in the additional insured endorsement to the 03 policy and ASIC could not insert the word "ongoing" into the 04, 05, and 06 policies on the grounds that the term restricts coverage beyond what D.R. Horton reasonably expected, and ASIC did not make the limitation in liability sufficiently clear to D.R. Horton. (ECF No.25–1 at 24; ECF No. 40 at 21). ASIC contends that it was not required to notify D.R. Horton of the insertion of the term "ongoing" into its policies on the grounds that insurance code excludes surplus line insurance, additional insured, and third party beneficiaries from the notice requirements. (ECF No. 43 at 7–8). Presuming that the 04, 05, and 06 policies contained a restriction on coverage to Ebensteiner's ongoing operations, ASIC has failed to eliminate coverage as discussed below.

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, Plaintiff,

v.

AMERICAN AND FOREIGN INSURANCE COMPANY, Defendant.

No. CV 04-7257 PA (PLAx).

Feb. 9, 2006.

2006 WL 4757339
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United States District Court,
C.D. California.

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, Plaintiff,
v.
AMERICAN AND FOREIGN INSURANCE COMPANY, Defendant.

No. CV 04-7257 PA (PLAx).
|
Feb. 9, 2006.

Attorneys and Law Firms

Anthony L. Osborn, James P. Wagoner, McCormick Barstow Sheppard Wayte & Carruth, Fresno, CA, for Plaintiff.

Bethany A. Pelliconi, David A. Tartaglio, Musick Peeler & Garrett, Los Angeles, CA, for Defendant.

Opinion

ORDER GRANTING IN PART AND DENYING IN PART PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT; GRANTING IN PART AND DENYING IN PART DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

PERCY ANDERSON, United States District Judge.

*1 Before the Court are cross-motions for summary judgment filed by the plaintiff National Union Fire Insurance Co. of Pittsburgh, PA ("National Union") and the defendant American and Foreign Insurance Co. ("American & Foreign"). (Docket Nos. 24, 28.) In this action, National Union asserts that American & Foreign was required to contribute to the settlement of a claim against a third party under principles of equitable contribution, equitable subrogation, and equitable indemnity. The Court's jurisdiction is based on diversity of citizenship pursuant to 28 U.S.C. § 1332.

I. FACTUAL BACKGROUND[1]

The underlying claim giving rise to this action occurred on a construction site in Lehi, Utah (the "Lehi Site"). Micron Technology, Inc. ("Micron Technology") was the owner of the site and Micron Construction ("Micron Construction") was the general contractor and project manager.

As part of an owner-controlled insurance program ("OCIP") for the Lehi Site, Micron Technology obtained a primary commercial general liability insurance policy from Aetna Casualty and Surety Co. ("Aetna") and a commercial umbrella policy from National Union. Both policies provided bodily injury liability coverage, with Aetna providing coverage up to $2 million per occurrence and National Union policy providing coverage up to $25 million per occurrence. One of the subcontractors on the Lehi Site was Okland Construction ("Okland"). As a subcontractor, Okland was an "additional insured" under the National Union and Aetna policies. Prior to becoming a subcontractor at the site, Okland had also obtained its own commercial general liability policy from American & Foreign, providing bodily injury liability coverage up to $1 million per occurrence.

On September 14, 1995, a worker at the Lehi Site named Kelly Ferguson was hit with a piece of plywood that was either owned or controlled by Okland. As a result, Ferguson was rendered a paraplegic and he filed a personal injury lawsuit against Okland (the *"Ferguson* Action"). American and Foreign did not participate in the defense of the *Ferguson* Action, which was undertaken entirely by Aetna and National Union. In June 2003, the *Ferguson* Action settled for $4.1 million. Aetna contributed its policy limits to the settlement, and National Union paid the remaining $2.1 million.

National Union now asserts that American & Foreign's policy provided primary coverage for the *Ferguson* Action and that its own coverage was excess. Thus, National Union urges, it was not required to contribute to the settlement unless and until American Foreign's per occurrence limit, $1 million, was exhausted. Because National Union has already contributed $2.1 million to the settlement, it asserts that it is entitled to reimbursement of $1 million, plus costs and pre-judgment interest, from American & Foreign. In response, American & Foreign argues that its policy was excess to both the National Union and Aetna policies, and thus it had no duty to contribute until both of their per occurrence limits were exhausted.

II. CHOICE OF LAW

*2 In a diversity case, a federal court applies the choice-of-law rules of the forum state. *Klaxon Co. v. Stentor Elec. Mfg. Co.,* 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941); *Estate of Darulis v. Garate,* 401 F.3d 1060 (9th Cir.2005). California Civil Code § 1646 states,

> A contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made.

Notwithstanding this statutory directive, many California courts instead apply a "governmental interest" approach to choice of law problems. *See, e.g., Stonewall Surplus Lines Ins. Co. v. Johnson Controls, Inc.,* 14 Cal.App.4th 637, 645, 17 Cal.Rptr. 713, 718 (Ct.App.1993). Under this three-step approach, a California court will generally apply its own rule of decision unless (1) the proponent of a foreign law identifies an applicable rule of law in the foreign state and shows that it "materially differs" from the law of California, (2) each state has an interest in having its own law applied, and (3) the foreign state's interests would be "more impaired" if its law were not applied. *Wash. Mut. Bank v. Superior Court,* 24 Cal.4th 906, 919-20, 103 Cal.Rptr.2d 320, 15 P.3d 1071, 1080-81 (2001). "The fact that two or more states are involved does not in itself indicate that there is a conflict of laws problem. Indeed, if the relevant laws of each state are identical, there is no problem and the trial court may find California law applicable." *Id.* at 919-920, 103 Cal.Rptr.2d 320, 15 P.3d at 1080 (internal citations omitted).

The Ninth Circuit has recognized that it is unclear whether § 1646 or the governmental interest test is the appropriate standard under California law. *Arno v. Club Med. Inc.,* 22 F.3d 1464, 1469 n. 6 (1994). American & Foreign urges the Court to apply Utah law pursuant to § 1646, but concedes that law from other jurisdictions may be applied' to the extent that "it is not in conflict with Utah insurance law." Thus, under either standard, California law is properly applied as long as it does not conflict with Utah law. American & Foreign offers no specific instances of conflict, except to the extent that it relies heavily on two cases applying Utah insurance law, *Prudential Federal Savings & Loan Ass'n v. St. Paul Insurance Cos.,* 20 Utah 2d 95, 433 P.2d 602 (1967), and *Caribou Four Corners. Inc. v. Truck Insurance Exchange,* 433 F.2d 796 (10th Cir.1971) (applying Utah law), in arguing that its policy is excess in this case because it provides more "general" coverage for claims relating to the Lehi Site. As explained in detail below, the Court finds that these cases offer no support for American & Foreign's position. Thus, the result in this case is the same under California and Utah law. The Court will apply insurance law principles consistent with the law of both states.

III. POLICY COVERAGE

Resolution of this dispute requires the Court to determine whether National Union's policy, American & Foreign's policy, or both provide primary coverage for the *Ferguson* Action. Liability under a primary policy attaches "immediately upon the happening of the occurrence that gives rise to liability," whereas liability under an excess policy does not attach until "a predetermined amount of primary coverage has been exhausted." *See, e.g., Reliance Nat'l Indem. Co. v. Gen. Star Indem. Co.,* 72 Cal.App.4th 1063, 1076, 85 Cal.Rptr.2d 627, 634 (Ct.App.1999) (quoting *Olympic Ins. Co. v. Employers Surplus Lines Ins. Co. .,* 126 Cal.App.3d 593, 597-598, 178 Cal.Rptr. 908, 910 (Ct.App.1981)) (internal quotations omitted).

*3 In construing insurance policy provisions, courts apply general principles of contract interpretation and give the provisions their plain and ordinary meaning. *Waller v. Truck Ins. Exch., Inc.,* 11 Cal.4th 1, 18, 44 Cal.Rptr.2d 370, 900 P.2d 619, 627 (1995); *Alf v. State Farm Fire & Cas. Co.,* 850 P.2d 1272, 1274 (Utah 1993). To determine whether multiple policies that cover the same risk are primary or excess, courts look to provisions the of the policies, including the "other insurance" clauses. *Travelers Cas. & Surety Co. v. Am. Equity Ins. Co.,* 113 Cal.Rptr.2d 613, 618, 93 Cal.App.4th 1142, 1149-50 (Ct.App.2001); *Utah Power & Light Co. v. Fed. Ins. Co.,* 983 F.2d 1549, 1559 (10th Cir.1993) (applying Utah law). Where the other insurance clauses in the two policies are consistent with each other, they are generally given effect. *See Travelers,* 113 Cal. Rtpr.2d at 618, 1149-50; *Utah Power & Light,* 983 F.2d at 1559 (like all insurance provisions, Utah courts give other insurance clauses their "plain and ordinary meaning").

Here, both National Union and American & Foreign's policies contain applicable other insurance clauses. National Union's policy states,

> If other valid and collectible insurance applies to a loss that is also

> covered by this policy, this policy will apply excess of the other insurance. However, this provision will not apply if the other insurance is specifically written to be excess of this policy.

In contrast, American & Foreign's policy states,
If other valid and collectible insurance is available to the insured for a loss we cover ....

...

This insurance is primary except ....

...

This insurance is excess over any of the other insurance, whether primary, excess, contingent or on any other basis:

(1) That is Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage for "your work" ....

Thus, by their plain terms, the other insurance clauses are consistent. National Union's clause establishes that its coverage is excess over American & Foreign's, because the latter provides "valid and collectible insurance" applicable to the *Ferguson* Action. Conversely, American & Foreign's clause establishes that its coverage is primary because, even though National Union's policy is "other valid and collectible insurance" applicable to the *Ferguson* Action, it provides bodily injury coverage, not "Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage."

American & Foreign makes three arguments for why the Court should ignore this plain meaning interpretation and hold that its coverage is excess over National Union's. First, it argues that its coverage is excess by virtue of the "similar coverage for 'your work' " provision of its policy. To reach this result, American & Foreign points out that both companies provide bodily injury coverage for Okland's work at the Lehi Site. Thus, it reasons that the two companies provide "similar coverage" for Okland's "work."

*4 The phrase "similar coverage" must be read in context, however. In the policy, it follows a specific list of coverages, indicating that it refers only to coverage types similar to those listed. *See Martin Corp. v. Ins. Co. of N. Am.,* 47 Cal.Rptr.2d 670, 678-79, 40 Cal.App.4th 1113, 1126-1127 (1995) ("where general words follow a specific enumeration, the general words should not be construed in their broadest sense but should be read as applying to the same general class of things as the specifically enumerated things"); *Swenson v. Erickson,* 998 P.2d 807, 812 (Utah 2000) ("Under the well-established rule of construction *ejusdem generis,* general language must be confined to its meaning by specific enumeration which proceeds it, unless a contrary intention is shown."). Fire, extended coverage, builder's risk, and installation risk are all types of first-party property coverages, while National Union's coverage is for third-party bodily injury liability. Thus, it is not "similar" to those types of coverages and does not trigger the excess insurance provision of American & Foreign's other insurance clause. *See Great N. Ins. Co. v. Mount Vernon Fire Ins. Co.,* 92 N.Y.2d 682, 687-89, 685 N.Y.S.2d 411, 708 N.E.2d 167 (Ct.App.1999) (interpreting the same clause that is at issue here to apply only "where first-party property loss coverage would serve as primary indemnification for a loss").

Second, American & Foreign argues that its coverage is excess to National Union's because the latter was purchased as part of an OCIP for the purpose of providing primary coverage for Okland's activities at the Lehi Site. In support of this argument, American & Foreign points out that Okland was not required to provide its own bodily injury coverage at all for its work at the Lehi Site and that Okland's contract with Micron Construction states that policies provided as part of the OCIP would be "primary insurance and non-contributing with respect to persons engaged in performance of work at the Project Site."

Assuming that the Court can properly look to this proffered parol evidence without first determining that the American & Foreign and National Union policies are ambiguous,[2] none of it actually undermines the conclusion reached above. As an initial matter, Okland's contract with Micron states, "Any portrayal of insurance policy coverage, terms, and conditions contained in this contract is informational, and is not a binding interpretation of coverage or conditions of the actual policies." Moreover, the evidence shows that Okland was specifically directed to "make modifications to [its] existing insurance program to prevent duplicate insurance coverage or cost" for its work at the Lehi Site. Thus, viewed as a whole, this evidence does not show that American & Foreign's policy, written before Okland even became a part of the Lehi Site project, was intended

to exclude coverage for liabilities also covered by the OCIP. If anything, it shows that the policy was intended to provide coverage for all of Okland's activities at the time it was written, that the premium paid by Okland reflected that liability, and that affirmative steps should have been taken by Okland and American & Foreign if a different result was desired in circumstances where Okland was protected by other bodily injury liability coverage.

*5 Third and finally, American & Foreign argues that the court should apply the "guiding principle that applicable insurance should be layered or 'stacked' in a way that recognizes which coverage most specifically applies to a covered loss." In essence, it argues that its coverage is general, because it applies to all of Okland's activities, and that National Union's coverage is specific because it applies only to Okland's activities at the Lehi Site.

To support the application of this principle, American & Foreign cites *Prudential Federal Savings & Loan Ass'n v. St. Paul Insurance Cos.,* 20 Utah 2d 95, 433 P.2d 602 (Utah 1967), and *Caribou Four Corners, Inc. v. Truck Insurance Exchange,* 443 F.2d 796 (10th Cir.1971). These cases do not, however, establish that the distinction between specific and general coverage is material when mutually consistent other insurance provisions can be interpreted and applied, as is this case here. In *Prudential,* the court specifically noted that one policy, which was a "blanket" policy, did provide that it would be excess to "other valid or collectible indemnity against any loss" covered. 433 P.2d at 603. In finding that another applicable policy was primarily liable, the court relied on the rule that, "where a blanket policy contains a provision limiting its liability to an excess over specific insurance, the blanket policy must respond, only if the specific fails to satisfy the loss." *Id.* at 603. Though the Tenth Circuit did apply *Prudential* in *Caribou* to hold that a comprehensive automobile liability policy was primarily liable because it "specifically" covered an accident while another policy was "general," the court made no reference to other insurance provisions in the two policies. 443 F.2d at 802-03. Thus, the Court finds that these cases provide no authority for the proposition that analysis of "specific" versus "general" coverage is appropriate where the plain language of the other insurance provisions of two policies is mutually consistent.

III. NATIONAL UNION'S THEORIES OF RECOVERY

Having determined that American & Foreign's policy provides primary coverage for the *Ferguson* Action and that National Union's provides excess, the Court now turns to National Union's three theories for recovery.

National Union is not entitled to equitable contribution because the two policies do not cover the same risk at the same level. *See Fireman's Fund Ins. Co. v. Md. Cas. Co.,* 65 Cal.App.4th 1279, 1300, 77 Cal.Rptr.2d 296, 308 (Ct.App.1998) ("in the absence of an express agreement to the contrary, there is *never* any right to contribution between primary and excess carriers of the same insured"); *see also* 15 *Couch on Insurance* § 217:4 (3d ed.1995) ("the right to contribution in insurance is predicated upon the principle that all insurers are equally liable for the discharge of a common obligation").

Nonetheless, National Union is entitled to equitable subrogation as an excess insurer who contributed an amount to the *Ferguson* Action that American & Foreign was obligated to pay as a primary insurer. *Reliance Nat'l Indem. Co.,* 72 Cal.App.4th at 1078, 85 Cal.Rptr.2d at 636; *State Farm Mut. Auto. Ins. Co. v. Northwestern Nat'l Ins. Co.,* 912 P.2d 983 (Utah 1996). In the insurance context, subrogation allows an insurer to "stand in the shoes" of an insured to assert a claim against a third party legally responsible for a loss which the insurer has both insured and paid. *Reliance,* 65 Cal.App.4th at 1291-93, 77 Cal.Rptr.2d at 302-03. Citing California law, American & Foreign argues that National Union cannot step into the shoes of Okland to assert a claim against American & Foreign because the *Ferguson* Action settlement was paid in full and therefore Okland suffered no loss. This argument has no merit because the insured will *never* have suffered a loss when an excess insurer pays a claim that a primary insurer was obligated to pay. Yet that is exactly the situation in which California and Utah recognize a right of reimbursement under the principle of equitable subrogation. *Reliance,* 72 Cal.App.4th at 1078, 85 Cal.Rptr.2d 627; *State Farm,* 912 P.2d at 985-86. Indeed, the only requirement of an insurer's cause of action for equitable subrogation that relates to the insured's damages is that the insured have "an existing, assignable cause of action against the defendant which the insured *could have* asserted for its own benefit *had it not been compensated for its loss by the insurer." Fireman's Fund Ins. Co.,* 65 Cal.App.4th at 1292, 77 Cal.Rptr.2d at 302-303 (emphasis added).

*6 National Union is also entitled to equitable indemnity. *See United Auto. Servs. v. Alaska Ins. Co.,* 94 Cal.App.4th 638, 644-45, 114 Cal.Rptr.2d 449, 453-54 (Ct.App.2001);

Salt Lake City Sch. Dist. v. Galbraith & Green, Inc., 740 P.2d 284, 287 (Utah Ct.App.1987); *see also* 15 *Couch on Insurance* § 217:16 ("where an excess insurer makes a payment which, as between it and the primary insurer, should have been paid by the latter, the excess insurer is entitled to recoup such payment by way of indemnity from the primary insurer").

Finally, National Union is entitled to prejudgment interest. *See* Cal. Civil Code § 3287(a); *Cornia v. Wilcox,* 898 P.2d 1379, 1387 (Utah 1995).

Conclusion

For the reasons stated above, the Court denies National Union's motion for summary judgment for equitable contribution and grants the motion for equitable subrogation and equitable indemnity. The court grants American & Foreign's motion for summary judgment for equitable contribution and denies the motion for equitable subrogation and equitable indemnity.

National Union shall submit a Proposed Judgment by February 20, 2006.

IT IS SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2006 WL 4757339

Footnotes

1 The facts stated here and relied on in this Order are found in the parties' Stipulation of Undisputed Facts (Docket No. 27) or in documents filed with the Court pursuant to the parties' Stipulation Regarding Authenticity of Documents (Docket No. 30).

2 California and Utah have both adopted the rule that parol evidence should be evaluated in determining whether contract provisions are ambiguous. *See Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.,* 69 Cal.2d 33, 69 Cal.Rptr. 561, 442 P.2d 641 (1968); *Ward v. Intermountain Farmers Ass'n,* 907 P.2d 264 (Utah 1995). However, the applicability of this principle to insurance cases has been questioned in California and the consistency of Utah court's application of the principle is in doubt. *See* H. Walter Croskey, Rex Heeseman & Thomas W. Johnson, Jr., *Insurance Litigation* ¶¶ 4:23.1 to 4:23.3 (2003); Mark O. Morris & Elizabeth Evensen, *What's Happening to the Parol Evidence Rule? More Holes in the Dike,* 67 Def. Couns. J. 209, 215-19 (2000).

PACIFIC RIM MECHANICAL CONTRACTORS, INC., Cross-complainant and Appellant,

v.

AON RISK INSURANCE SERVICES WEST, INC., et al., Cross-defendants and Respondents.

No. D058321.

Feb. 28, 2012.

203 Cal.App.4th 1278
Court of Appeal, Fourth District, Division 1, California.

PACIFIC RIM MECHANICAL CONTRACTORS, INC., Cross-complainant and Appellant,
v.
AON RISK INSURANCE SERVICES WEST, INC., et al., Cross-defendants and Respondents.

No. D058321.
|
Feb. 28, 2012.

Synopsis
Background: Homeowners association brought construction defect action against general contractor and subcontractors. General contractor filed cross complaint against subcontractors, seeking indemnity, and subcontractor filed cross-complaint against general contractor and insurance broker for declaratory relief, breach of contract, negligence, fraudulent concealment, and negligent concealment arising out of liability insurer's insolvency and broker's failure to disclose the insolvency. The Superior Court, San Diego County, No. 37–2009–00089657–CU–BC–CTL, Ronald L. Styn, J., sustained broker's demurrer, and subcontractor appealed.

[Holding:] The Court of Appeal, Nares, J., held that, as a matter of first impression, broker did not have a duty to subcontractor to inform it of insurer's insolvency.

Affirmed.

Opinion

NARES, J.

*1280 In this case we are presented with an issue of first impression in California: Does an insurance broker, after procuring a policy of insurance for a developer on a construction project, owe a duty to apprise a subcontractor that was later added as an insured under that policy of the insurance company's subsequent insolvency? We conclude that, absent the assumption of a contractual duty to do so, insurance brokers owe no such duty.

Cross-complainant Pacific Rim Mechanical Contractors, Inc. (PacRim), appeals from a judgment entering dismissal of its cross-complaint against cross-defendants Aon Risk Insurance Services West, Inc., and Aon Reed Stenhouse, Inc. (together, Aon), after sustaining Aon's demurrer to all causes of action PacRim asserted against it. We affirm.

FACTUAL AND PROCEDURAL BACKGROUND

Because we are reviewing a judgment following the sustaining of a demurrer, we take the factual background largely from PacRim's cross-complaint against Aon and Bosa Development California, Inc.

A. *The Construction Project and Insurance*

The underlying litigation relates to a construction project (the project) in downtown San Diego, which was completed in 2002. In June 1999 the project's developer, cross-defendant Bosa Development California, Inc. (Bosa),[1] engaged Aon as its insurance broker to obtain insurance for the project. Aon procured a general liability insurance policy (the policy) for the project with Legion Indemnity Company (Legion) at the request of its client, Bosa. **296 Legion was solvent at the time it issued the policy.

In 2000 Bosa hired PacRim as one of several subcontractors to work on the project. The parties entered into a contract (the contract) in which Bosa *1281 agreed to provide PacRim with liability insurance through the policy for its work on the project. Aon, however, was not a party to the contract and PacRim was never its client.

The policy was a unified blanket insurance policy known as an owner controlled insurance program (OCIP) that provided liability insurance for every contractor and subcontractor on the project. The OCIP provided up to $25 million in liability coverage for 10 years after the construction was completed—the duration of California's 10-year construction defect statute of limitations.

PacRim became an enrolled party in the OCIP by contacting Aon and providing all necessary paperwork, and in October 2000 Aon provided PacRim with a "Certificate of Liability Insurance," identifying PacRim as an insured, and Legion as the primary insurer.

In April 2002, during the construction project, the Illinois Department of Insurance obtained an order of conservation against Legion. In 2002, the construction project was completed.

In April 2003, after the project was complete, the Circuit Court of Cook County, Illinois, entered an order of liquidation with a finding of insolvency against Legion.

In April 2002 Aon informed Bosa that Legion had been placed into rehabilitation. However, according to PacRim, neither Bosa nor Aon notified PacRim of Legion's financial condition. PacRim alleges that had Bosa or Aon informed it of Legion's "financial condition" PacRim "could and would have immediately suspended work and insisted that Bosa obtain alternative insurance coverage for the Project."

B. *The Construction Defect Lawsuit and PacRim's Cross-complaint*

In May 2009 the project's homeowners association filed a complaint for construction defects against Bosa and its subcontractors, including cross-complainant PacRim.[2] Bosa filed a cross-complaint against PacRim (and its other subcontractors) seeking indemnity. PacRim then filed a cross-complaint against Bosa and Aon for declaratory relief, breach of contract, negligence, fraudulent concealment, and negligent concealment. As against Bosa, PacRim alleged that Bosa *1282 breached the contract by failing to provide and maintain insurance as required by the contract. PacRim further asserted that Bosa breached the contract by "failing to provide the required written notice of a modification or discontinuation of the required coverage."

As against Aon, PacRim asserted that it "owed a duty of reasonable care to procure and maintain [the insurance policy] in PacRim's favor," which Aon breached by negligently or intentionally failing to disclose "Legion's deteriorating financial condition and eventual insolvency." Thus, PacRim explains its "claims against [Aon] are negligence based, not contract based."

Aon demurred to all of PacRim's causes of action, alleging (1) PacRim expressly asserted in its cross-complaint it was not a party to the contract and thus Aon had no liabilities to it and (2) even if PacRim were **297 a party to the contract, PacRim (a) waived all rights of recovery against Aon for any coverage limitation or failure in the contract, and (b) Aon had no affirmative duty to notify PacRim of Legion's insolvency postissuance of the policy.

The trial court sustained Aon's demurrer with 10 days' leave to amend. The trial court found it "unnecessary to impose" on Aon a "duty to notify an insured of an insurer's post-issuance insolvency" because (1) Bosa was contractually obliged to notify PacRim of Legion's insolvency and (2) *Kotlar v. Hartford Fire Ins. Co.* (2000) 83 Cal.App.4th 1116, 100 Cal.Rptr.2d 246 (*Kotlar*), which "addresses the issue of a broker's duty," was analogous and controlling. The court cited *Kotlar* for the proposition that the duty of a broker is " 'to use reasonable care, diligence, and judgment in procuring the insurance requested by its client.' " The court went on to note that PacRim "fails to provide California authority imposing on a broker a duty to notify an insured of an insurer's post-issuance insolvency" and declined to impose such a duty.

The court entered a judgment of dismissal of PacRim's cross-complaint against Aon because it sustained the demurrer as to all of the causes of action. PacRim elected to file this appeal instead of amending its cross-complaint.

DISCUSSION

I. *STANDARD OF REVIEW*

We review de novo an order sustaining a demurrer. (*Gomes v. Countrywide Home Loans, Inc.* (2011) 192 Cal.App.4th 1149, 1153, 121 Cal.Rptr.3d 819.) Thus, our " ' " 'only task in reviewing a ruling on a demurrer is to determine whether the complaint states a cause of action [as a matter of law].' " ' " (*Gentry v. eBay, Inc.* (2002) 99 Cal.App.4th 816, 824, 121 Cal.Rptr.2d 703.) We treat the demurrer as admitting all material facts properly pleaded, but not contentions, deductions or conclusions of fact or law. *1283 (*Blank v. Kirwan* (1985) 39 Cal.3d 311, 318, 216 Cal.Rptr. 718, 703 P.2d 58.) Accordingly, a complaint survives demurrer if it alleges facts sufficient to state a cause of action under any possible legal theory. (*Sunset Drive Corp. v. City of Redlands* (1999) 73 Cal.App.4th 215, 219, 86 Cal.Rptr.2d 209.)

II. *THE TRIAL COURT DID NOT ERR IN SUSTAINING THE DEMURRER*

[1] On appeal, PacRim asserts the trial court erred in concluding its causes of action against Aon fail as a matter of law because Aon did not have a duty to inform PacRim of Legion's insolvency. We conclude Aon did not have a duty to inform PacRim of Legion's postissuance insolvency. Accordingly, we affirm the trial court's judgment.

A. *Aon Had No Duty to Inform PacRim of Legion's Insolvency*

[2] [3] Insurance brokers owe a limited duty to their clients, which is only "to use reasonable care, diligence, and judgment in *procuring* the insurance requested by an insured." (*Jones v. Grewe* (1987) 189 Cal.App.3d 950, 954, 234 Cal.Rptr. 717, italics added; see *Kotlar, supra,* 83 Cal.App.4th at p. 1123, 100 Cal.Rptr.2d 246.) Accordingly, an insurance broker does not breach its duty to clients to procure the requested insurance policy unless "(a) the [broker] misrepresents the nature, extent or scope of the coverage being offered or provided ... , (b) there is a request or inquiry by the insured for a particular type or extent of coverage ... , or (c) the [broker] assumes an additional duty by either express agreement or by 'holding himself out' as having expertise in a given field of **298 insurance being sought by the insured." (*Fitzpatrick v. Hayes* (1997) 57 Cal.App.4th 916, 927, 67 Cal.Rptr.2d 445.)

California law is well settled as to this limited duty on the part of insurance brokers. (*Hydro–Mill Co., Inc. v. Hayward, Tilton & Rolapp Ins. Associates, Inc.* (2004) 115 Cal.App.4th 1145, 1153, 10 Cal.Rptr.3d 582 [insurance brokers owe a duty to procure the requested insurance]; *Nowlon v. Koram Ins. Center, Inc.* (1991) 1 Cal.App.4th 1437, 1447, 2 Cal.Rptr.2d 683 ["the duty of the broker ... is incurred in the procurement or issuance of an insurance policy ..."]; see also *Wilson v. All Service Ins. Corp.* (1979) 91 Cal.App.3d 793, 798, 153 Cal.Rptr. 121 [holding that a broker has no duty to investigate the financial condition of insurer authorized to conduct business when policy issued].)

PacRim does not allege that Aon failed to use reasonable care in procuring the insurance policy from Legion. Moreover, PacRim does not allege that Aon assumed any additional contractual duties beyond procuring the insurance. Rather, PacRim is asking this court to create a new legal duty of *1284 notification of "Legion's conservation order and insolvency" after the policy is procured, and to apply that retroactively upon Aon. As we shall explain, we decline to impose such a new duty.

Kotlar, supra, 83 Cal.App.4th 1116, 100 Cal.Rptr.2d 246, is analogous to the issue presented in this case, and, we conclude, persuasive. In *Kotlar,* the issue presented was whether an insurance broker has a common law duty to give notice to an insured of discontinued coverage after the broker properly placed the policy. (*Kotlar, supra,* 83 Cal.App.4th at p. 1123, 100 Cal.Rptr.2d 246.) The plaintiff in *Kotlar,* like PacRim, was insured under a policy procured by the defendant insurance broker at the request of another party. (*Id.* at p. 1119, 100 Cal.Rptr.2d 246.) There, the tenant maintained an insurance policy naming the landlord Kotlar as an insured pursuant to the tenant's lease and, like PacRim in this case, Kotlar received a certificate of insurance from the broker. (*Ibid.*) The plaintiff insured, Kotlar, sought to impose liability on the broker for its alleged failure to notify Kotlar that the insurer intended to cancel the policy for nonpayment of premiums, which rendered Kotlar without coverage when a later loss occurred. (*Ibid.*)

The *Kotlar* trial court sustained the insurance broker's demurrer that the negligence claim failed as a matter of law, finding the broker owed no duty to notify the insured that the policy was being cancelled. (*Kotlar, supra,* 83 Cal.App.4th at pp. 1119–1120, 100 Cal.Rptr.2d 246.) The Court of Appeal upheld this ruling. In doing so, the court noted "Kotlar cites no case holding an insurance broker owes a duty ... to provide ... notice... . Instead, he asks us to create such a duty. We decline to do so for several reasons." (*Id.* at p. 1123, 100 Cal.Rptr.2d 246.) The court first noted that because Insurance Code section 677.2 "imposes a duty on the insurer to notify the named insureds of its intent to cancel the policy we see no purpose in judicially imposing such a duty on a broker." (*Kotlar, supra,* at p. 1123, 100 Cal.Rptr.2d 246.) The court also concluded, "[T]he relationship between an insurance broker and its client is not the kind which would logically give rise to such a duty. The duty of a broker, by and large, is to use reasonable care, diligence, and judgment in *procuring* the insurance requested by its client." (*Ibid.,* italics added.) Finally, the *Kotlar* court distinguished a broker-client relationship from an attorney-client relationship, which is fiduciary in nature. (*Ibid.*)

As in *Kotlar,* Aon had no legal duty to provide notice of the discontinuation of **299 coverage caused by Legion's insolvency. PacRim does not allege that Aon failed to use reasonable care in procuring the policy in question. Rather, like the plaintiff in *Kotlar,* PacRim seeks to impose upon brokers a new legal duty of notification *after* the policy has been procured, to an insured that has a certificate of insurance, of the insolvency of an insurance company. That duty, as explained in *Kotlar,* under Insurance Code section 677.2 rests with the insurer. Additionally, as we shall explain, *post,* according to PacRim's own allegations, that duty rested with Bosa. Because *1285 PacRim's claims are based entirely on the allegation that Aon failed to satisfy a duty that California law does not recognize and that the Court of Appeal rejected in *Kotlar,* PacRim's claims against Aon fail as a matter of law.

B. *Public Policy Supports the Conclusion There Is No Duty to Notify of Insolvency*

We are further disinclined to retroactively impose on

Aon (and all other insurance brokers) the duty PacRim asks us to impose because of considerations of public policy. We agree with Aon that imposition of a duty requiring insurance brokers to inform an insured of "any adverse changes in the carrier's financial capability" postissuance of the insured's policy is properly the function of the Legislature because it would (a) fundamentally alter the nature and corresponding duties of insurance brokers, which would (b) increase the costs of procuring insurance.

[4] " '[W]hether, and the extent to which a new duty is recognized is a question of public policy.' " (*Butcher v. Truck Ins. Exchange* (2000) 77 Cal.App.4th 1442, 1451, 92 Cal.Rptr.2d 521.)

[5] We first must note that, contrary to its assertion on appeal, PacRim is not merely seeking to impose a narrow duty on the part of brokers to notify an insured when it has actual knowledge of an insurer's insolvency that "would impose almost no burden on brokers." The very facts alleged in PacRim's cross-complaint dispel this notion. PacRim alleges that if it had been notified it would have suspended work and demanded that Bosa obtain alternative insurance. This duty, according to PacRim, must have arisen in 2002, when the Illinois Department of Insurance obtained an order of conservation against Legion, as, according to PacRim's cross-complaint, Legion was not declared insolvent until 2003, *after* the project was completed. However, an order of conservation does not necessarily mean an insurance company is insolvent. Insurance Code section 1011 provides that an order of conservation may be sought against an insurance company upon a showing:

> "(a) That such person has refused to submit its books, papers, accounts, or affairs to the reasonable inspection of the commissioner or his or her deputy or examiner. [¶] (b) That such person has neglected or refused to observe an order of the commissioner to make good within the time prescribed by law any deficiency in its capital if it is a stock corporation, or in its reserve if it is a mutual insurer. [¶] (c) That such person, without first obtaining the consent in writing of the commissioner, has transferred, or attempted to transfer, substantially its entire property or business or, without such consent, has entered into any transaction the effect of which is to merge, consolidate, or reinsure substantially its entire property or business in or with the property or business of any other person. [¶] (d) That such person is found, after an examination, to be in such *1286 condition that its further transaction of business will be hazardous to its policyholders, or creditors, **300 or to the public. [¶] (e) That such person has violated its charter or any law of the state. [¶] (f) That any officer of such person refuses to be examined under oath, touching its affairs. (g) That any officer or attorney in fact of such person has embezzled, sequestered, or wrongfully diverted any of the assets of such person. [¶] (h) That a domestic insurer does not comply with the requirements for the issuance to it of a certificate of authority, or that its certificate of authority has been revoked; or [¶] (i) That the last report of examination of any person to whom the provisions of this article apply shows such person to be insolvent... ."

[6] Moreover, after an order of conservation is obtained, the insurance company may challenge the order by proving that the grounds alleged for the conservation do not exist or have been removed. (Ins.Code, § 1012.) A "conservatorship proceeding ... contemplates, not the liquidation of the company involved, but a conservation of the assets and business of the company over the period of stress by the commissioner who thereafter yields the control and direction to the regular officers of the company." (*Caminetti v. Superior Court in and for City and County of San Francisco* (1941) 16 Cal.2d 838, 843, 108 P.2d 911.)

Illinois law, under which a conservation order was obtained against Legion, is similar: "Pursuant to an Order of Conservation, the [Illinois Director of Insurance] takes possession of property, business and affairs of a company to protect the interests of policyholders and other creditors, and proceeds to ascertain the condition and situation of the company." (Ill. Div. of Insurance, Off. of Special Deputy Receiver, 2003 Ann. Rep., p. 37.) That was done in Legion's case in April 2002. (*Id.* at p. 46.) Legion contested that order and it was not until after one year of court proceedings that Legion was declared

insolvent and placed in liquidation in April 2003. (*Ibid.*)

Thus, according to PacRim's own allegations in this case, it is asking brokers to notify an insured not just of an actual insolvency of an insurer, but of any adverse changes in its financial condition because an order of conservation is not necessarily an adjudication that an insurer is insolvent. Indeed, the cross-complaint alleges that Aon had a duty to notify PacRim not just of Legion's insolvency, but its "deteriorating financial condition." This necessarily imposes a duty of monitoring and presents brokers with uncertainty as to when the notification duty arises. We decline to impose such a duty that fundamentally changes the relationship between brokers and their insureds.

Further, the Legislature has already statutorily imposed a number of duties on insurers and insurance brokers. (See, e.g., Ins.Code, §§ 785, 1732, 10089.23, 10113.2, subd. (d)(13), 10119.3, 10192.55, 10234.8.) We decline to *1287 impose a new duty on insurance brokers as PacRim requests us to do because "[i]f it is in the interest of the public ... , the people of California, by initiative or through the Legislature, can create that duty ... ." (*Schimmel v. NORCAL Mutual Ins. Co.* (1995) 39 Cal.App.4th 1282, 1286, 46 Cal.Rptr.2d 401) "We may not legislate on the subject in their stead." (*Id.* at p. 1283, 46 Cal.Rptr.2d 401.)

Moreover, as discussed, *ante,* imposing on insurance brokers " 'a continuing duty to apprise [insureds] of any adverse changes in the [insurer's] financial capability' " as PacRim urges would significantly expand and redefine a broker's role. The duty PacRim seeks us to impose on brokers is unpredictable because what constitutes an adverse change in the insurer's financial capability that triggers the duty to notify the insured is exceedingly ambiguous. **301 The scope of such a standard would take an unknown amount of time to define. The costs necessary to determine its exact scope through litigation, as well as the costs for brokers to effectively perform the duty, would be substantial. Further, because PacRim asks us to impose the duty retroactively, every insurance broker that failed at any time to advise any claimant under a policy it brokered of any adverse change in the insurer's financial capability faces liability. These concerns reinforce our conclusion that imposing the duty on insurance brokers as PacRim requests is properly the role of the Legislature, not the courts. (See *Green v. Ralee Engineering Co.* (1998) 19 Cal.4th 66, 71, 78 Cal.Rptr.2d 16, 960 P.2d 1046 [holding "the Legislature, and not the courts, is vested with the responsibility to declare the public policy of the state"].)

Indeed, as PacRim acknowledges, at least 10 states and Puerto Rico have elected to impose a *statutory* duty to notify an insured of a subsequent insolvency as soon as the agent or broker receives notice of that insolvency. (See Sinder et al., Agent/Broker Liability for Insurer Insolvency (4th ed. 2006) pp. 3, 10 < https://www.ciab.com/WorkArea/DownloadAsset.aspx?id=1043&lib ID=1064> [as of Feb. 27, 2012].) California has chosen not to enact such legislation. We decline to create such a duty where our Legislature could have done so, but has not.

Further, if anyone had a duty to inform PacRim of Legion's insolvency, it was Legion. (See Ins.Code, § 677.2, subds. (b) & (c) [requiring insurers inform insured of intent to cancel in writing with at least 30 days' advance notice].)

Moreover, creating such a new duty could expose brokers to personal liability for claims made against them by insureds. In most agents' and brokers' errors and omissions (E&O) policies there is an exclusion for claims made by an insured because the insurer with which the agent or broker placed coverage is unable to pay an otherwise covered claim because of the *1288 insurer's insolvency. For example, in *Barron v. Scaife* (La.Ct.App.1988) 535 So.2d 830, an insurance agent was accused of failing to notify its insured of the insurance company's insolvency. The court held that an exclusion in the agent's E&O policy for "claims made against the insured arising from or related to: [¶] ... [¶] ... [t]he insolvency, receivership, bankruptcy or liquidation of any insurance company" applied and found no coverage for the claim made by the insured against the agent. (*Id.* at p. 832; see also *Transamerica Ins. Co. v. Snell* (Fla.Dist.Ct.App.1993) 627 So.2d 1275, 1276–1277; *St. Paul Fire & Marine Ins. Co. v. Cohen–Walker, Inc.* (1984) 171 Ga.App. 542, 320 S.E.2d 385.)

Imposing continuing duties of monitoring and notification upon the broker after issuance of the policy creates other practical difficulties. In the case of occurrence-based policies, the proposed common law notification duty could last indefinitely, well after brokers (and the client) may have ceased doing business. For example, in this case the Legion policy extended 10 years after completion of the project in 2002, more than 13 years after the policy was procured in 1999. We decline to impose such a new, continuing duty retroactively against brokers. We reiterate that adoption of the rule advocated by PacRim should be done prospectively by the Legislature to avoid uncertainty as to the duties of brokers in this state.

C. *Bosa's Contractual Duty to Inform PacRim of Insolvency*

Aon contends, and the trial court agreed, Bosa had a contractual duty to inform PacRim of Legion's insolvency.

> **302 "10.3.2(g) CONTRACTOR'S ELECTION TO MODIFY OR DISCONTINUE [THE POLICY] [Bosa] may, for any reason, modify the [policy], discontinue [the policy], or request that [PacRim] or any of its Subcontractors withdraw from the [policy] upon thirty (30) days written notice."

Based upon this language PacRim alleges in its cross-complaint that Bosa had a contractual duty to notify it of Legion's insolvency, and breached the contract by failing to do so. We must accept these allegations as true for the purposes of reviewing the court's order sustaining Aon's demurrer. (*Blank v. Kirwan, supra,* 39 Cal.3d at p. 318, 216 Cal.Rptr. 718, 703 P.2d 58.) As the court found, because Bosa had a contractual duty to inform PacRim of Legion's insolvency, there was no need to create a new duty on the part of Aon to also inform PacRim of Legion's insolvency.

D. *PacRim's Citation to Out-of-state Authorities Is Misplaced*

PacRim asserts we should "join with every other state to consider the issue by recognizing an insurance broker's duty to share its actual knowledge of the insurer's insolvency with the insured." This contention is unavailing.

*1289 First, this statement is simply incorrect. In fact, several states have refused to impose such a duty upon a broker after it has procured the insurance policy.

For example, in *Williams–Berryman Ins. Co. v. Morphis* (1971) 249 Ark. 786, 461 S.W.2d 577, the Arkansas Supreme Court dismissed a policyholder's claim against an insurance broker for negligence based on the subsequent insolvency of the carrier. The court held that a broker has no duty to provide notice of an insolvency of the insurer that occurs after the policy is placed. (*Id.* at p. 580.) Rather, the broker's only relevant duty was to exercise reasonable care to procure insurance from an insurer that was solvent at the time the policy was placed, which the broker had done. (*Ibid.*)

In *Beckman v. Edwards* (Wash.1910) 59 Wash. 411, 413, 110 P. 6, the Supreme Court of Washington dismissed a similar complaint against a defendant independent insurance agent, holding: "Where an agent provides a policy in a company which is solvent or generally considered so, he is not personally liable for a loss which occurs when the company subsequently becomes insolvent." (See also *Sternoff Metals Corp. v. Vertecs Corp.* (1984) 39 Wash.App. 333, 693 P.2d 175, 180 [granting summary judgment to defendant broker because broker owed no duty to client after placing coverage with a surplus lines insurer that was solvent at the time (citing *Beckman, supra,* 110 P. 6)].)

Vermont and Maine have also held that brokers have no duty to give notice to an insured of a cancellation of a policy postissuance: "The duty of an insurance agent is to use reasonable care and diligence to procure insurance that will meet the needs and wishes of the prospective insured, as stated by the insured. [Citation.] Absent special facts not present here, it is generally well settled that once a policy has been procured as requested, the relationship terminates and no further duty is owed the insured by the insurance agent in respect to such insurance. [Citation.] Specifically, where an insurance company is required to give direct notice of cancellation to the insured, as is the case here, the insurance agent is not liable for a failure to notify, since he is justified in assuming that the insured would be made aware of the cancellation from other sources." (*Rocque v. Co–operative Fire Ins. Ass'n* (1981) 140 Vt. 321, 438 A.2d 383, 386 [dismissing negligence claim against independent **303 insurance agent in the position of a broker for failure to notify the insured of the policy's cancellation, resulting in no coverage]; *Sunset Enterprises v. Webster & Goddard, Inc.* (Me.1989) 556 A.2d 213, 215 [same].)

In *Eastham v. Stumbo* (Ky.Ct.App.1929) 212 Ky. 685, 279 S.W. 1109, 1110, the court stated, "We have been referred to no authority holding an insurance agent *1290 liable to the policyholder where the company subsequently becomes insolvent and the agent fails to notify the policyholder of the insolvency of the company. We do not well see upon what legal principle such a duty would rest. This would require an agent to notify all those holding policies in the company through him, and would impose on him a duty not in the interests of the company, which might require of him action that would justly be deemed by the company a breach of his duties to it. No man can serve two masters."

Further, in all but one case, in the out-of-state cases PacRim relies upon to support such a duty, the plaintiff insured was the broker's *client.* (See *AYH Holdings, Inc. v. Avreco, Inc.* (2005) 357 Ill.App.3d 17, 292 Ill.Dec. 675, 826 N.E.2d 1111, 1132 [" 'Assuming that a broker is on notice that an insurance company is insolvent, he or she has an affirmative duty to notify the *client* of the fact' " (italics added)]; *Kinder Mortgage. Co. v. Celestine* (La.Ct.App.1994) 635 So.2d 527, 529 ["the general

principles of the fiduciary relationship ... [hold that] an independent broker has an affirmative duty to inform *the client* of a premature termination of the coverage" (italics added)]; *Glenn v. Leaman & Reynolds, Inc.* (La.Ct.App.1983) 442 So.2d 1224, 1226 [an "independent broker has an affirmative duty to inform *the client* ..." (italics added)]; *Hobbs v. Midwest Ins.* (1997) 253 Neb. 278, 570 N.W.2d 525, 528 ["The evidence indicates that in January 1990 [the insurance agent] met with [the client] to discuss the proposed changes to the policy."]; *Cateora v. British Atlantic Assur., Ltd.* (S.D.Tex.1968) 282 F.Supp. 167, 174 [the "duty of an insurance agent [is] to inform *his clients* when said agent knew that the insurer had become insolvent, or to replace the insurance" (italics added)]; *Higginbotham & Associates, Inc. v. Greer* (Tex.Ct.App.1987) 738 S.W.2d 45, 48 (*Higginbotham*) [plaintiff client spoke directly with employees of the defendant insurance agency regarding the type of coverage needed to insure his business and specifically requested that the insurance policy be procured].)

Although PacRim was an insured, and was given a certificate of insurance, it was not Aon's client. Bosa was. An insurance broker's client is the person or entity that contracts with the broker, communicates to the broker its insurance needs, reviews the quotes provided by the broker and decides what policy to purchase. The minimal contact between Aon and PacRim, that occurred over a year *after* Aon procured the policy on behalf of Bosa, also supports a finding of no duty on the part of Aon to notify the subcontractor insureds. Thus, these cases are not persuasive in deciding the issue presented in this case.

Higginbotham, supra, 738 S.W.2d 45, upon which PacRim heavily relies, is particularly inapposite. There, the claim was that the insurance agent failed *1291 to exercise reasonable care in *procuring* an insurance policy where the insurance company later became insolvent. The *Higginbotham* court found that the agent exercised reasonable diligence in obtaining insurance from the carrier inasmuch as nothing indicated at the time that the carrier was an unreasonable risk. Therefore, the agent was not negligent. (*Id.* at p. 48.)

**304 In so holding, the court stated, "The general rule is that an insurance agent or broker is not a guarantor of the financial condition or solvency of the company from which he obtains the insurance. He is required, however, to use reasonable skill and judgment with a view to the security or indemnity for which the insurance is sought, and a failure in that respect may render him liable to the insured for resulting losses." (*Higginbotham, supra,* 738 S.W.2d at p. 46.) As such, "where the company was solvent when the policy was procured, its subsequent insolvency generally does not impose liability on the agent or broker." (*Id.* at pp. 46–47.)

There was no issue raised in *Higginbotham* as to an agent's duty to *notify* an insured of an insurer's insolvency that occurs *after* the policy is procured. However, PacRim cites the following language from that case for the proposition that Aon had such a duty: "[A]n agent is not liable for an insured's lost claim due to the insurer's insolvency if the insurer is solvent at the time the policy is procured, unless at that time *or at a later time when the insured could be protected,* the agent knows or by the exercise of reasonable diligence should know, of facts or circumstances which would put a reasonable agent on notice that the insurance presents an unreasonable risk." (*Higginbotham, supra,* at p. 47, italics added.) The italicized portion of that sentence was dicta, as the issue of a continuing duty to notify insureds of the postprocurement financial condition of an insurance company was not at issue in that case.

Moreover, because of the holding in *Kotlar,* which we have found dispositive, and principles of public policy, which we have discussed, *ante,* we decline to follow out-of-state authority that imposes a duty upon a broker to inform an insured, postprocurement, of an insurer's insolvency.

E. *Biakanja v. Irving*

Finally, PacRim's contention *Biakanja v. Irving* (1958) 49 Cal.2d 647, 320 P.2d 16 (*Biakanja*) should control here is unavailing. In *Biakanja,* our Supreme Court established a test to determine when a defendant will be liable for negligent performance of a *contractual duty* to a party not in privity of contract with the defendant. (*Id.* at pp. 648–650, 320 P.2d 16.) However, as PacRim concedes, its "claims against [Aon] are negligence based, not contract based." PacRim contends Aon is liable in tort because Aon failed to inform PacRim *1292 immediately of Legion's insolvency. Thus, PacRim does not assert Aon breached any contract, which renders *Biakanja* inapplicable here.

We conclude the trial court properly sustained Aon's demurrer because it had no duty as Bosa's insurance broker to inform PacRim of Legion's insolvency, and we are unwilling to extend that duty as PacRim requests. Because we conclude Aon did not owe any duty to PacRim, all of its causes of action necessarily fail. Accordingly, the trial court's judgment is affirmed.

DISPOSITION

The trial court's judgment is affirmed. Aon shall recover its costs on appeal.

WESTCHESTER SURPLUS LINES INSURANCE COMPANY,
Plaintiff,
v.

LIBERTY MUTUAL INSURANCE COMPANY, Defendant.

Case No. 16-cv-07282-WHO

Signed 02/22/2018

WESTCHESTER SURPLUS LINES INSURANCE COMPANY, Plaintiff,
v.
LIBERTY MUTUAL INSURANCE COMPANY, Defendant.

Case No. 16-cv-07282-WHO
|
Signed 02/22/2018

Opinion

ORDER REGARDING MOTIONS FOR SUMMARY JUDGMENT

William H. Orrick, United States District Judge

INTRODUCTION

*1 Plaintiff Westchester Surplus Lines Insurance Co. ("Westchester") brings an action against defendant Liberty Mutual Insurance. ("Liberty Mutual") for equitable contribution stemming from Westchester's defense and indemnity of Tractel, Inc. ("Tractel") following an accident occurring on August 4, 2011 at a residential building located at 300 Berry Street in San Francisco, California. Westchester, which insured Tractel as part of a "wrap up" insurance program, argues that it is entitled to equitable contribution from Liberty Mutual because both parties previously issued a primary insurance policy to Tractel, while Liberty Mutual contends that its policy carves out coverage when a wrap up insurance program applies and that it had no obligation, equitable or otherwise, to defend Tractel in that circumstance. Both parties moved for summary judgment. For the reasons discussed below, Westchester is not entitled to equitable contribution from Liberty Mutual. I grant Liberty Mutual's motion and deny Westchester's.

BACKGROUND

I. FACTUAL BACKGROUND

A. The Owner Controlled Insurance Program

In 2006, Arterra Mission Bay, LLC began work on the construction of 268 mid-level condominiums and townhome units in the Mission Bay area of San Francisco (the "Arterra Project"). *See* Declaration of Nancy Adams ("Adams Decl."), Ex. 1, Tractel/Bovis Subcontract, at Ex. B.1 at 1 (Dkt. No. 35-1). As a part of the Arterra Project, the owner created an owner controlled insurance program ("OCIP") in order to provide insurance coverage to contractors working on the project. *See* Adams Decl., Ex. 2, OCIP Manual at 5 (Dkt. No. 35-2). Enrollment and participation in the OCIP were mandatory for all the contractors working on the project. *Id.* Westchester issued the wrap up insurance policy, providing primary general liability coverage under the OCIP. *See* Adams Decl., Ex. 3, Westchester Policy at Endorsement No. 1 (ECF p. 7) (Dkt. No. 35-3).

Tractel was awarded a subcontract with Bovis Lend Lease as a part of the Arterra Project, related to the construction and installation of the Exterior Building Maintenance System that facilitates window washing and other exterior building maintenance. *See* Adams Decl., Ex. 1, Tractel/Bovis Subcontract, at 1, Ex. B.1 at 2 (Dkt. No. 35-1). The Tractel/Bovis Subcontract incorporates the OCIP Manual by reference. *See id.* at 15 (listing "Exhibit C.1 (Wrap Manual)" as a contract document). Even though Tractel was already insured by Liberty Mutual, per the terms of the subcontract Tractel was obligated to enroll in the OCIP and pay premiums to Westchester, which it did. *See* Adams Decl., Ex. 4, Lockton Insurance Brokers OCIP Enrollment Spreadsheet (Dkt. No. 35-4) (listing Tractel as an "enrolled contractor").

B. The Westchester Policy

Westchester issued a general liability policy to Mission Bay LLC, effective from May 1, 2006 to March 1, 2009. Corona Decl., Ex. 3, Westchester Policy (Dkt. No. 32-6). By endorsement, Mission Bay LLC and "all subcontractors that are enrolled in the [OCIP]" were the "Named Insured" for the Westchester policy. *Id.* ¶ 12; Adams Decl., Ex. 3, Westchester Policy at Endorsement No. 1 (ECF p. 7).

*2 Relevant to this action, the Westchester Policy contains an "Other Insurance" provision that states:

4. Other Insurance

If other valid and collectible insurance is available to the insured for a loss we cover under Coverages A or B of this Coverage Part, our obligations are limited as follows:

a. Primary Insurance

This insurance is primary except when b. below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. Then, we will share with all that other insurance by the method described in c. below.

b. Excess Insurance

This insurance is excess over:

(1) Any of the other insurance, whether primary, excess, contingent or on any other basis:

(a) That is Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage for "your work" ...;

(2) Any other primary insurance available to you covering liability for damages arising out of the premises or operations for which you have been added as an additional insured by attachment of an endorsement.

c. Method of Sharing

If all of the other insurance permits contribution by equal shares, we will follow this method unless the insured is required by contract to provide insurance that is primary and non-contributory, and the "insured contract" is executed prior to any loss. Where required by a contract, this insurance will be primary only when and to the extent as required by that contract. However, under the contributory approach each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first. If any of the other insurance does not permit contribution by equal shares, we will contribute by limits. Under this method, each insurer's share is based on the ratio of the applicable limit of insurance to the total applicable limits of insurance of all insurers.

Adams Decl., Ex. 3, Westchester Policy at Section IV ¶ 4, as amended by Endorsement No. 25 (ECF pp. 33, 57).

C. The Liberty Mutual Policy

Liberty Mutual issued a Commercial General Liability policy to Tractel North America, Inc., effective from May 1, 2011 to May 1, 2012. *See* Adams Decl., Ex. 11, Liberty Mutual Policy at Declarations (ECF p.5) (Dkt. No. 35-11). By endorsement, Tractel, Inc. is a named insured on the policy. *Id.* at Endorsement No. 19 (ECF p. 51). Relevant to this action, the Liberty Mutual Policy contains an "Other Insurance" provision and a "Difference in Conditions/Difference in Limits Endorsement Wrap Up Liability" provision. *See id.* at Section VIII ¶ 12 (ECF p.23), Endorsement No. 9 (ECF p. 35).

The "Other Insurance" provision provides that:

The coverage afforded by this Policy is primary insurance, except when stated to apply in excess of or contingent upon the absence of other insurance. When this insurance is primary and the "Insured" has other insurance, which is applicable to a loss on an excess or contingent basis, the Limits of Liability under this Policy will not be reduced by the existence of such other insurance. When insurance provided by this Policy and by "other insurance" apply to a loss on the same basis, whether primary, excess or contingent, the Insurer will be liable under this Policy for the proportion of such loss stated in the applicable contribution provision below:

*3 (a) Contribution by Equal Shares:

If all "other insurance" provides for contribution by equal shares, the Insurer will also follow this method. Under this method, each insurer contributes equal amounts until it has paid its applicable limit of liability or the full amount of the loss is paid, whichever comes first.

(b) Contribution by Limits:

If any "other insurance" does not provide for contribution by equal shares, the Insurer will contribute by limits. Under this method, each insurer's share is based on the ratio of its applicable limit of liability to the total limits of liability of all insurers.

Id. at Section VIII ¶ 12 (ECF p.23).

The "Difference in Conditions/Difference in Limits Endorsement Wrap Up Liability" provision provides that:

To the extent that this Policy affords broader coverage or higher limits of liability than any wrap-up liability policy in place to cover the "Insured's work", this policy is extended to provide coverage for the "Insured", subject to the following conditions:

(a) no coverage is provided under this Policy for any claim that is below the amount of any applicable

deductible contained in any wrap-up liability policy;

(b) no coverage is provided under this Policy for any claim arising out of the "Insured's work" for damage to any property under construction or any property forming part of the insured project under any wrap-up liability policy; and
(c) if coverage applies under both this Policy and a wrap-up liability policy and the limits of liability provided by this Policy is greater, this Policy is restricted to provide coverage only for the difference between the greater limit of liability applicable to this Policy and the lower limit of liability applicable to the wrap-up liability policy

Id. at Endorsement No. 9 (ECF p. 35).

D. The Underlying Accident and Litigation

On August 4, 2011, Benito Carrera and Raul Carrera were working as window washers at a residential building located at 300 Berry Street, San Francisco. Adams Decl., Ex. 5, Carrera Complaint ¶¶ 4-5 (Dkt. No. 35-5). Benito Carrera alleges that he heard "a sudden loud metallic noise, and one side of the scaffolding support system failed and the scaffolding fell precipitously about 3 floors down." *Id.* ¶ 6. He was injured, *id.* ¶¶ 11-12, and filed suit with his wife and Raul Carrera in the Superior Court of the State of California, County of San Francisco, captioned *Carrera & Alfaro v. Tractel, Inc., et al.*, case number CGC-11-515902 (the "Underlying Litigation"). *Id.* The plaintiffs asserted three counts against Tractel: (i) Negligence; (ii) Negligent Infliction of Emotional Distress; and (iii) Loss of Consortium. Corona Decl., Ex. 2, First Amended Complaint (Dkt. No. 32-5).

Tractel tendered the defense and indemnity of the Underlying Litigation to Westchester. Corona Decl. ¶ 9 (Dkt. No. 32-2). Westchester assumed the defense under the terms and conditions of the Westchester Policy. *See id.*; Adams Decl., Ex. 8, Westchester Reservation of Rights Letter (December 9, 2011) (Dkt. No. 35-8). On October 1, 2015, the Underlying Litigation was settled for $1,352,500, with Westchester paying (i) $415,000 to the workers' compensation insurer that was providing benefits to Plaintiff Carrera; (ii) $540,000 to Benito Carrera; (iii) $12,500 to Gloria Alfaro; and (iv) $385,000 to Raul Carrera. Corona Decl. ¶¶ 10-11. Westchester also paid (i) $9,000 to resolve a subrogation claim; (ii) $65,926.81 to the Arterra Homeowner Association for a property damage claim; and (iii) $318,740.39 in defense fees and costs. *Id.* Liberty Mutual did not contribute any amount to the settlement.

II. PROCEDURAL BACKGROUND

*4 On December 21, 2016, Westchester filed this action against Liberty Mutual. Compl. (Dkt. No. 1). Westchester asserts a cause of action for equitable contribution, alleging that as a matter of "fairness and equity," Liberty Mutual should have paid an equal share of the costs of indemnification and defense of Tractel in the Underlying Litigation. *See id.* ¶ 22. Both parties now move for summary judgment on the equitable contribution claim. (Dkt. Nos. 30, 32)

LEGAL STANDARD

Summary judgment on a claim or defense is appropriate "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). In order to prevail, a party moving for summary judgment must show the absence of a genuine issue of material fact with respect to an essential element of the non-moving party's claim, or to a defense on which the non-moving party will bear the burden of persuasion at trial. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Once the movant has made this showing, the burden then shifts to the party opposing summary judgment to identify "specific facts showing there is a genuine issue for trial." *Id.* The party opposing summary judgment must then present affirmative evidence from which a jury could return a verdict in that party's favor. *Anderson v. Liberty Lobby,* 477 U.S. 242, 257 (1986).

On summary judgment, the Court draws all reasonable factual inferences in favor of the non-movant. *Id.* at 255. In deciding a motion for summary judgment, "[c]redibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge." *Id.* However, conclusory and speculative testimony does not raise genuine issues of fact and is insufficient to defeat summary judgment. *See Thornhill Publ'g Co., Inc. v. GTE Corp.,* 594 F.2d 730, 738 (9th Cir. 1979).

DISCUSSION

Liberty Mutual argues that it is entitled to summary judgment on Westchester's equitable contribution claim because (i) the Westchester Policy was intended to be the sole insurance policy applicable for job site related claims against an OCIP-enrolled contractor and (ii) the Liberty Mutual Policy expressly provided that, when Tractel is insured under an OCIP policy, the Liberty Mutual Policy is excess over the applicable limits for the OCIP policy. I agree.

I. LIBERTY MUTUAL'S POLICY ACTS AS EXCESS OVER WESTCHESTER'S

Westchester contends that both the Liberty Mutual Policy and the Westchester Policy insured Tractel as primary policies for the Underlying Litigation, and because the Liberty Mutual Policy is not a "true" excess policy, the Westchester Policy and the Liberty Mutual Policy are at the same level of risk. Liberty Mutual concedes that its policy is not a "true" excess policy because it generally provides primary insurance to Tractel. But where Tractel is insured under a wrap-up policy, such as the OCIP for the Arterra Project, the Liberty Mutual Policy responds on an excess basis. It contains specific coverage carve outs when Tractel is also covered by wrap-up insurance. *See* Adams Decl., Ex. 11, Liberty Mutual Policy, at Endorsement No. 9 (ECF p. 35). Section VIII ¶ 12 (ECF p. 23) ("The coverage afforded by this Policy is primary insurance, except when stated to apply in excess of ... other insurance"). Liberty Mutual contends that Endorsement 9 of its policy renders the Liberty Mutual Policy excess to the OCIP.

*5 Westchester argues that Endorsement 9 is not applicable on its plain terms because the Liberty Mutual Policy does not afford higher limits of liability than the Westchester Policy. Its argument ignores that Endorsement 9 also applies where the Liberty Mutual Policy affords broader coverage than the Westchester Policy. Liberty Mutual provides several examples of how its policy provides broader coverage than the Westchester Policy, such that if implicated, Liberty Mutual would need to provide coverage to the Insured subject to limiting conditions (a)-(c) in its Policy; it would not provide coverage for (a) any claim below the amount of any applicable deductible of the wrap-up policy or (b) any claim "arising out of the "Insured's work" for damage to any property under construction or any property forming part of the insured project under any wrap-up liability policy." Further, Liberty Mutual would provide coverage for claims for which the limits of liability for the Liberty Mutual Policy were greater (c) only for the difference between the Liberty Mutual Policy and the wrap up policy. *See* Adams Decl., Ex. 11, Liberty Mutual Policy, at Endorsement No. 9 (ECF p. 35). While Westchester contends that these examples are immaterial and irrelevant because Liberty Mutual has not demonstrated that it covered defense fees or settlement funds excluded by the Westchester Policy, it is the potential reach of the policy, not how it applied in this circumstance, that is germane. Either the Liberty Mutual Policy provides no coverage for loss also subject to a wrap-up policy or it provides coverage subject to the language of Endorsement 9. Regardless, Endorsement 9 is applicable on its plain terms.

Westchester also argues that Endorsement 9 is not applicable because it only applies to a wrap-up policy to cover "the Insured's work," and Tractel's role for the Arterra Project that gave rise to liability was to supply a product. Westchester contends that Tractel supplied a defective product through its off-site operations, which is not a risk that the OCIP policy was intended to cover. But Westchester expressly disavowed this "product defect" defense as a coverage position. Adams Decl., Ex. 16, August 30, 2011 Email (Dkt. No. 39-1) ("[Westchester] is not distinguishing between the manufacturing issue and the installation issue ... [and will not] attempt to claim this was a product defect and deny liability"). It cannot now contradict that position to assert that the Underlying Litigation involved a product defect such that Endorsement 9 was not triggered. Moreover, the work that Tractel performed on the Arterra project extended beyond merely providing a product. *See* Adams Decl., Ex. 1 at Ex. B.1 at 2 (detailing the scope of Tractel's work for the Arterra Project). Tractel's work and the subsequent claims arise out of its "onsite" activities. Westchester's argument that Endorsement 9 was not triggered because Tractel's role for the Arterra Project that gave rise to liability was to supply a product fails.

Westchester then asserts that even if Endorsement 9 is applicable, it should be disregarded as an unenforceable "other insurance" clause because (1) "other insurance" provisions are strongly disfavored and (2) Endorsement 9 is an unenforceable excess "other insurance" provision. *See Travelers Casualty & Surety Co. v. Century Surety Co.*, 118 Cal. App. 4th 1156, 1159-64 (2004) (invalidating an excess insurance provision as an escape clause). Accordingly, Westchester argues that Endorsement 9,

which it describes as both an "excess only" and "escape" clause, should not be enforceable. An "excess only" clause "require[s] the exhaustion of other insurance; in effect, this insurer does not provide primary coverage but only acts as an excess insurer." *Residence Mut. Ins. Co. v. Travelers Indem. Co.*, 26 F.Supp.3d 965, 975 (C.D. Cal. 2014). An "escape" clause "extinguishes the insurer's liability if the loss is covered by other insurance." *Id.*

Westchester is correct that courts have frequently decided against rigid enforcement of "other insurance" clauses. *See Travelers Cas. & Surety Co.*, 118 Cal.App.4th at 1159-64; *CSE Ins. Group v. Northbrook Property & Cas. Co.* 23 Cal.App.4th 1839, 1845 (1994) (noting that "public policy disfavors 'escape' clauses whereby coverage purports to evaporate in the presence of other insurance"). But courts have rejected a bright line rule that "other insurance" clauses are always unenforceable. *Compare Hartford Cas. Ins. Co. v. Travelers Indemnity Co.*, 110 Cal. App. 4th 710, 725-26 (2003) (noting that equitable considerations favor enforcement of the excess clause as written), *with Fireman's Fund Ins. Co. v. Md. Cas. Co.*, 65 Cal. App. 4th 1279 (1998) (holding that, given the circumstances, a pro rata allocation for equitable contribution was appropriate). When insurance policies share the same risk but have "other insurance" clauses that are inconsistent, the general rule is to prorate according to the policy limits. *Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 45 Cal. App. 4th 1, 52 (1996).

*6 Liberty Mutual relies on *Hartford* to argue that because the clauses at issue in this case are not inconsistent, the general rule to prorate does not apply. In *Hartford*, the court analyzed the "other insurance" provisions in each party's insurance policy. 110 Cal. App. 4th at 710. Each policy contained excess "other insurance" provisions. *Id.* at 726. As explained by the court, the policies each contained narrow exceptions to their operation as primary insurance and not merely broad "excess only" clauses that purport to make the coverage excess whenever there is other insurance. *Id.* "A clause that carves out this intended exception to primary coverage is not similar to an escape clause, where the insurer appears to offer coverage that in fact evaporates in the presence of other insurance." *Id.* at 726-27. The court also noted that where "excess only" clauses do not act as an escape clause, "equity should not be employed to override the terms of the insurance policies."

Hartford applies. Each insurance policy in this case states that it is primary insurance and states limited circumstances in which it does not apply as primary insurance. *See* Adams Decl., Ex. 3, Westchester Policy ¶ 4; Adams Decl., Ex. 11, Liberty Mutual Policy, at Endorsement 9, ¶ 12. Endorsement 9 is not a broad excess clause; it is rather a narrow exception to primary coverage. Where Tractel is enrolled in an OCIP, as it was for the Arterra Project, the Liberty Mutual Policy acted as an excess policy. *See* Adams Decl., Ex. 11, Liberty Mutual Policy, at Endorsement 9. It is not an escape clause "where the insurer appears to offer coverage that in fact evaporates in the presence of other insurance." *See Hartford*, 110 Cal. App. 4th at 726-27. Given that Endorsement 9 is a "narrow exception" rather than a broad excess clause and the circumstances under which the Westchester Policy acts as excess insurance were not triggered in the Underlying Litigation, it is clear that the "other insurance" provisions in the two policies do not conflict. This case is distinguishable from the cases in which the court found the "other insurance" provisions to be conflicting and consequently unenforceable. Accordingly, Endorsement 9 is enforceable under California law.

"Contractual terms of insurance coverage are honored whenever possible. The courts will therefore generally honor the language of excess "other insurance" clauses when no prejudice to the interests of the insured will ensue." *Fireman's Fund Ins. Co.*, 65 Cal. App. 4th at 1303. Nothing in the record demonstrates that Tractel would be prejudiced by the language of Endorsement 9 of the Liberty Mutual Policy. Accordingly, I honor its language. Endorsement 9 renders the Liberty Mutual Policy excess to the Westchester Policy and "provide[s] coverage only for the difference between the greater limit of liability applicable ... and the lower limit of liability applicable to the wrap-up liability policy." Because the Underlying Litigation was settled for an amount within the limits of the Westchester Policy, the Liberty Mutual Policy did not provide coverage.

II. EQUITY DOES NOT REQUIRE LIBERTY MUTUAL TO CONTRIBUTE

Liberty Mutual also argues that the Westchester Policy was intended to be the sole insurance policy applicable for job site related claims for the Arterra Project and so equitable considerations dictate the failure of Westchester's equitable contribution claim as a matter of law. In support, Liberty Mutual offers the OCIP manual for the Arterra Project as well as other extrinsic evidence.

Westchester responds that such extrinsic evidence cannot be used to interpret ambiguous policy provisions, and even if the evidence is considered, it supports a finding in Westchester's favor.

Westchester relies on *Commerce & Industry Insurance Co. v. Chubb Custom Insurance Co.*, 75 Cal. App. 4th 739, 745 (1999), to argue that Liberty Mutual cannot use extrinsic evidence to demonstrate that Tractel intended for the Westchester Policy to be solely responsible for job site related claims for the Arterra Project. In *Commerce*, the insurer tried to support its argument that its policy was not intended to be primary insurance by submitting extrinsic evidence in an attempt to demonstrate that the policy in question was intended to provide contingent coverage. *Id.* The court rejected the extrinsic evidence, holding that it "cannot be used to substantiate unexpressed intention and thereby vary clear and explicit contract provisions." *Id.* at 746.

*7 *Commerce* is inapposite. Liberty Mutual introduces extrinsic evidence to support its equitable arguments, not to vary express contract provisions. It argues that "equity overrides the terms of the insurance policies." *Id.* at 749. For two insurers that arguably provide coverage for the same event, "[t]heir respective obligations flow from equitable principles designed to accomplish ultimate justice in the bearing of a specific burden. As these principles do not stem from agreement between the insurers, their application is not controlled by the language of their contracts with the respective policy holders." *Id.* Accordingly, to "accomplish ultimate justice," I can and should consider extrinsic evidence.

Liberty Mutual argues that review of the OCIP manual, in addition to the general function and purposes of OCIPs in the construction industry, demonstrates that the parties intended that the Westchester Policy would be the sole insurance implicated by all claims related to Tractel's onsite job activities for the Arterra Project, and that Liberty Mutual's policy carves out its obligation to provide primary insurance in this circumstance. Westchester takes the opposite view.

The OCIP is a wrap-up insurance program, designed to prevent the "plethora of third-party action litigation, in which the various parties associated with the project seek indemnification or contribution from other parties." 4 Steven G.M. Stein, Construction Law ¶ 13.08 (2009). It seeks to "reduce the incidence of insurance companies' disputes and litigation and the associated costs because the policies are with a single carrier that is responsible for claims." U.S. General Accounting Office, Advantages and Disadvantages of Wrap-Up Insurance for Large Construction Projects 4 (June 1999), *available at* http://www.gao.gov/archive/ 1999/rc99155.pdf. Given this backdrop, Liberty Mutual argues that the intended function of the OCIP was that the Westchester Policy would cover any claims and liabilities arising from the Arterra Project.

As mandated by Tractel's subcontract with Bovis Lend Lease, which incorporated the OCIP manual by reference, Tractel enrolled in the OCIP. *See* Adams Decl., Ex. 2, OCIP Manual, at 9. The cost of the Westchester Policy premium was deducted from the payments Tractel was due under the contract. Accordingly, Tractel is entitled to enjoy the benefits of an OCIP, specifically, the consolidated risk. By becoming the insurance carrier for the OCIP, Westchester received premiums from all contractors and subcontractors on the project in exchange for being the insurer for claims arising out of the Arterra Project. To allow Westchester to enjoy the benefits of being an OCIP insurer without being subject to the inherent risk would not "accomplish ultimate justice."

Westchester responds that Liberty Mutual is equally liable for the costs of the Underlying Litigation because: (1) The Liberty Mutual Policy is a primary policy and not a "true excess" policy at the same level of risk as the Westchester Policy; (2) Liberty Mutual was on notice of the Underlying Lawsuit from its onset and yet refused to pay any sums toward the defense or indemnity toward its insured's loss; (3) Tractel was contractually required to provide general liability insurance and the Liberty Policy afforded such coverage; (4) the Underlying Litigation stemmed from offsite operations; and (5) Tractel's liability for strict products liability for the activities that were intended to be covered under the Liberty Policy were the predominant basis compelling a settlement in the Underlying Lawsuit. Argument (2) is irrelevant, and the others are answered by the discussion in Section I, above.

*8 In sum, the Liberty Mutual Policy generally insured Tractel as a primary policy but responds as excess insurance in instances in which Tractel was also covered by a wrap-up policy. Liberty Mutual, by the language of its policy, was not required to pay toward the defense or indemnity of the loss because there was not excess past the limits of the Westchester Policy. Though Tractel was

required to provide general liability insurance for the project, it had to do so in addition to the wrap-up policy, which acts as a way for an owner to consolidate risk and avoid insurance litigation over which policy should cover what loss. Westchester received the benefit of premiums from all the contractors and subcontractors on the Arterra Project. That it had to pay the costs of the primary coverage it provided for Tractel is not unjust; it is what it contracted to do. Westchester expressly disavowed the "product defect" defense as a coverage position and cannot now revive it merely for the sake of this litigation for equitable consideration. The accident occurred on-site and did not stem from off-site activities. Westchester is not entitled to equitable contribution from Liberty Mutual.

CONCLUSION

For the reasons stated above, I GRANT Liberty Mutual's motion for summary judgment. Westchester is not entitled to equitable contribution from Liberty Mutual for settlement and defense costs of the Underlying Litigation, and I DENY Westchester's motion. Judgment shall be entered accordingly.

IT IS SO ORDERED.

Section 3.

West Coast Casualty's
Construction Defect Seminar
May 16th 17th and 18th, 2018

Grand Ballroom

Wednesday May 16th 2018
3:30 PM – 4:30 PM

Course Title:
East Coast Meets West Coast –
Hot Construction Defect Issues and Coverage Cases from the Other Coast

Anthony Miscioscia, Esq., Mark Parisi, Esq. and Mark McGivern

25th ANNIVERSARY 1993 - 2018

East Coast Meets West Coast –

Hot Construction Defect Issues and Coverage Cases from the Other Coast

Mark L. Parisi
Anthony L. Miscioscia
White and Williams LLP

Mark McGivern
CCA

White and Williams LLP

CCA

Introduction

"It is not too much of an exaggeration to say that as soon as the last nail in a project is hammered and the keys are handed over to the homeowners, the ink on the first lawsuit over the construction of the homes is starting to dry."

Forecast Homes, Inc. v. Steadfast Ins. Co., 181 Cal. App. 4th 1466, 1482 (2010).

White and Williams LLP

CCA

Construction Defect Pleading – What Plaintiff Attorneys Are Doing

Complaints are frequently drafted to include the necessary policy language to trigger a duty to defend.

– Expressly pleading consequential damage and damage to work of other contractors/subcontractors

17. On information and belief, the defendants performed the relevant work through the use of subcontractors.

18. Damage to the building includes damage to the defendants' own work but also separate damage to parts of the building that were not the work of the defendants.

19. The damages sustained by Plaintiffs due to the defendants' conduct were neither expected nor intended from the standpoint of the defendants or their subcontractors and the subcontractors to their subcontractors.

White and Williams LLP

CCA

Is Faulty Workmanship an "Occurrence"?

- Most courts on East Coast say yes – but Pennsylvania is a significant exception
  - Faulty workmanship may be "property damage," caused by "occurrence," but is subject to exclusions
    - Cypress Point Condo. Ass'n v. Adria Towers, L.L.C., 143 A.2d 273 (N.J. 2016)
    - Black & Veatch Corp. v. Aspen Insurance (UK) Ltd., 2018 U.S. App. LEXIS 3342 (10th Cir. Feb. 13, 2018)
  - Faulty workmanship is not an "occurrence"
    - Kvaerner Metals Div. of Kvaerner of U.S., Inc. v. Commercial Union Ins. Co., 589 Pa. 317 (2006)
    - Millers Capital Ins. Co. v. Gambone Bros. Development Co., Inc., 941 A.2d 706 (Pa. Super. Ct. 2007)
    - S.C. Code Ann. § 38-61-70 (CGL policy deemed to contain definition of "occurrence" that includes "property damage or bodily injury resulting from faulty workmanship, exclusive of the faulty workmanship itself")

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What Plaintiff Attorneys Are Doing

- Expressly pleading "manifestation" – or in some states purposefully remaining silent or vague as to when damages occurred

302. The deterioration of the building sheathing and framing began immediately after the first Building was constructed in or around March 2009.

303. However, the deterioration of the building sheathing and the framing elements did not manifest itself to the Association until in or around November 2015.

304. The deterioration of the building sheathing and framing continues.

White and Williams LLP

Varying "Trigger" Rules

Connecticut – somewhat in flux – as there is authority for both injury-in-fact and continuous trigger

R.T. Vanderbilt Co. v. Hartford Acc. & Indem. Co., 156 A.3d 539 (Conn. Ct. App. 2017), appeal granted, 171 A.3d 63 (Conn. 2017) (contrasting cases applying both triggers)

Florida – also in flux

Voeller Const., Inc. v. Southern-Owners Ins. Co., 2014 U.S. Dist. LEXIS 61862 (M.D. Fla. May 5, 2014) (noting that "Florida Supreme Court has yet to issue an opinion on which 'trigger of coverage' theory should apply under Florida law", and there is disagreement among the courts)

Pennsylvania – manifestation

Pa. Nat'l Mut. Cas. Ins. Co. v. St. John, 106 A.3d 1 (Pa. 2014)

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Air Master & Cooling v. Selective Ins. Co. of Am., 171 A.3d 214 (NJ App. Div. 2017)

"[W]e hold, first, that a 'continuous trigger' theory of insurance coverage may be applied in this State to third-party liability claims involving progressive damage to property caused by an insured's allegedly defective construction work."

"Second, we hold that the 'last pull' of that trigger — for purposes of ascertaining the temporal end point of a covered occurrence — happens when the essential nature and scope of the property damage first becomes known, or when one would have sufficient reason to know of it."

"Third, we reject Air Master's novel argument that the last pull of the trigger does not occur until there is expert or other proof that 'attributes' the property damage to faulty conduct by the insured."

White and Williams LLP

What Plaintiff Attorneys Are Doing

– Assert claims based on installation of defective products

- Indalex Inc. v. Nat'l Union Fire Ins. Co., 83 A.3d 418 (Pa. Super. 2013) ("Here, there are issues framed in terms of a bad product, which can be construed as an 'active malfunction,' and not merely bad workmanship.")

White and Williams LLP

What Defense Attorneys Are Doing

– Identifying risk transfer opportunities

– Identifying additional parties to join

– Evaluating statute of limitations/repose issues

- The Palisades at Fort Lee Condominium Association, Inc. v. 100 Old Palisades, LLC, 230 N.J. 427 (2017) (construction defect cause of action accrues at time building's original or subsequent owners first knew, or through the exercise of reasonable diligence, should have known of basis for claim; from that point, plaintiff has six years to file claim)

– Repair Doctrine

- In Pennsylvania, can extend statute of limitations BUT NOT statute of repose

White and Williams LLP

Current Developments/Issues

- Second Owner Problems
  - Proposed PA legislation – 20 year SOR, 2nd owner rights, recall duty
- Consumer Fraud Act claims
  - Danganan v. Guardian Prot. Servs., 2018 Pa. LEXIS 955 (Feb. 21, 2018) (non-Pa resident could bring suit under Pa UTPCPL against Pa-headquartered business based on out-of-state transactions)
  - New Jersey Consumer Fraud Act - Automatic treble damages, attorney fees
- Right to Repair Statutes
  - Do not exist on East Coast

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Current Developments/Issues

- Reimbursement of attorneys fees
  - Can the insured recover costs from insurer for coverage litigation?
    - New Jersey allows insured to recover attorney fees if it is "prevailing party"
    - Pennsylvania requires insured to prove bad faith (or exception to American Rule)
  - Can insurer get reimbursement from the insured?
    - Buss v. Superior Court, 939 P.2d 766 (Cal. 1997) (reimbursement permitted where no duty to defend existed)
    - American & Foreign Ins. Co. v. Jerry's Sport Center, Inc., 2 A.3d 526 (Pa. 2010) (recoupment not allowed unless authorized by insurance policy)
    - Holyoke Mut. Ins. Co. v. Vibram USA, Inc., No SJC-12401 – Massachusetts Supreme Judicial Court heard argument in February 2018 to decide whether insurers can recoup defense costs if it is later determined that they owed no duty to defend an underlying claim (trademark case)

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Current Developments/Issues

- Choice of Law disputes
  - Significant because of differences in neighboring states laws
    - Mega Constr. Corp. v. XL Am. Group, 2017 U.S. App. LEXIS 6210 (3d Cir. April 6, 2017) (holding, despite New Jersey being the state where the policy was issued to the insured, Pennsylvania law applied)
    - K. Hovnanian v. General Star Indemnity, NJ Super. Law Div., CAM-L-4039-13 (March 6, 2015) (holding NJ law applies to PA policy covering PA insured for construction defects in projects in NJ, finding coverage for insured stucco subcontractor)
  - Creates incentive to be first to file coverage action

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Appeal Bonds Required for an Appeal Does the Insurance Company Always Lose?

- Does an insurance company that is defending – even under a ROR – have a duty to appeal an adverse verdict?
  - Reasonable grounds to believe that a judgment in excess of policy limits might be reversed or materially reduced
  - Reasonable grounds to believe a judgment entered on a non-covered claim might be reversed
- Requirement of collateral or supersedeas bond
- What it takes to get a bond
  - Still have to post 100% collateral but to the bonding company
  - Principal on the bond must contractually agree to pay the judgment if the appeal is unsuccessful and the verdict stands
- What does this mean for the insurance company?
- What can the insurance company do?

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Duty to Defend Issues

- Four corners versus extrinsic evidence
  - DE, PA, VA – four corners; CT, MD, MA, NJ, NY – extrinsic; FL – four corners w/ exceptions
- No Cumis statutes on East Coast
- Right to independent counsel not as developed
- New Jersey's unique reimbursement rule
  - Burd v. Sussex Mut. Ins. Co., 56 N.J. 383 (1970) (converts duty to defend into duty to reimburse)

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Florida Stat. Chapter 558

- Claimants must provide written notice of claim on a contractor, subcontractor, supplier or design professional prior to filing an action; must provide at least 60 days notice, or at least 120 days notice prior to filing an action involving an association representing more than 20 parcels.

  Altman Contractors, Inc. v. Crum & Forster Specialty Ins. Co., 2017 Fla. LEXIS 2492 (Fla. Dec. 14, 2017) (Chapter 558 pre-suit process is not a "civil proceeding", but qualifies as an "alternative dispute resolution proceeding" and constitutes a "suit" that insurer must defend if it consented to the insured's participation)

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Reservation of Rights

- Increasing emphasis on proper, detailed reservation of rights
  - Merchants Indem. Corp. v. Eggleston, 179 A.2d 505 (N.J. 1962)
    - liability insurer is not permitted to control the defense of the insured under a reservation of rights unless the insured consents to the conditions of that representation
    - agreements may be "inferred from an insured's failure to reject an offer to defend upon those terms, but to spell out acquiescence by silence, the letter must fairly inform the insured that the offer may be accepted or rejected"
  - Harleysville Group Ins. v. Heritage Cmtys., Inc., 803 S.E.2d 288 (S.C. 2017)
    - reservation of rights letter "must give fair notice to the insured that the insurer intends to assert defenses to coverage or to pursue a declaratory relief action at a later date"
    - See also Hoover v. Maxum Indem. Co., 730 S.E.2d 413 (Ga. 2012) ("[a] reservation of rights is not valid if it does not fairly inform the insured of the insurer's position")

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Bringing Litigation to a Close

- Bringing all parties to the table
  - Joinders of additional contractors and/or material suppliers
  - Contractual indemnity tenders
  - Additional insured tenders
  - Additional insured coverage actions
    - Burlington Ins. Co. v NYC Tr. Auth., 29 N.Y.3d 313 (2017) (rejects "but for" causation formulation, and concludes that "where an insurance policy is restricted to liability for any bodily injury 'caused, in whole or in part' by the 'acts or omissions' of the named insured, the coverage applies to injury *proximately caused* by the named insured."

White and Williams LLP

Bringing Litigation to a Close

- Mediation
  - Costly, multi-party litigation may make early mediation desirable
    - Insurance company saves money
    - Defense attorneys lose money
  - More difficult to locate experienced mediators for East Coast matters
    - Consider mediator "team" comprised of an out of towner with experience and a local mediator familiar with the jurisdiction
    - Construction Mediator ≠ Construction Defect Mediator
  - Determine what information is needed
    - Damages allocation by type and cost of repair for each element
    - Allocation – by percentage and by cost, between trades, between parties if more than one in same trade, time periods and covered/non-covered damages
    - Timing of damages for coverage analysis

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Retention and Use of Experts

- Early use of experts can be invaluable
  - Experts in NJ cannot allocate liability beyond a party (i.e., no % allocation opinion)

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Questions

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Section 4.

West Coast Casualty's
Construction Defect Seminar
May 16th 17th and 18th, 2018

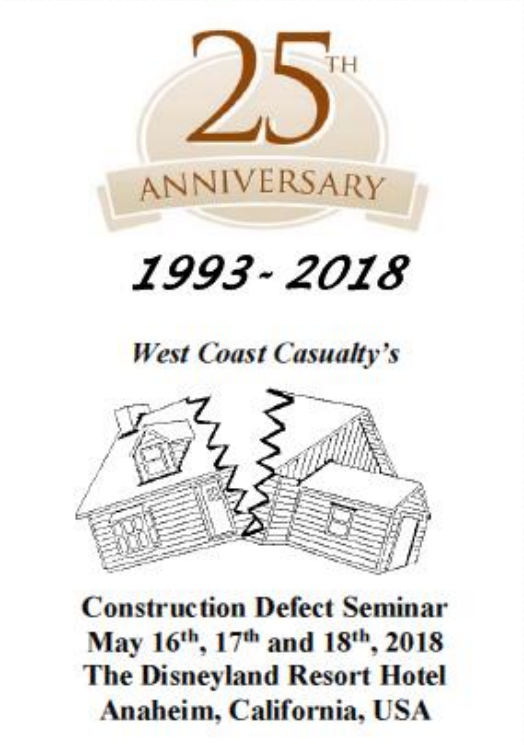
Grand Ballroom

Wednesday May 16th 2018
4:30 PM – 5:30 PM

Course Title:
How to Conduct Your Claim Investigation and Early Claims Handling To Avoid Bad Faith Traps

Jennifer Crow, Esq. Julia Manganaro, Melanie Brown, Brendan Keeley and Lee Wright

HOW TO CONDUCT YOUR CLAIMS INVESTIGATION



Presenters:

Jennifer Crow

Brendan Keeley

Julia Manganaro

Lee Wright

Melanie Brown

Overview of State Requirements

Washington – Key Statutes

- RCW 48.01.030: Good Faith Statute
  - Requires all persons in all insurance matters to:
    - Act in good faith
    - Practice honesty and equity
- RCW 48.30.015: Insurance Fair Conduct Act
    - Unreasonable denial of a claim for coverage
    - Unreasonable denial of a payment of benefits
    - Also triggered if the Unfair Claim Settlement Practices (administrative code) is violated

Washington – Timing Requirements

- Respond to all communication within 10 working days (15 days for group insurance contracts)
- Accept or deny or explain why more time is needed to investigate within 15 days of proof of loss
- Complete investigation of claim within 30 days
- Follow up in writing in 45 days, then every 30 days

Oregon – Key Statutes

- ORS 746.230: Unfair Claims Settlement Practices
  - Examples of violations:
    - Failing to promptly acknowledge communications
    - Failing to affirm or deny coverage in reasonable time
    - Refusing to pay claims without conducting investigation
    - Delaying investigation by requiring a preliminary claim report AND subsequent loss form if both contain same information
- OAR 836-080-0205, *et. seq*.: Oregon Administrative Code

Oregon – Timing Requirements

- Complete claim investigation within 45 days of notification of claim
- Notify insured of acceptance or denial of claim within 30 days of proof of loss
- If additional time required, notification to insured in writing explaining reasons within 30 days of proof of loss
- Must notify claimant of SOL if actively negotiating settlement

California – Key Statutes

- California Insurance Code § 790.03
  - Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies
  - Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies
  - Delaying investigation by requiring a preliminary claim report and subsequent loss form if both contain same information

California – Timing Requirements

- Respond to any communication from claimants that suggest a response is expected within 15 days of receipt Upon receiving a claim, acknowledge receipt in writing within 15 days
  - Also provide the necessary forms, instructions, and reasonable assistance (including specifying what information is needed)
  - Begin the investigation of the claim
- Accept or deny the claim within 40 days
  - If additional time required, notification to insured within that time period

Arizona – Key Statutes

- Arizona Rev. Stat. Ann. 20-461D
  - Misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue
  - Failing to acknowledge and act reasonably and promptly upon communications
  - Making claims payments to insureds or beneficiaries not accompanied by a statement setting forth the coverage under which the payments are being made
- Arizona Admin. Code 20-6-801

Arizona – Timing Requirements

- Within 10 days, acknowledge the receipt of a new claim in writing
- Within 10 days, respond to other communications which reasonably suggest a response is required
- Provide all necessary forms, instructions, and assistance within 10 days of notice of a claim
- Complete your investigation within 30 days, and if not possible must update every 45 days
- Within 15 days of a properly executed proof of loss, advise a first party claimant whether the claim is denied or accepted

Florida – Key Statutes

- Florida Statute § 624.155 (1) – Florida Bad Faith Statute
  - Not attempting in good faith to settle claims when, under all circumstances, it could and should have done so, had it acted fairly and honestly to its insured and with due regard for the insured's interests.
  - Failing to promptly settle the claim when the obligation to settle has become reasonably clear.
  - Refusing to disclose policy limits to a liability claimant.
- Florida courts consider the "totality-of-the-circumstances" when analyzing alleged violations of the Florida Bad Faith Statute. State Farm Mut. Auto. Ins. Co. v. LaForet, 658 So. 2d 55 (Fla. 1995).

Florida – Timing Requirements

- Florida Statute § 627.70131
  - Within 14 days, must acknowledge receipt of communication.
  - Within 10 days of the proof of loss statement receipt, begin investigation.
  - Within 90 days of notice of claim receipt, notify of denial or acceptance of claim.
- Time-limit demands require acceptance of all demand conditions, if the demand is to be accepted.
  - If all conditions are not accepted, it is considered a rejection and counter-offer.
- Florida Statute § 624.155 (3)(a)
  - Condition precedent to filing a bad faith claim: A proper civil remedy notice must be sent to both the insurer and the Department of Financial Services at least 60 days prior to bringing suit against insurer.
  - A response to the civil remedy notice would be due within 60 days.

Duty To Investigate – What Does This Encompass?

- What should I review first?
  - Pleadings, policy, loss notice, correspondence
- What if there is not enough to make a coverage determination?
  - Talk to the insured and claimant!
- What if I still don't have enough information after talking to the insured?
- How do I determine whether to engage defense counsel early?
- Who else should I involve? Co-carriers…

How To Best Update Your Insured

- Always in writing
- Every 30
- Make sure to always check the state requirements
- What language do I want to include in every update?
  - What steps you have taken during the last 30-90 days
  - What information you have considered
  - What additional information you need from the insured
  - Who you have worked with (counsel, investigator, co-carrier)

Working With Personal Counsel In Investigations

- Make sure to obtain all information that personal counsel has
- What do I do if personal counsel is not on my panel?
  - Attempt to resolve before you have to engage defense counsel
  - But if you need to, then retain panel counsel
- How much say does my insured have when they want me to pay for their personal counsel?
- How does Cumis counsel come into this?
  - An ROR is NOT a Cumis trigger!

What If You Can't Find The Insured?

- How can I complete my investigation if I cannot locate my insured?
- Work with the claimant to attempt to locate the insured
  - If your claimant hired the contractor, they may have different contact information than in the file or listed with the state
  - Developers can have additional contact information or additional names of persons they knew to work for your client
- Utilize defense counsel
  - SkipTrace
  - Investigators
  - Social media searches

What If The Insured Doesn't Cooperate

c. You and any other involved insured must:

(1) Immediately send us copies of any demands, notices, summonses or legal papers received in connection with the claim or "suit";

(2) Authorize us to obtain records and other information;

(3) Cooperate with us in the investigation or settlement of the claim or defense against the "suit"; and

(4) Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the insured because of injury or damage to which this insurance may also apply.

When To Retain An Independent Adjuster

- This may be surprising – but in construction defect cases an independent adjuster is rarely used
- Very common in property damage cases where there has been a flood, landslide, fire, etc.
- Use your construction experts early in site investigation
- Eventually you will need them anyway, so have them do the early investigation and estimate potential damages
- Interview the claimant yourself, or utilize defense counsel

When Do You Want A Recorded Statement

- Again, recorded statements are generally not used in construction defect cases
- Most of the damages/defects will be documented in expert reports
- Very different than a personal injury case where memory fades and the conversation after an accident is important
- Instances where you may want to stray from the norm include if your insured is elderly, ill, or is about to leave the country
  - If you get a recorded statement, get a signed transcript too

What If I Need To Pull The Defense

- Critical decision that cannot be made lightly (especially in certain jurisdictions)
- Be very cognizant of whether there are any other insurers that have coverage and can take over
- Attempt to try to resolve first for a cost of defense number – rely on your coverage issues and tell plaintiff if you are prepared to file a dec action
- Harder to get out of a defense once you are in it than it is to stay out from the get go

Do Architect/Engineer Claims Differ?

- YES!!
- These claims are drastically different than claims against contractors
- Typical CGL policy excludes professional services – which is exactly what architects and engineers do
  - Some insureds, especially companies who work in the construction defect repair realm are both architects and contractors. They may have a CGL and a PL policy in place.
  - Can make the assessment of what is covered very complicated
  - Preparation of repair scope versus project oversight

Do Architect/Engineer Claims Differ?

- Architect/Engineer Contracts
  - Often have limitations of liability
  - Often have a designation as the owner's agent
- Statute of limitation for a design professional may be different
- Pleading requirements for a claim against a design professional may be different
- Make sure you are familiar with this field and that your defense counsel is familiar with this field

Do Large Builders Differ?

- Working with a large builder/developer is quite different than small subcontractors
- These policies usually have substantial SIRs – sometimes large enough that your defense costs and a small settlement are entirely within the SIR
  - So expect the insured to be much more engaged
- May also have in house claims staff or legal staff
- Typically have much stronger contracts
  - Safety provisions
  - AI requirements
  - Indemnity provisions
  - Incorporation of master contract

Best Practices For Coverage Correspondence

- Issue an ROR any time it is unclear whether the claim is covered under the applicable policy or where some portion of the claim may not be covered
- But don't use this as a vehicle to "buy time" or to avoid compliance with the regulatory time frame
- Make sure that you are informing the insured that additional time is needed to make a coverage decision, without waiving any rights the insurer may have to assert coverage defenses

Best Practices For Coverage Correspondence

- Be thorough – Include every possible coverage defense to avoid waiver
- Involve Insured – Invite the insured to correct or supplement facts
- Qualify Conclusions – Limit to the facts that are known, and subject to change
- State Status of Investigation – update regularly
- Write for the jury or judge, not the insured
- Supplement ROR letter with newly discovered factual or legal theories immediately – delay may constitute a waiver

How To Best Structure Your ROR

- What to include:
  - A description of the claim
  - A list of the evidence and information considered
  - A statement of the relevant facts
  - Verbatim recitation of all applicable policy language
  - A statement of the benefits the insurer will provide and the rights it wishes to reserve
  - Explanation of the insurer's reasoning
  - A statement of possible conflicts and advise insured to obtain independent legal counsel

Making Sure The Insured Understands Your ROR

- Use a short introduction section telling the insured what the key policy provisions are that you are going to rely on
- Tell the insured they are welcome to submit additional information
- If you aren't going to rely on a portion of the policy at all, don't include it unless necessary for some reason
- Be clear in headings where you are going to explain how the policy provisions apply

Nasty Letters From Personal Counsel On Settling

- Provide a copy to defense counsel
- Compare your defense counsel's assessment of damages against the policy limits
- Assess the reasonableness of the potential offer you are going to make – bad faith exposure is triggered when the refusal to settle is unreasonable
  - CAI 2334 – bad faith instruction
  - A settlement demand is reasonable if Defendant knew or should have known at the time the settlement demand was rejected that the potential judgment was likely to exceed the amount of the settlement demand based on Mrs. Smith's injuries or loss and Plaintiff's probable liability.

How To Deal With Bad Faith Threats

- Review provisions cited in the letter with the applicable laws
- Assess whether there are any actual violations
- Document all of your communications with the insured/their personal counsel
  - Especially instances where you requested additional information
- Objective standard applies - the principal concern is whether the investigation was reasonable
- Develop evidence of the insured's bad faith

Responding To Policy Limits Demands

- Communicate the demand to the insured (quickly!) and understand the insured's position
- Assess whether the state requires you disclose all available coverage information
- Determine applicable standards for evaluating and responding to policy limits demands
- Document the file and analysis the demand with the assistance of counsel

Section 5.

West Coast Casualty's
Construction Defect Seminar
May 16th 17th and 18th, 2018

Grand Ballroom

Thursday May 17th 2018
8:30 AM – 9:30 AM

Course Title:
Recent Important Appellate Decisions in California, Nevada and Arizona

Jon Turigliatto, Esq. and Barry Vaughan, Esq.

CHAPMAN GLUCKSMAN

CHAPMAN GLUCKSMAN DEAN ROEB & BARGER

JON A. TURIGLIATTO, ESQ.

RECENT IMPORTANT SUPREME COURT & APPELLATE COURT DECISIONS

Mr. Turigliatto is a partner in the law firm of Chapman, Glucksman, Dean, Roeb and Barger. His practice focuses on the representation of developers and general contractors complex multi-party construction litigation, products liability, general negligence, and commercial/business litigation. He also advises owner and contractors in the drafting and negotiation of construction agreements.

He is a contributor to Chapman, Glucksman, Dean Roeb & Barger's National Construction Risk Management Handbook. He has been a speaker on issues related to construction litigation at events sponsored by the Association of Southern California Defense Counsel, Quality Built, Lorman, and HalfMoon.

He received his undergraduate degree in political science from the University of California, Irvine, in 1989. He earned his Juris Doctorate degree in 1993 from Southern Methodist University School of Law. He was an extern law clerk to the Honorable A. Andrew Hauk, United States District Court for the Central District of California, in 1992.

Mr. Turigliatto is admitted to the State Bar of California, United States District Court for the Northern and Central Districts of California, United States Court of Appeal for the Ninth Circuit, and United States Supreme Court. Mr. Turigliatto has trial, arbitration, and mediation experience.

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CALIFORNIA

RIGHT TO REPAIR ACT / SB800

THE CALIFORNIA SUPREME COURT HAS RULED THAT THE RIGHT TO REPAIR ACT (SB800) IS THE EXCLUSIVE REMEDY FOR CONSTRUCTION DEFECT CLAIMS NOT INVOLVING PERSONAL INJURIES WHETHER OR NOT THE UNDERLYING DEFECTS GAVE RISE TO ANY PROPERTY DAMAGE.

***MCMILLIN ALBANY LLC V. SUPERIOR COURT* (2018) 4 CAL.5TH 241.**

By way of background, the Fourth District Court of Appeal held in *Liberty Mutual Insurance Co. v. Brookfield Crystal Cove LLC* (2013) 219 Cal.App.4th 98 that compliance with SB800's pre-litigation procedures prior to initiating litigation is only required for defect claims involving violations of SB800's building standards that have not yet resulted in actual property damage. Where damage has occurred, a homeowner may initiate litigation under common law causes of action without first complying with the pre-litigation procedures set forth in SB800. Two years later, the Fifth District Court of Appeal, in *McMillin Albany LLC v. Superior Court* (2015) 239 Cal.App.4th 1132, held that the California Legislature intended that all claims arising out of defects in new residential construction sold on or after January 1, 2003 are subject to the standards and requirements of the Right to Repair Act, including specifically the requirement that notice be provided to the builder prior to filing a lawsuit. Thus, the Court of Appeal ruled that SB800 is the exclusive remedy for all defect claims arising out of new residential construction sold on or after January 1, 2003.

After extensive examination of the text and legislative history of the Right to Repair Act, the Supreme Court affirmed the Fifth District Court of Appeal's ruling that SB800 preempts common law claims for property damage. The Complaint at issue alleged construction defects causing both property damage and economic loss. After filing the operative Complaint, the homeowners dismissed the SB800 cause of action and took the position that the Right to Repair Act was adopted to provide a remedy for construction defects causing only economic loss and therefore SB800 did not alter preexisting common law remedies in cases where actual property damage or personal injuries resulted. The builder maintained that SB800 and its pre-litigation procedures still applied in this case where actually property damages were alleged to have occurred.

The Supreme Court found that the text and legislative history reflect a clear and unequivocal intent to supplant common law negligence and strict product liability actions with a statutory claim under the Right to Repair Act. Specifically, the text reveals "…an intent to create not merely a remedy for construction defects but the remedy." Additionally, certain clauses set forth in SB800 "…evinces a clear intent to displace, in whole or in part, existing remedies for construction defects." Not surprisingly, the Court confirmed that personal injury damages are expressly not recoverable under SB800, which actually assisted the Court in analyzing the intent of the statutory scheme. The Right to Repair Act provides that construction defect claims not involving personal injury will be treated the same procedurally going forward whether or not the underlying defects gave rise to any property damage.

The California Supreme Court further found that the legislative history of SB800 confirms that displacement of parts of the existing remedial scheme was "…no accident, but rather a considered choice to reform construction defect litigation." Further emphasizing how the legislative history confirms what the statutory text reflects, the Court offered the following summary: "the Act was designed as a broad reform package that would substantially change existing law by displacing some common law claims and substituting in their stead a statutory cause of action with a mandatory pre-litigation process." As a result, the Court ordered that the builder is entitled to a stay and the homeowners are required to comply with the pre-litigation procedures set forth in the Right to Repair Act before their lawsuit may proceed.

PRE-*MCMILLIN ALBANY LLC V. SUPERIOR COURT* (2018) 4 CAL.5TH 241, CALIFORNIA'S THIRD DISTRICT COURT OF APPEAL ALSO HELD THE RIGHT TO REPAIR ACT (SB800) IS THE EXCLUSIVE REMEDY FOR CONSTRUCTION DEFECT CLAIMS NOT INVOLVING PERSONAL INJURIES.

***GILLOTTI V. STEWART* (2018) 11 CAL.APP.5TH 875.**

The defendant grading subcontractor added soil over tree roots to level the driveway on the plaintiff homeowner's sloped lot. The homeowner sued the grading subcontractor under SB800 claiming that the subcontractor's work damaged the trees.

After the jury found the subcontractor was not negligent, the trial court entered judgment in favor of the subcontractor. The homeowner moved for a judgment notwithstanding the verdict or a new trial on the grounds that the trial court improperly barred a common law negligence theory against the grading subcontractor. The trial court denied the motions on the grounds that "[t]he Right to Repair Act specifically provides that no other causes of action are allowed." The homeowner appealed, arguing that the trial court improperly construed SB800 as barring a common law negligence theory against the subcontractor and erred in failing to follow *Liberty Mutual Insurance Co. v. Brookfield Crystal Cove LLC* (2013) 219 Cal.App.4th 98.

The Third District Court of Appeal the Third District Court of Appeal stated that the *Liberty Mutual* court failed to analyze the language of *Civil Code* § 896, which "clearly and unequivocally expresses the legislative intent that the Act apply to all action seeking recovery of damages arising out of, or related to deficiencies in, residential construction, except as specifically set forth in the Act."

The homeowner further argued that she was not precluded from bringing a common law claim because a tree is not a "structure," and therefore the alleged tree damage did not fall within the realm of SB800. The Court of Appeal also rejected this argument, holding that while the tree damage itself was not expressly covered, the act of adding soil to make the driveway level (which caused the damage) implicated the standards covered by SB800. The Court explained that since under the Act a "structure" includes "*improvement located upon a lot* or within a common area" (*Civil Code* § 895(a)), as the driveway was an improvement upon the lot, the claim was within the

purview of SB800. As the soil, a component of the driveway, caused damage (to the trees), it was actionable under SB800.

CONSTRUCTION DEFECT

THERE WAS NO ACTUAL KNOWLEDGE AS TO ALLEGED MISREPRESENTATIONS AND OMISSIONS IN THE SALE OF A RESIDENCE, NOR WAS ANY KNOWLEDGE GAINED BEFOREHAND BY CONSTRUCTION PROFESSIONALS REGARDING ALLEGED STRUCTURAL DEFECTS IMPUTABLE TO THE SELLERS BECAUSE THE PROFESSIONALS ACTED AS DESIGNERS AND BUILDERS RATHER THAN AS AGENTS UNDER CIVIL CODE § 2295.

***RSB VINEYARDS, LLC V. ORSI* (2017) 15 CAL.APP.5TH 1089.**

After purchasing a vineyard, defendants remodeled it to convert the residence on the property into a wine tasting room. Defendants were not construction professionals, so they relied on their architect, structural engineer, and general contractor to ensure that they were following proper building codes and standards. Plaintiff subsequently purchased the vineyard and the wine tasting room, to later discover that the room was structurally flawed and had to be demolished. Plaintiff sued defendants for misrepresentation and omissions regarding the sale. Defendants moved for summary judgment, claiming that they did not have actual knowledge of the defects.

The trial court granted summary judgment because the defendants could not be held liable for nondisclosure when there is no evidence that they had actual knowledge of the facts to be disclosed. The court reasoned that RSB was required to show that the defendants had actual knowledge of the alleged property defects, but RSB failed to do so. Therefore, the trial court rejected RSB's claim that knowledge of the defects could be imputed to defendants from the presumed knowledge of their construction professionals. The court concluded that an agent's knowledge cannot be imputed when actual knowledge is required.

The First District Court of Appeal agreed and affirmed the trial court's decision. The court found that there was a lack of evidence proving that the defects would have been evident to non-professionals. Furthermore, the court accepted the rule that a principal could be charged with the knowledge of his agents while the agent acts in the role and within the scope of his authority as an agent, but the court did not accept plaintiff's suggestion that defendants' contractual professionals were "agents." Civil Code section 2295 defines an agent as "one who represents another . . . in dealings with third persons." The court noted that there was no evidence showing that the defendants' professionals acted in the role of agent when they acquired the knowledge of the defects. Such knowledge would have been discovered while professionals were doing the renovation, not while they were acting as agents. The court also dismissed plaintiff's misrepresentation claims, finding that the representations were in fact true.

HOMEOWNERS ASSOCIATIONS

A HOMEOWNERS ASSOCIATION CAN RECOVER COSTS FROM A HOMEOWNER WHO BROUGHT A FRIVOLOUS SUIT TO INSPECT THE RECORDS OF THE ASSOCIATION, BUT MAY NOT RECOVER ATTORNEY'S FEES.

***RETZLOFF V. MOULTON PARKWAY RESIDENTS' ASSN.* (2017) 14 CAL.APP.5TH 742.**

Several former board members of the Homeowners Association ("HOA") filed suit against their HOA because the HOA allegedly did not follow properly the provisions of the *Davis Sterling Act* concerning the conduct of board meetings and inspection of records. This suit was dismissed because plaintiffs failed to engage in ADR prior to filing the suit as required under the *Davis Sterling Act*. The plaintiffs filed a second action against the HOA alleging that the association conducted business outside of their meetings and failed to make specific records available.

The trial court awarded the HOA its attorney's fees and allowed it to recover costs finding that the homeowners' claims in the second action were frivolous. The trial court relied on Civ. Code § 5235(c) and interpreted it to mean that the prevailing party can recover "any costs" if the court finds the action to be frivolous, unreasonable, or without foundation. The trial court agreed with the HOA's interpretation of the statute that the meaning of "any costs" included attorney's fees. Plaintiffs appealed the award of attorney's fees and costs, arguing that section 5235(c) does not entitle the prevailing party to attorney's fees because "any costs" does not include reasonable attorney's fees. The plaintiffs further argued on appeal that the HOA should not have been awarded costs because their action was not frivolous.

The Fourth District Court of Appeal partially reversed the trial court's holding. The court held that the trial court correctly found that the plaintiff's suit was frivolous, but erred in awarding the HOA its attorney's fees. Under Civ. Code section 5235(a), a homeowner's association member may sue the association to compel it to allow inspections and copying of the association's records. Section 5235(c) provides that "[a] prevailing association may recover any costs if the court finds the action to be frivolous, unreasonable, or without foundation." Furthermore, Code of Civil Procedure section 1021 states that attorney's fees are awarded only when they are specifically provided for by statute. The court held that "any costs" does *not* specifically provide for recovery of attorney's fees pursuant to section 5235(c), and therefore a plain reading of section 5235(c) does not support the inclusion of attorneys' fees as costs.

INVERSE CONDEMNATION

A TRIAL COURT ERRED IN HOLDING A CITY INVERSELY LIABLE FOR THE DAMAGE THAT A CITY-OWNED TREE CAUSED WHEN IT FELL ON A RESIDENCE DURING A STORM BECAUSE THE TREE WAS NOT A WORK OF PUBLIC IMPROVEMENT, AND BECAUSE THE CITY'S TREE MAINTENANCE PLAN WAS NOT DEFICIENT.

***MERCURY CASUALTY CO. V. PASADENA* (2017) 14 CAL.APP.5TH 917.**

A city-owned tree fell onto a residence in the City of Pasadena due to hurricane-force winds. The City asserted ownership of the tree which was in a public parkway, and the City maintained the tree. However, there was no record of who planted it. The Mercury Casualty Company sued the City for $800,000 in insurance benefits paid to the homeowners under the homeowners' insurer, theory of inverse condemnation.

The trial court ruled in favor of Mercury Casualty, finding that the tree that fell and damaged the residence was a work of public improvement, which proximately caused the damage to the residence. Thus, the trial court held that under the theory of inverse condemnation, the City was strictly liable for the property owner's loss. The City of Pasadena appealed the trial court ruling, contending that the tree in question was not part of a public improvement as is required for the theory of inverse condemnation. While the City acknowledged that they owned the tree, the City contended that the tree was planted between the late 1940s and early 1950s by an unknown party, and therefore could not have been part of a public improvement project that had yet to be undertaken by the City.

The Second District Court of Appeal reversed the trial court's ruling and held that the City of Pasadena was *not* in fact liable for damages caused by falling tree. The court held that while the tree was owned by the City, was located in a public parkway, and was maintained by the City's tree maintenance program, there was no record of the City planting the tree for a construction project to serve a public purpose. Thus, the City could not have been liable under the inverse condemnation theory, because that would require that private property be damaged by a "public improvement." Furthermore, to establish an inverse condemnation claim premised upon a government entity's maintenance of an improvement, it must be established that the plan of maintenance was deficient. There was no evidence showing that the City's maintenance plan was deficient. Thus, the court held that the City was not subject to liability for inverse condemnation.

PRIVETTE DOCTRINE

UNDER *PRIVETTE*, A HIRER IS GENERALLY PROHIBITED FROM LIABILITY FOR WORKPLACE INJURIES OF EMPLOYEES OF SUB-CONTRACTORS OR ITS EMPLOYEES, EXCEPT WHERE A HIRER RETAINS AND NEGLIGENTLY EXERCISES CONTROL IN A MANNER THAT AFFIRMATIVELY CONTRIBUTES TO AN EMPLOYEE'S INJURY, CONCEALS A KNOWN HAZARD OR THERE IS A KNOWN OR OPEN HAZARD THAT CANNOT BE PRACTICALLY AVOIDED, THROUGH REASONABLE SAFETY PRECAUTIONS.

***GONZALEZ V. MATHIS*, (2018) 20 CAL.APP.5TH 257.**

A sub-contractor window-washer, ("Plaintiff"), brought suit against Defendant homeowner where Plaintiff was performing work at Defendant's home and fell off of the roof. Plaintiff alleged that there were various dangerous conditions of the roof that had caused him to fall.

The Trial Court granted summary judgment for Defendant, holding that Plaintiff's claims were barred by *Privette v. Superior Court* (1993) 5 Cal.4th 689, which generally prohibits an independent contractor or his employees from suing the hirer of the contractor for workplace injuries. Further, the Trial Court denied Plaintiff's arguments that there were triable issues of fact as to whether Plaintiff met the two exceptions to the *Privette* rule: (1) when the hirer exercises retained control of contractor's work in a manner that affirmatively contributes to the injury, and (2) when the hirer fails to warn the contractor of a known, concealed hazard on the premises, or a known or open hazard that cannot be practically avoided by the contractor.

The Court of Appeals held first that Plaintiff failed to present evidence showing a triable issue of fact as to the retained control exception to *Privette*, because Defendant never instructed Plaintiff how to clean the windows, and the fact that Defendant's agent instructed Plaintiff to perform the projects and to use less water was not sufficient to establish that Defendant *retained control* that affirmatively contributed to Plaintiff's injuries.

However, the Court reversed as to second exception to *Privette*, and held that Defendant failed to establish that there was no triable fact as to whether Plaintiff qualified for the failure to warn exception. The Court held that the failure to warn exception applies not only to concealed conditions, but also to open or known hazardous conditions that cannot be avoided by application of reasonable safety precautions. Here, the homeowner did not establish that the roofer could have avoided the hazardous condition (unguarded ledge) by taking an alternate path to access areas of the roof.

PRIVETTE DOCTRINE EXPANDED TO BAR LIABILITY FOR INJURY TO INDEPENDENT CONTRACTOR'S EMPLOYEE WHERE HIRER BREACHED STATUTORY DUTIES.

***DELGADILLO V. TELEVISION CENTER, INC*. (2018) 2018 WL 1069715.**

Decedent was an employee of a window washing subcontractor ("subcontractor"). While washing window's on the defendant's three-story building, Decedent decided to rappel off the building from the room using roof anchor points to get to the windows. As there were no structural roof anchors, Decedent attached his decent line to an angle iron bracket that was supporting the air conditioning unit, which was in turn attached to a small piece of wood. He did not attach a safety line, as required by his employer's policy. Decedent's descent line detached and he fell to his death. The surviving family of decedent brought suit against the defendant building owner for the negligent failure to install structural roof anchors on its building.

The Trial Court affirmed summary judgment for Defendant, holding that the plaintiffs' suit was barred by *Privette v. Superior Court*, (1993) 5 Cal.4th 689, or the "Doctrine of Peculiar Risk", which holds that when a property owner hires an independent contractor, the property owner is not liable for injuries sustained by the contractor's employees unless the defendant's affirmative conduct contributed to the injuries. The plaintiffs appealed arguing that *Privette* did not bar Defendant's direct liability under the doctrines of (1) nondelegable duties and (2) negligent exercise of retained control.

The Court of Appeals affirmed the trial court's granting of summary judgment, holding that while the defendant building owner had a statutory duty to install structural roof anchors to which window washers could attach their descent equipment, its affirmative conduct did not contribute to the injuries. The Court found that the defendant's tort duty to decedent to provide a safe workplace was delegated to the window-washing subcontractor. The Court explained that under *SeaBright Ins. Co. v. US Airways, Inc.* (2011) 52 Cal.4th 590, by hiring an independent contractor, a hirer implicitly delegates to the contractor the tor law duty the hirer owes to the contractor's employees to comply with applicable statutory or regulatory safety requirements to ensure workplace safety, including a duty to identify the absence of safety guards and take reasonable steps to address the hazard, and that the *SeaBright* court did not limit its holding to Cal-OSHA safety requirements.

Further, the Court of Appeals held that Defendant's failure to provide safety equipment did not constitute an "affirmative contribution" to an injury that displays negligent exercise of retained control. The Court stressed that Defendant did not interfere with the means or methods of accomplishing the work on the property, did not suggest or request that the sub-contractor use the anchor points, and that subcontractor and its employees made all decisions as to how the job was done.

INSURANCE

THE "PROFESSIONAL SERVICES" EXCLUSION IS EXPANDED BY THE CALIFORNIA COURT OF APPEAL.

ENERGY INSURANCE MUTUAL LIMITED V. ACE AMERICAN INSURANCE (2017) 14 CAL.APP.5TH 281.

Several defendants, to include Kinder Morgan and Comforce, were sued for personal injury and wrongful death following the explosion of a pipeline owned by Kinder Morgan, which killed five employees, seriously injured another four employees, and resulted in extensive property damage. The California Division of Occupational Safety and Health ("Cal/OSHA") investigated the incident and determined that the accident was caused by a failure to mark the location of the petroleum pipeline. Additionally, Cal/OSHA found that Kinder Morgan "employees were aware that an unsafe condition existed and failed to assure that the utility was clearly marked which would have resulted in its relocation or other appropriate measures to safeguard employees." The general bases of the lawsuits were that the parties' negligence caused the pipeline's rupture. Defendants alleged that the negligence occurred when Kinder Morgan and Comforce failed to identify and mark the location of Kinder Morgan pipeline and when they failed to properly supervise contractors that were working near the pipeline.

Kinder Morgan sought coverage under its insurance coverage policies issued by Associated Electric & Gas Insurance Services Limited ("AEGIS") and Energy Insurance Mutual Limited ("EIM"), as well as under Comforce's primary and umbrella policies with ACE American Insurance Company ("ACE"). EIM and AEGIS defended Kinder Morgan in the actions. ACE indicated that it would defend Kinder Morgan under Comforce's primary CGL policy under a reservation of rights. ACE declined coverage under Comforce's umbrella policy, stating that the claims were excluded from coverage. All claims settled prior to trial. AEGIS exhausted its policy limits from payments it made in defense costs and settlements. EIM paid more than $30 million to reimburse Kinder Morgan for settlements payments to resolve the lawsuit.

EIM sued ACE and sought full reimbursements of the payments it made to Kinder Morgan under its excess policy, seeking Comforce's umbrella policy limit of $25 million that it had with ACE. ACE filed motions for summary judgment alleging, among other things, that the Comforce umbrella policy categorically excluded coverage under its professional services exclusion. In its grant of this motion, the trial court stated that the litigation fell within "clear policy language" of the professional services exclusion. An appeal followed thereafter.

The Court of Appeal affirmed the trial court's holding regarding that policy's professional services exclusion and determined that this exclusion precluded coverage. The Court noted that the policy itself did not define "professional liability" or "services of a professional nature." The Court then looked to how California courts have previously defined those terms and determined that its definition is broader than "profession," warranting a broader application to bar coverage from damages resulting from a wide range of professional services. The Court found that the activities involved in owning and operating a pipeline are analogous to other skilled services that have been

deemed professional services. The Court also discussed the fact that specialized knowledge and training is required of construction inspectors. It further determined that Kinder Morgan's failure to mark pipeline was the essence of their underlying actions and the very task they were required to perform.

INSURER ENTITLED TO PREJUDGMENT ATTACHMENT WHERE IT SHOWED PROBABLE VALIDITY OF PREVAILING ON CLAIMS FOR UNJUST ENRICHMENT DUE TO APPLICABLE POLICY EXCLUSION FOR INTENTIONAL NONCOMPLIANCE AND RESCISSION OF POLICY WHERE INSURED MADE MISREPRESENTATIONS IN INSURANCE APPLICATION.

***SANTA CLARA WASTE WATER CO. V. ALLIED WORLD NATIONAL ASSURANCE CO.* (2017) 18 CAL.APP.5TH 881.**

The plaintiffs owned a wastewater treatment facility and operated a trucking unit that transported wastewater. In their application for insurance coverage with the defendant insurer and related correspondence, the plaintiffs represented that they did not accept, process, transport, or discharge hazardous waste. Based on these representations, the insurer issued a $2 million primary environmental liability policy and a $5 million umbrella policy to the plaintiffs. The policy contained an "intentional noncompliance" provision, which excluded coverage for environmental damages resulting from the "intentional disregard of or deliberate willful or dishonest noncompliance" with law or regulations.

After a chemical explosion and resulting fire at their treatment facility, the plaintiffs submitted an insurance claim to the defendant insurer for the cleanup costs, which were covered by the policy. The insurer refused to pay the claim. Thereafter, the parties reached settlement during mediation whereby the insurer would pay $2.5 million, but if the insurer obtained a judgment that the claim was not covered by the policy, the plaintiffs would have to reimburse the entire amount. The plaintiffs sued the insurer for failing to pay damages up to the policy limit and the insurer cross-complained against the plaintiffs for declaratory relief, unjust enrichment, fraud, rescission of the policy, and reimbursement of defense fees and expenses.

In conjunction with its cross-complaint, the insurer filed applications for a right to attach order and writ of attachment against the insureds for $2.5 million plus cost and interest. In support thereof, the insurer presented evidence that the insureds had violated laws and regulations by storing and concealing the presence of the hazardous chemical that cause the explosion and that they had made misrepresentations on their insurance application. On these grounds, the insurer argued that the intentional noncompliance policy exclusion applied and that the policy should be rescinded due to fraud. The trial court granted the insurer's applications and issued writs of attachment, finding that the insurer had "established the probable validity" of its unjust enrichment and rescission claims, as required by *Code of Civil Procedure* §484.090. The insureds appealed, arguing that the insurer did not establish the probable validity of the claims.

The Second District Court of Appeal affirmed the trial court's order on the grounds that the insurer had a right of reimbursement because the facts showed that the intentional noncompliance policy exclusion applied and under an unjust enrichment theory, where an insurer pays an amount not covered by its policy (here the $2.5 million at mediation), it has a right of reimbursement. Thus, the insurer had established a probable validity (i.e., "more likely than not") of prevailing on its unjust enrichment claim.

The Court of Appeal also held that the evidence showed that the insureds' misrepresentation and concealed that they did not accept, process, transport, or discharge hazardous waste both before and after the inception of the policy and that this was a material fact such that the insurer had established the probable validity of its rescission claim. Pursuant to the California *Insurance Code*, misrepresentation or concealment of material fact in connection with an insurance application is grounds for rescission of the policy. Furthermore, the Court held that the insurer's filing of its action against the insureds was sufficient to meet the notice and offer to restore premiums requirements an insured must comply with prior to bringing a rescission claim.

DUTY TO DEFEND OWED TO ADDITIONAL INSURED UNDER ONGOING OPERATIONS POLICY AFTER WORK COMPLETE WHERE HOMEOWNER'S CLAIM "ARISES OUT OF" WORK PERFORMED BY NAMED INSURED.

***MCMILLIN MANAGEMENT SERVICES, L.P. V. FINANCIAL PACIFIC INSURANCE COMPANY* (2017) 17 CAL.APP.5TH 187.**

McMillin Management Services, L.P., and Imperial Valley Residential Builders, L.P. (collectively "McMillin"), a developer and general contractor, hired numerous subcontractors to build a residential development project (the "project"). Lexington Insurance Company ("Lexington") and Financial Pacific Insurance Company ("Financial Pacific") (collectively the "AI Insurers") issued comprehensive general liability ("CGL") insurance policies to some of the subcontractors. The policies named McMillin as an additional insured.

In June 2005, McMillin completed construction of the project and had completed all initial sales of the homes by August 2005. In June 2010, several homeowners filed a construction defect action against McMillin. McMillin tendered its defense to the AI Insurers. Both refused to defend. Accordingly, on October 2010, McMillin brought claims against the AI Insurers alleging that they had breached their contractual obligations to defend McMillin in the underlying action. The AI Insurers each filed a motion for summary judgment, arguing that they did not owe McMillin a duty to defend because their additional insured endorsements made it clear that McMillin was only afforded ongoing operations coverage. Thus, since there were no homeowners during the time their insureds performed their work and the homeowners alleged damages sustained after the project was complete, there could be no potential coverage and therefore no duty to defend. The trial court granted both motions for summary judgment. McMillin appealed.

The Fourth District Court of Appeal reversed the trial court's entry of summary judgment as to Lexington, finding that under its policy, Lexington had a duty to defend McMillin, and affirmed the trial court's entry of judgment in favor of Pacific Financial.

With respect to Lexington's additional insured endorsement, the Court of Appeal stated:

> The Lexington policies contain substantively identical additional insured endorsements that amend the policies to provide coverage to McMillin "'but only with respect to liability arising out of [the subcontractor's] ongoing operations performed for [McMillin].'" The endorsements also each contain an exclusion that states:
>
> With respect to the insurance afforded to these additional insureds, the following exclusion is added:
>
> …Exclusions
>
> "This insurance does not apply to 'bodily injury' or 'property damage' occurring after:
>
> "(1) All work, including materials, parts or equipment furnished in connection with such work, on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the site of the covered operations has been completed; or
>
> "(2) That portion of 'your work' out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or subcontractor engaged in performing operations for a principal as a part of the same project."

The Court held that this language did not state that Lexington would provide coverage solely for liability occurring during the subcontractors' ongoing operations, but rather stated that Lexington would provide coverage to McMillin for liability "arising out of" such ongoing operations. As the phrase "arising out of" has been given a broad interpretation in the context of additional insured endorsements, that term in the policy provided only that McMillin's liability only had to be "linked" through a minimal causal connection or incidental relationship with the subcontractors' ongoing operations. Therefore, the fact that there were no homeowners at the time the subcontractors were performing their work, did not establish that McMillin could not suffer any liability arising out of such ongoing operations. The Court also stated that a homeowner's construction defect claim is not necessarily one brought to recover under the "products-completed" coverage of a named insured subcontractor's policy. Thus, under the additional insured endorsement, notwithstanding the exclusions, a duty to defend was owed to McMillin.

GIVEN THAT OTHER INSURANCE CLAUSES IN LIABILITY INSURANCE POLICIES WERE NOT SPECIFIC TO OTHER LOWER-LAYER INSURANCE AND THE POLICIES DID NOT REQUIRE EXHAUSTION OF ANY OTHER INSURANCE, BUT RATHER PROVIDED THAT THE INSURER'S DUTY TO PAY AROSE IMMEDIATELY AFTER THE RETENTION WAS EXHAUSTED, VERTICAL EXHAUSTION APPLIES FOR A CONTINUOUS LOSS.

***STATE OF CALIFORNIA V. CONTINENTAL INSURANCE COMPANY* (2017) 15 CAL.APP.5TH 1017.**

The State of California sued to recover from various insurers for the cost of remediation of a hazardous waste site. Continental Insurance Company was an insurer who had issued the State policies of insurance that were excess to retained limits. The State purchased insurance to cover most of its exposure within the retentions. The parties filed cross-motions for summary adjudication to determine whether Continental's policies attached immediately upon exhaustion of the specified retention for the policy period (vertical exhaustion), or upon exhaustion of all of the retentions across all policy periods (horizontal exhaustion).

The trial court held that vertical exhaustion applied, and Continental agreed to pay its policy limits. The trial court also awarded the State prejudgment interest on the policy limits at 7%. Continental appealed, arguing that the award of mandatory prejudgment interest was erroneous because the start date to calculate the interest was premised on the trial court's holding that Continental's coverage immediately attached upon exhaustion of the specified retention (vertical exhaustion). Continental further argued that "other insurance" clauses in its policies supported horizontal exhaustion, and California precedent mandated it. Application of horizontal exhaustion would have made it so that no excess policy would attach until the State's self-insured retention, and the amounts of all lower-lying policies and retentions, for every policy period applicable was exhausted.

The Fourth District Court of Appeal rejected both of Continental's arguments and affirmed the trial court's holding that an excess insurer's policies were triggered as soon as the insured exhausted its retention for the specified policy period (vertical exhaustion applies). The court held that "other insurance" clauses are to be applied to contribution actions between insurers rather than coverage litigation between the insured and insurer. The court also noted that if Continental's interpretation of "other insurance" clauses was applied, a court would not be able to determine the amount *any* insurer owes without first establishing what *every* insurer owes, undermining the timely indemnity for policy holders' claims. The court also rejected the argument that California precedent mandated horizontal exhaustion, holding that where a policy states that it is excess to a specifically described policy or retention, the policy terms would rebut the presumption of horizontal exhaustion.

AN INSURER'S DENIAL OF COVERAGE FOR COMPLETED OPERATIONS BASED ON THE INCLUSION OF THE PHRASE "ONGOING OPERATIONS" IN AN ADDITIONAL INSURED ENDORSEMENT, WAS IMPROPER, AND AN INSURER WISHING TO LIMIT COVERAGE UNDER AN ADDITIONAL INSURED ENDORSEMENT TO ONGOING OPERATIONS MUST DO SO VIA CLEAR AND EXPLICIT LANGUAGE.

PULTE HOME CORP. V. AMERICAN SAFETY INDEMNITY CO. **(2017) 14 CAL.APP.5TH 1086.**

Pulte was a general contractor and developer for two residential housing projects. Pulte entered into subcontracts that required the subcontractors to name Pulte as an additional insured on their policies for completed operations. American Safety, one of the insurers, issued three additional insured endorsements with similar language. The first endorsement provided coverage for "liability arising out of 'your [the subcontractor's] work' which is ongoing and performed by the [named insured subcontractor] for [Pulte]." The second provided coverage for "liability arising out of 'your [the subcontractor's] work' and only as respects ongoing operations performed by the [named insured subcontractor] for [Pulte]." The third provided for coverage for "liability arising out of 'your [the subcontractor's] work'" performed at the project designated in the endorsement and only for "ongoing operations performed by the [named insured subcontractor]." When two construction defect lawsuits were filed against Pulte by homeowners, Pulte tendered its defense to American Safety which denied the tenders on the basis that the coverage under the additional insured endorsements was limited to "ongoing operations" and the lawsuits alleged liability arising out of completed operations. Pulte sued American Safety for breach of duty to defend and bad faith.

The trial court ruled that American Safety's denial of the tender was improper and the additional insured endorsements reference to "ongoing operations" were ambiguous given that they did not effectively *exclude* coverage for completed operations. The trial court awarded Pulte underlying defense fees and costs and also found that American Safety was in bad faith, and awarded Pulte its *Brandt* attorney's fees. American Safety appealed.

The Fourth District Court of Appeal affirmed the trial court's ruling that the additional insured endorsements were ambiguous because they combined coverage for ongoing and completed operations in one clause and failed to expressly limit coverage to the time of the subcontractors' ongoing operations. The Court of Appeal rejected American Safety's argument that the "ongoing operations" language applied as a limiting term excluding the completed operations coverage. The Court of Appeal held that the additional insured endorsements could be reasonably read as a grant of coverage for the insured's completed operations if property damage ensued from them. The Court also held that substantial evidence supported the trial court's finding of bad faith and award of punitive damages. The Court, however, remanded with instructions to recalculate the *Brandt* fees awarded, and thus, the punitive damages award as well, because recalculation of the attorney's fees awarded required an adjustment to the amount of punitive damages.

CIVIL PROCEDURE

THE RELATION BACK DOCTRONE DOES NOT APPLY TO ALLOW BELATED FILING OF CERTIFICATE OF MERIT WITH AMENDED COMPLAINT.

CURTIS ENGINEERING CORP. V. SUPERIOR COURT (2017) 16 CAL.APP.5TH 542.

A crane operator brought a professional negligence action against an engineering corporation arising out of injuries sustained when his crane tipped over. The plaintiff's first amended complaint was identical to his original complaint, except that a certificate of merit was attached to the amended complaint. The engineering corporation demurred to the plaintiff's first amended complaint on the grounds that a certificate of merit, as required by *Code of Civil Procedure* §411.35, was not filed within the statute of limitations period because one was not filed with the original complaint or within 60 days thereafter. The trial court denied the engineer's demurrer, concluding that the amended complaint, and therefore the certificate of merit, related back to the filing date of the original complaint. The Court of Appeal reversed the trial court's order, stating that the plain language of Section 411.35 does not allow the application of the relation-back doctrine. Therefore, the plaintiff's certificate of merit was filed belatedly and his claim was barred by the statute of limitations.

THE 10-YEAR STATUTE OF REPOSE DOES NOT APPLY TO PROPERTY CONTAMINATION CLAIMS WHEN THE CRUX OF THE CLAIM IS NOT BASED ON DEFECTIVE WORK ACCORDING TO THE COURT OF APPEAL.

ESTUARY OWNERS ASSOCIATION V. SHELL OIL COMPANY (2017) 13 CAL.APP.5TH 899.

Estuary Owners Association ("EOA"), the condominium owners association, and other homeowners sued the project developers, design professionals, subcontractors, and prior landowners, which included Shell, alleging construction defect and contamination of groundwater and soil on the condominium site. The condominium site was previously owned by Shell and was used as a fuel distribution terminal from 1925 until 1980. Petroleum products that were delivered to the site were stored in both above and below ground storage tanks. The property was purchased in 1980 by Simmons Terminal Corporation, and it continued to be used as a fuel distribution terminal. From 1985 until around 2003, the property was sold to new owners and used as a demolition contracting business. The new owners left the underground pipelines and facilities in place and used two of the above ground storage tanks, demolishing the others.

In 2002, the California Regional Water Quality Control Board discovered that leaks from the fuel storage had contaminated the soil and groundwater. Measures were taken to clean up the site in 2002 and 2003. In 2003, the site was purchased by Signature at the Estuary LLC which built condominiums on the property between 2004 and 2006. In August 2004, groundwater monitoring wells were installed, and the association's covenants, conditions, and restricts indicated that there would be a risk management plan that must be disclosed by the sellers to all future buyers of the homes.

In 2010, EOA filed a lawsuit alleging that defendants knew about the contaminated soil and groundwater, failed to adequately clean and remove the contamination, and failed to construct the condominium buildings with property vapor/moisture barriers beneath the slab. With regards to Shell, EOA asserted claims of negligence and negligence per se as well as private and public nuisance.

Shell moved for summary judgment against EOA, on the grounds that their cause of action was barred by the 10-year statute of limitations for construction defects, pursuant to California *Code of Civil Procedure* § 337.15, and that all of their causes of action were barred by the 3-year statute of limitations for real property damage. The trial court agreed with Shell's contentions and granted its motion for summary judgment. EOA appealed.

The Court of Appeal determined that California *Code of Civil Procedure* § 337.15 only applies to claims based on construction defect and, therefore, cannot be used as a basis to grant Shell's summary judgment motion because the claims against Shell pertained to the contamination of the site due to Shell's negligence during its operation on the property. Further, the Court of Appeal found that with regards to the statute of limitation for real property damage, that the actual and constructive knowledge of prior landowners is imputed to future owners. The court determined that EOA's claims arose from the same contamination and were not new and different to warrant the application of a new statute of limitations period. Therefore, the Court imputed the developer's knowledge to EOA and found that EOA's claims were barred by the 3-year statute of limitations for damage to real property.

RIGHT TO INDEPENDENT COUNSEL UNDER CALIFORNIA *CIVIL CODE* SECTION 2860 IS INAPPLICABLE WHERE THERE IS ONLY A POTENTIAL CONFLICT OF INTEREST, RATHER THAN AN ACTUAL CONFLICT OF INTEREST.

***CENTEX HOMES V. ST. PAUL FIRE & MARINE INSURANCE CO.* (2018) 19 CAL.APP.5TH 789.**

After homeowners brought a construction defect action against developer, insurer of developer's subcontractor agreed to defend developer as additional insured, subject to a reservation of rights including the right to deny indemnity to any claims against developer not covered by the policy, along with the right for reimbursement of costs incurred from defending uncovered claims. Developer filed a cross-complaint against the subcontractor and the insurer arguing that it was entitled to independent counsel under California Civil Code § 2860, because the insurer's reservation of rights created significant conflicts of interests. Section 2860 gives an insured the right to obtain independent counsel when their competing interests create an ethical conflict for counsel. Insurer appointed an attorney solely to represent developer and defend against the homeowner's claims.

The trial court granted insurer's motion for summary adjudication, denying developer's claim for independent counsel explaining that insurer had negated the existence of a conflict by its appointment of separate counsel for developer's matters.

The Court of Appeals affirmed summary judgment for insurer, holding that the rule governing representation of more than one client in which interests of clients potentially conflict was inapplicable where there is only a potential conflict of interest, and similarly, Rule 3-310(C)(1) of the Rules of Professional Conduct was inapplicable because there was no reasonable likelihood of an actual conflict of interest. Further, the court determined that there was no evidence that the insurer could control the outcome of the coverage dispute nor was there evidence that the insurer controlled both sides of the litigation. The Court therefore affirmed summary judgment for the insurer and developer was not eligible for appointment of independent counsel.

ARBITRATION

TRIAL COURT PREJUDICIALLY ERRED IN APPLYING INCORRECT STANDARDS IN REVIEWING ARBITRATOR'S AWARD. THE APPELLATE COURT HELD THAT SUBSTANTIAL EVIDENCE DID NOT SUPPORT ARBITRATION AWARD AND THAT ALLEGED REIMAGING CONTRACT TO BE PERFORMED OVER A THREE-YEAR PERIOD VIOLATED THE STATUTE OF FRAUDS.

***HARSHAD & NASIR CORPORATION V. GLOBAL SIGN SYSTEMS* (2017) 14 CAL.APP.5TH 523.**

Plaintiff sued defendant for over $100,000 in unpaid invoices. Three weeks prior to trial, the parties agreed to arbitrate their dispute of the unpaid invoices. The arbitration agreement specified that the arbitrator must provide a written decision with findings of fact, including California laws as if he were a Superior Court judge. The arbitration agreement also provided for full judicial review of the arbitration award as if it were decided by a court. After nearly five years, the arbitrator awarded approximately $1 million in damages, approximately $1.1 million in costs and attorney's fees, and approximately $700,000 in prejudgment interest. The arbitrator also added four affiliates of the defendant's as debtors on the judgment.

The trial court affirmed the award against the defendant, but vacated the award against the defendant's affiliates. The trial court also denied all parties' requests for post-award attorney's fees, but held that such fees could be awarded in discretion of the arbitrator. The plaintiff and defendant both appealed.

The Second District Court of Appeal reversed the judgment in favor of the plaintiff and affirmed the order granting the defendant's affiliates' motion to vacate the arbitrator's award. The Court held that the trial court prejudicially erred by failing to apply the correct standards in reviewing the arbitrator's award, holding that the trial court should have reviewed the arbitrator's decision under the appellate review standards of a court's judgment. The Court of Appeal held on the merits that substantial evidence did not support the arbitration award and that an alleged reimaging contract which was to be performed over a three-year period violated the statute of frauds. Given that the defendant did not agree to submit to arbitration any claim for lost profits based upon an alleged reimaging contract, the arbitrator had no right to award damages on such a claim. However, the Court found that the trial court did not err in denying the plaintiff's petition to

confirm the awards as to defendant's affiliates and in granting the affiliates' petition to vacate the award as to them.

NEVADA

A SUBSTANTIAL IDENTITY BETWEEN RELATED CORPORATE PARTIES MET THE PRIVITY REQUIREMENT FOR APPLYING CLAIM PRECLUSION, AND AN ORDER BASED ON AN ACCEPTED OFFER OF JUDGMENT UNDER *NRCP* 68 WAS CONSIDERED A FINAL JUDGMENT FOR PURPOSES OF PRECLUSION.

***MENDENHALL V. TASSINARI* (2017) 403 P.3d 364.**

Brownstone Entities sued appellants for breach of contract alleging appellants failed to contribute to the development of the real property as they had promised. Before trial commenced, appellants presented Brownstone Entities with an offer of judgment, based on the Nevada Rules of Civil Procedure 68, to settle the case. During the offer's ten-day irrevocable period, appellants learned that respondent, Ronald Tassinari, a principal of Brownstone Entities and a corporate officer of AVB (Brownstone Entities' parent company), allegedly committed fraud by signing the term sheet on behalf of other investors. Tassinari misled appellants into believing there were other third-party investors. Brownstone Entities accepted the offer, and the first action was dismissed with prejudice. Appellants initiated the second action by filing a complaint that alleged fraud against respondents. Respondents filed a motion to dismiss appellants' complaints.

The trial court granted respondent's motion to dismiss appellants' complaints because (1) the order of dismissal from the first action was a final and valid judgment; (2) the claims asserted by appellants in the second action were based on the same claims in the first action, or could have been brought in the first action; and (3) respondents were privies of the Brownstone entities. Appellants appealed, claiming that the trial court misinterpreted the doctrine of claim preclusion when it granted respondents' motion to dismiss.

The Supreme Court of Nevada affirmed the trial court's decision, holding that Appellants' claims were barred by the doctrine of claim preclusion and by the terms of the offer of judgment between the parties. The Court used a three-part factor-based test in determining that claim preclusion applied: (1) the parties or their privies are the same; (2) the final judgement is valid; and (3) the subsequent action is based on the same claims or any part of them that were or could have been brought in the first case. The Court found that: (1) the parties or their privies are the same and that a substantial identity between the parties exists, among other reasons because appellants were parties to both the first and second action, and although respondents were not parties to the first action, they were privies of the Brownstone Entities (AVB was the parent company of Brownstone Entities and a party to the term sheet); (2) the final judgment was valid because an order based on an accepted offer of judgment under *NRCP* 68 constitutes a final judgment for purposes of claim preclusion; and (3) the second action was based on the same claims or any part of them that were or could have been brought in the first action, because both claims were based on the facts underlying the term sheet of the contract and the claims could have been raised in the first action as an affirmative defense. The Court also found that the claims were not permissive counterclaims, that no formal barriers existed that prevented appellants' claims in the first action, and that the terms in the offer foreclosed the claims in the second action.

OREGON

THINKING ABOUT CANCELLING AN INSURANCE POLICY FOR NON-PAYMENT? IF YOU ARE IN NEVADA, BE SURE THE NOTICE INCLUDES AN EXPRESS STATEMENT OF THE POLICY HOLDER'S RIGHT TO REQUEST ADDITIONAL INFORMATION AS TO WHY THE POLICY WAS CANCELLED. OTHERWISE, THE CANCELLATION IS NOT EFFECTIVE.

***O.P.H. OF LAS VEGAS, INC. V. OREGON MUTUAL INSURANCE COMPANY* (2017) 401 P.3D 218.**

O.P.H. of Las Vegas, Inc. ("OPH") operated a restaurant called the Original Pancake House in Las Vegas Nevada. For almost every year between 2002 and 2012 OPH used Dave Sandin ("Sandin") or Sandin & Co. as its insurance broker, with the exception of a two-year period where OPH used a different insurance broker. In December 2011, OPH purchased a Business Owner Protector policy from Oregon Mutual Insurance Co. ("Oregon Mutual") for the restaurant upon Sandin's recommendation. The policy allowed periodic premium payments, and its term was from December 26, 2011 until December 26, 2012. OPH defaulted on its premium payment obligation on July 26, 2012. Oregon Mutual sent OPH a cancellation notice ("Notice") five days later in which it stated that it would cancel the policy on August 15, 2012 should it not receive a payment by that date. The Notice did not include a statement informing OPH of its right to request, and receive within 6 days, additional reasonably precise information as to why OPH decided to cancel the policy, as required by NRS 687B.360. Oregon Mutual claims that it mailed this notice on August 1, 2012, but OPH denied having ever received it. Oregon Mutual cancelled the policy for failure to pay the premium on August 16, 2012. On August 17, 2012 a fire destroyed Original Pancake House. OPH reported the loss and submitted a claim to Oregon Mutual, which Oregon Mutual denied because policy had been cancelled the day prior.

OPH sued Oregon Mutual, Sandin and Sandin & Co. on various claims related to the cancelled policy, to include breach of fiduciary duty against the Sandin defendants. OPH filed a motion for partial summary judgment against Oregon Mutual on the grounds that the Notice had no effect because it didn't comply with NRS 687B.360. The trial court denied the motion. Oregon Mutual then moved for summary judgment on the grounds that the policy had been validly cancelled for premium nonpayment prior to the occurrence of the fire, and therefore, the loss wasn't covered. The Sandin defendants filed a motion for summary judgment against OPH on the grounds that it had no duty to monitor and notify OPH of its premium payment default. The trial court granted both motions, and OPH filed an appeal.

The Supreme Court of Nevada opted to review the district court's grant of summary judgment *de novo*. It affirmed the grant of summary judgment for Sandin and Sandin & Co. holding that insurance brokers do not have a duty to monitor its insured client's premium payments and alert clients when a policy is subject to cancellation for nonpayment. The Court acknowledged that the Sandin defendants could assume additional duties, but it noted that the Sandin defendants had not done so in this case. The Court reversed Oregon Mutual's grant of summary judgment. The Court

determined that Notice did not strictly comply with NRS 687B.360, as required by the statute, and that it was not sufficient for the Notice to only substantially comply. The Court further noted that a loss that occurs, even when an insurance policy is in default, may be covered if the loss occurred before a statutorily compliant notice of termination is given.

ARIZONA

A SUCCESSFUL PARTY ON A CLAIM FOR BREACH OF THE IMPLIED WARRANTY OF WORKMANSHIP AND HABITABILITY QUALIFIES FOR AN ATTORNEY-FEE AWARD.

***SIRRAH ENTERPRISES, LLC V. WUNDERLICH* (2017) 242 ARIZ. 542.**

The plaintiffs, Wayne and Jacqueline Wunderlich (collectively "Wunderlich"), were sued by Sirrah Enterprises, LLC ("Sirrah") for unpaid amounts on a contract for the construction of a basement at the Wunderlichs' home. Sirrah was partially paid for the work it performed, but the Wunderlichs refused to pay the full amount due under the contract, alleging construction defects. Sirrah sued for the amount it was due under the contract. The Wunderlichs filed a counterclaim and alleged breach of the implied warranty of workmanship and habitability, among other claims.

The jury ruled in favor of Sirrah on its claim, awarding it $31,374. The jury also found in favor of Sirrah on the Wunderlichs' claims for breach of the covenant of good faith and fair dealing and breach of contract. However, the jury ruled in favor of the Wunderlichs' on their claim for breach of the implied warranty of workmanship and habitability, awarding them $297,782. The contract between the parties granted attorney fees to the prevailing party, should either party be required to retain an attorney to enforce a provision of the contract. Sirrah argued that an implied warranty of workmanship and habitability is not a term or provision of the contract, but the Wunderlichs argued that it is imputed into the contract by law making it a "term or provision" of the contract. The trial court and Court of Appeal ultimately agreed with the Wunderlichs' contention, and it awarded the Wunderlichs' attorney fees upon its finding that they were the prevailing party.

The Arizona Supreme Court reviewed the case de novo to evaluate "the courts' interpretation of the parties' contractual provision as applying to Implied Warranty claims." The Arizona Supreme Court ultimately agreed with the trial court's analysis but found flaw with the analysis of the Court of Appeal. The Court of Appeal relied on a line of cases that stood for the proposition that an Implied Warranty was implied by law. This meant that claimants not in privity of contract with the original contractor could not obtain attorney's fees. Because this case involved a claimant that was in privity of contract with the builder, the Court of Appeal awarded attorney's fees. The Arizona Supreme Court determined that this reasoning was incorrect. The Supreme Court held that the Implied Warranty is actually imputed into an express contract. This means that it can be enforced by subsequent homeowners. Therefore, the Arizona Supreme Court found that a successful party can obtain attorney's fees under A.R. S. § 12-341.01(a) for claims of breach of the Implied Warranty because these claims would "arise out of" an express contract.

Section 6.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

Grand Ballroom

Thursday, May 17th 2018
9:30 AM – 10:30 AM

Course Title:
Litigating In The Western States - A Judge's Perspective

Holly Davies, Esq. Hon. Justice Michael Cherry,
Hon. Sue Kurita, Hon. Carl Butkus, Hon. Ronald Styn and Hon. Peter Swann

Case Law Update (2018)

Presented to:

31st Annual Construction Law Conference
San Antonio, Texas

Presented by:

Gregory M. Cokinos
Cokinos | Young
Houston, Texas

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RECENT DEVELOPMENTS IN TEXAS CONSTRUCTION LAW

This paper is a summary of recent judicial decisions that have an impact on construction law in Texas. As with all surveys, the selection of materials lies with the authors.[1]

I. CONSTRUCTION CONTRACTS

A. Conditions Precedent

In *Star Operations, Inc. v. Dig Tech, Inc.*, No. 03-15-00423-CV, 2017 WL 3263352 (Tex. App.—Austin July 27, 2017, pet. filed) (mem. op.), the Austin Court of Appeals considered whether compliance with certain federal regulatory requirements was a condition precedent to the formation or enforceability of a lower-tier subcontract on a highway-construction project.

Central Texas Highway Constructors, LLC was hired as the design-build contractor for the construction of SH 130 toll-road Segments 5 and 6 southeast of Austin. The project received some amount of federal funding. Central Texas hired Star Operations, Inc. as a subcontractor to build infrastructure for the illumination, signal, intelligent-transportation, and toll-collection systems for the project. Central Texas also separately hired Dig Tech, Inc. as a subcontractor to relocate and adjust electric-distribution facilities. Star later entered into an oral subcontract with Dig Tech to perform hole-boring work for the installation of electrical conduit on Star's portion of the project. When Star failed to pay Dig Tech for the work it performed, Dig Tech filed suit against Star and its surety, asserting claims for breach of contract and quantum meruit. Following a jury trial, the trial court entered judgment in favor of Dig Tech, awarding it damages and attorney's fees for Star's breach of the oral subcontract.

On appeal, Star contended that the trial court should have applied a federal-law principle, the *Christian* Doctrine, to incorporate into the oral subcontract all applicable federal regulations, in particular those requiring (1) prior written consent of TxDOT to any subcontract, (2) a written contract between Star and Dig Tech, and (3) Dig Tech's provision of statutorily compliant certified payroll. According to Star, applying the *Christian* doctrine ultimately meant that Dig Tech failed to comply with all conditions precedent to formation or enforceability of the oral subcontract. Alternatively, Star contended that irrespective of the *Christian* doctrine, the federal regulations at issue were expressly incorporated into any and all contracts on the highway-construction project, including its oral subcontract with Dig Tech.

The Austin Court of Appeals held that the *Christian* doctrine did not require the incorporation of the three federal regulatory requirements into Star's oral subcontract with Dig Tech; and that those requirements were not expressly incorporated into the subcontract. The Austin court first discussed the origins and applicability of the *Christian* doctrine. Under the *Christian* doctrine, which has been developed in a line of decisions from the Federal Circuit beginning with *G. L. Christian & Assocs. v. United States*, 312 F.2d 418 (Ct. Cl. 1963), *aff'd on reh'g*, 320 F.2d 345 (Ct. Cl. 1963), a court may insert a clause into a government contract by operation of law if that clause is required under applicable federal administrative regulations, so long as the clause "expresses a significant or deeply ingrained strand of public procurement policy." Notably, however, the *Christian* doctrine does not allow all mandatory contract clauses to be automatically incorporated by operation of law into a contract. Rather, the doctrine is

[1] Anthony T. Golz, Ryan A. Cunningham, and Mitchell R. Powell, attorneys with my firm, Cokinos | Young, assisted in the preparation of this paper. Christopher C. Wan, also with my firm, assisted in the preparation of the presentation. Many thanks for their hard work.

limited to those mandatory clauses expressing significant public procurement policy and to "less fundamental or significant mandatory procurement contract clauses if not written to benefit or protect the party seeking incorporation." Here, Star had not argued that the federal regulations at issue "express a significant or deeply ingrained strand of public procurement policy," as required for the *Christian* doctrine to apply. Further, none of the federal regulations Star sought to incorporate in its oral subcontract with Dig Tech prescribed mandatory contract clauses like those incorporated into contracts under the *Christian* doctrine.[2] According to the Austin court, Star sought "to broaden the reach of the *Christian* doctrine, arguing not only that under the doctrine *all* applicable federal regulations should be incorporated into the subcontract…, but also that those incorporated regulations should be read as implied conditions precedent to the formation or performance of the oral subcontract. We decline to extend the reach of the *Christian* doctrine in this manner." Accordingly, the Austin court held that the federal regulations relied upon by Star did not require the incorporation of any mandatory contract clauses under the *Christian* doctrine into the oral subcontract between Dig Tech and Star.

The Austin court next considered whether the federal regulations at issue were expressly incorporated into Star's oral subcontract with Dig Tech, ultimately holding that they were not. Construing the pertinent contract provisions together, the Austin court concluded that the parties' respective subcontracts with Central Texas expressly contained the federal requirements at issue, but nothing in the record indicated that the parties intended to incorporate those requirements into Star's oral subcontract with Dig Tech. Likewise, there was no evidence that the parties intended (1) the agreement between Star and Dig Tech to become binding only after it was memorialized in a written contract and approved by TxDOT, or (2) that Dig Tech was required to submit statutorily compliant certified payroll to Star as a condition precedent to Star's obligation to pay Dig Tech for its work. Accordingly, while the three federal regulatory requirements were express provisions of Star's subcontract with Central Texas and Dig Tech's subcontract with Central Texas, they were not incorporated into Star's oral subcontract with Dig Tech. Nor did Star and Dig Tech agree to make them conditions precedent to the formation or enforceability of Star's subcontract with Dig Tech. Thus, the Austin court held that the trial court properly awarded Dig Tech damages for Star's breach of the oral subcontract.

B. Materiality of Breach

1. Contractor's failure to provide adequate refrigeration unit did not constitute a material breach as a matter of law.

In *Bartush-Schnitzius Foods Co. v. Cimco Refrigeration, Inc.*, 518 S.W.3d 432 (Tex. 2017) (per curiam), the Texas Supreme Court considered whether an owner's and a contractor's competing claims for breach of contract were viable despite the fact that both parties breached the contract.

Bartush-Schnitzius Foods Co. contracted with Cimco Refrigeration, Inc. to install a new refrigeration system at Bartush's food-production facilities. Soon after installation, the system began to fail. The parties were unable to agree on a plan to repair the system, leading Bartush to

[2] 2017 WL 3263352, at *3 (citing *S.J. Amoroso Constr. Co., Inc. v. United States*, 12 F.3d 1072, 1075 (Fed. Cir. 1993) (applying *Christian* doctrine to construction contract to substitute mandatory clause of Buy American Act applicable to construction contracts by operation of law when contract had incorrectly included clause for nonappropriated fund supply contracts); *Christian*, 312 F.2d at 424 (incorporating standard termination clause that regulation required to "be inserted in all fixed-price construction contracts amounting to more than $1,000")).

withhold further payment to Cimco. Bartush subsequently contracted with a third party to install an additional unit to the system, allowing it to perform at the desired temperature.

Cimco sued Bartush to recover the balance owed on the contract. Bartush counterclaimed for breach of contract, seeking damages for the costs associated with the additional unit it had installed. Bartush also asserted that its failure to pay was justified by Cimco's prior material breach. The jury found that both parties failed to comply with the contract, Cimco failed to comply first, and Bartush's failure to comply was not excused. The trial court entered judgment in favor of Bartush, awarding it damages, attorney's fees, interest, and costs and awarding nothing to Cimco, and Cimco appealed. The court of appeals reversed, holding that the jury impliedly found that Cimco's prior breach was not a material breach. The court of appeals additionally held that Bartush's failure to pay was a material breach as a matter of law and, thus, Bartush was barred from any recovery.

The Texas Supreme Court held that, notwithstanding its failure to pay the balance due on the contract, Bartush was not barred from recovering damages for Cimco's prior breach. The Supreme Court explained that a material breach by Cimco would have excused Bartush from making further contractual payments, while a nonmaterial breach would have simply given rise to a claim for damages. The Supreme Court held that Cimco's breach—by providing a refrigeration system unable to maintain the target temperature—was not material as a matter of law, explaining that the issue of materiality is generally one for the fact-finder, and finding no conclusive evidence of materiality. The Supreme Court further held that Bartush's subsequent breach did not discharge Cimco's prior breach, as a material breach excuses only *future* performance, but not *past* performance. Therefore, although Bartush remained liable for its subsequent failure to comply, Bartush's claim for damages resulting from Cimco's prior breach remained viable.

2. Owner continued to accept performance under general contract, thereby excusing any prior breach by general contractor; and owner's failure to make final payment constituted material breach, thereby excusing any subsequent breach by general contractor.

In *Levco Construction, Inc. v. Whole Foods Market Rocky Mountain/Southwest L.P.*, — S.W.3d — , 2017 WL 3429939 (Tex. App.—Houston [1st Dist.] 2017, no pet.), first reported in the 2012 case law update, the Houston (First) Court of Appeals considered whether an owner's failure to make final payment constituted a material breach of contract, thereby excusing any subsequent breach by the general contractor.

Whole Foods contracted with Cleveland Construction, Inc. ("CCI") to construct a Whole Foods store in Houston. CCI, in turn, entered into subcontracts with various subcontractors, including a subcontract with Levco Construction, Inc. to perform site, concrete, and utility work on the project. Construction was hindered by numerous delays and problems, most of which stemmed from Whole Foods' failure to obtain the requisite permits for the project, as well as defects in the plans and specifications. The project was finally completed, and CCI subsequently issued its final pay application to Whole Foods, requesting the last progress payment, release of the contractual retainage, and payment for an outstanding change order. Whole Foods paid the final progress payment, but refused to release the retainage or make payment on the final change order. CCI offered to provide conditional lien releases and waivers in exchange for Whole Foods' agreement to release the final payment, and CCI also offered to bond around or otherwise discharge Levco's lien on the project in exchange for Whole Foods' commitment to make the final payment. CCI also asked Whole Foods to release some of the retainage amounts directly to its subcontractors. Whole Foods nevertheless continued to withhold the final payment. CCI then

filed its own lien affidavit for amounts owed on the project, and several of CCI's subcontractors also filed liens. Whole Foods ultimately issued some payments directly to CCI's subcontractors, but Whole Foods never paid the amounts due for the final change order or retainage.

Levco filed suit against CCI and Whole Foods, and CCI and Whole Foods asserted competing claims for breach of the general contract. CCI asserted that Whole Foods had breached the general contract by withholding the final payment and retainage, while Whole Foods asserted that CCI had breached the general contract by allowing liens to be filed on the property. Following a bench trial, the trial court found that Whole Foods materially breached the general contract by withholding final payment, and that any breach of the general contract by CCI in subsequently failing to obtain lien releases from its subcontractors or filing its own lien on the project was excused by Whole Foods' prior material breach; and awarded CCI damages, attorney's fees, and interest. On appeal, Whole Foods contended that the trial court erred by concluding that Whole Foods breached the general contract and that CCI did not.

The Houston (First) Court of Appeals held that the trial court correctly determined that Whole Foods, and not CCI, breached the general contract and that Whole Foods was obligated to make final payment to CCI. The Houston court reasoned that, even if CCI committed the first breach of the general contract with regard to its progress payment applications, as Whole Foods had claimed, such a breach by CCI would not excuse Whole Foods from subsequent performance after continuing to accept CCI's performance. If, after a breach of a contract, the non-breaching party continues to insist on performance by the party in default, the previous breach constitutes no excuse for nonperformance on the part of the party not in default and the contract continues in force for the benefit of both parties. Because Whole Foods treated the general contract as continuing after CCI's alleged breach by paying CCI's progress payment applications, requiring CCI to continue its work on the project, and acknowledging final completion of the project, Whole Foods is thus deprived of any excuse for subsequently terminating its own performance of its obligation to make the final payment to CCI.

The Houston court additionally held that Whole Foods' failure to make the final payment constituted a material breach of the general contract. Under the plain language of the general contract, Whole Foods was not entitled to withhold final payment in the event a subcontractor, like Levco, had an unreleased lien. Rather, Whole Foods was obligated to make the payment, and if such payment did not result in the final release of any liens, Whole Foods would then be liable to seek a bond from CCI or obtain a refund of all money that Whole Foods may be compelled to pay in discharging such liens. Further, the evidence demonstrated that CCI's lien and the other subcontractors' liens were filed *after* Whole Foods had withheld final payment from CCI, and that Whole Foods' failure to make final payment was the very reason those liens were filed. Thus, the Houston court concluded that CCI met its obligations under the general contract up until the point that Whole Foods breached the general contract by withholding final payment. Accordingly, the trial court correctly determined that Whole Foods, not CCI, breached the general contract.

Finally, the Houston court rejected Whole Foods' argument that it was entitled to withhold final payment because (1) Levco had filed a "fund-trapping notice" as permitted by Section 53.056(b) of the Texas Property Code, and (2) Whole Foods had established the existence of a "good faith dispute" pursuant to Section 28.003(b) of the Prompt Payment Act. The Houston court reasoned that even if Levco's "fund-trapping notice" were timely (which it was not), Levco's claims against Whole Foods were not for funds that it alleged were wrongfully withheld by CCI, but rather damages allegedly owed to Levco by Whole Foods for Whole Foods' own failures and delays relevant to Levco's work on the Project. Further, neither Levco nor CCI had

asserted any claims under the Prompt Payment Act, and Whole Foods failed to cite any authority indicating that its own conduct in breaching the general contract could constitute a "good faith dispute" justifying its withholding payment of amounts due to CCI under the contract.

C. Third-Party Beneficiary

In *First Bank v. Brumitt*, 519 S.W.3d 95 (Tex. 2017), the Texas Supreme Court considered several issues pertaining to the determination of third-party beneficiary status, including whether it is a question of law for the court or a question of fact for the jury, and whether extrinsic evidence may be considered in the determination of third-party beneficiary status.

Richard Brumitt agreed to sell his stock in Southway Systems, Inc. to DTSG, Ltd. DTSG, in turn, sought financing for the purchase from First Bank. A total of three loan-commitment letters were issued by First Bank to DTSG and executed by both parties. Unfortunately, however, things did not go as planned. Over the next 14 months, First Bank scheduled and postponed numerous closings. Ultimately, DTSG never obtained a loan and never acquired Southway. By the time of trial, Southway no longer had any employees and had essentially failed.

DTSG filed suit against First Bank for breach of contract. Brumitt intervened as an additional plaintiff, claiming he was a third-party beneficiary of the three loan-commitment letters executed by DTSG and First Bank. At trial, the trial court submitted the issue of whether Brumitt was a third-party beneficiary to the jury, and instructed the jury that it was permitted to consider extrinsic evidence if the requisite intent to benefit Brumitt was not expressed in the loan-commitment letters themselves. The jury found that First Bank was liable to Brumitt for breach of contract, and the trial court entered judgment awarding Brumitt damages and attorney's fees for First Bank's breach. The court of appeals affirmed as to Brumitt's breach-of-contract claim. Before the Texas Supreme Court, First Bank contended that the loan-commitment letters were unambiguous and did not clearly express the parties' intent to make Brumitt a third-party beneficiary; that the trial court erred by submitting the issue of third-party beneficiary status to the jury; and that extrinsic evidence may not be considered in determining whether a party is a third-party beneficiary of an unambiguous contract.

The Texas Supreme Court held that the loan-commitment letters executed by DTSG and First Bank were unambiguous and did not clearly express the parties' intent to make Brumitt a third-party beneficiary. The Supreme Court reasoned that, absent a statutory or other legal rule to the contrary, a person's status as a third-party beneficiary depends solely on the contracting parties' intent. Specifically, a person seeking to establish third-party-beneficiary status must demonstrate that the contracting parties intended to secure a benefit to that third party and entered into the contract directly for the third party's benefit, such that the third party has the right to be a "claimant" in the event of a breach. The contract must include a clear and unequivocal expression of the contracting parties' intent to directly benefit a third party, and any implied intent to create a third-party beneficiary is insufficient. The Supreme Court found nothing in the loan-commitment letters which clearly, fully, and unequivocally expressed the parties' intent to contract directly for Brumitt's benefit and thus to confer on Brumitt the right to be a "claimant" in the event of a breach. Relying on the letters' plain and unambiguous language, the Supreme Court concluded that Brumitt was not a third-party beneficiary.

The Supreme Court additionally held that when a contract is unambiguous, the issue of whether a party is a third-party beneficiary is a question of law for the court to decide. The

Supreme Court reasoned that, when a contract is unambiguous, the issue of whether a non-contracting party is a third-party beneficiary depends solely on the contracting parties' intent as expressed within the parties' agreement. Thus, "[t]he parties' intent to create a third-party beneficiary is…simply a contract term like any other of the contract's terms." Accordingly, the trial court should have decided whether the loan-commitment letters expressed the parties' mutual intent to make Brumitt a third-party beneficiary, and the trial court erred by submitting the issue to the jury.

Finally, the Supreme Court held that when a contract is unambiguous and does not clearly express the parties' intent to create a third-party beneficiary, extrinsic evidence is irrelevant and inadmissible on that issue. The Supreme Court explained that, in such a case, the trial court can neither submit the issue to a jury nor rely upon extrinsic evidence to add terms to the parties' unambiguous agreement. While courts are permitted to consider the "facts and circumstances" surrounding the formation of a contract as an aid in the construction of the contract's language (e.g., to determine the identity of third parties who are not named in the contract), courts may not look to the surrounding "facts and circumstances" to add to, alter, or contradict the terms to which the parties agreed. Therefore, the trial court erred by permitting the jury to consider extrinsic evidence. Because the loan-commitment letters were unambiguous, the trial court—not a jury—should have determined the parties' intent as a matter of law, and it could not do so by relying on extrinsic evidence to create an intent that the loan-commitment letters themselves did not express.

D. Indemnity Provisions

In *Levco Construction, Inc. v. Whole Foods Market Rocky Mountain/Southwest L.P.*, — S.W.3d — , 2017 WL 3429939 (Tex. App.—Houston [1st Dist.] 2017, no pet.), the Houston (First) Court of Appeals also considered whether an owner was entitled to indemnity from a general contractor or a subcontractor pursuant to an indemnity provision in the general contract.

Whole Foods contracted with Cleveland Construction, Inc. ("CCI") to construct a Whole Foods store in Houston. The general contract provided that CCI owned indemnity

> only in proportion to and to the extent such indemnified claims are directly or indirectly caused, occasioned or contributed to, in whole or in part,…by (1) the negligent act or omission of [CCI] or [its] officers, partners, employees, agents, subcontractors (of any tier), or anyone acting under their direction, control or on their behalf (collectively "Indemnitor"); (2) the breach by Indemnitor of any of the provisions of this agreement; or (3) willful misconduct by Indemnitor.

CCI, in turn, entered into a subcontract with Levco Construction, Inc. to perform site, concrete, and utility work on the project. Notably, the subcontract expressly incorporated the general contract by reference. Construction was hindered by numerous delays and problems, most of which stemmed from Whole Foods' failure to obtain the requisite permits for the project, as well as defects in the plans and specifications.

A payment dispute later arose, leading Levco to file suit against CCI and Whole Foods. CCI and Whole Foods asserted competing claims against one another for breach of the general contract. Whole Foods also asserted that it was owed indemnity by both CCI and Levco pursuant to the indemnity provision in the general contract, which Whole Foods contended also applied to Levco because Levco agreed to be bound by the general contract. Following a bench trial, the trial court found that Whole Foods was not entitled to any relief on its breach-of-contract or

indemnity claims. On appeal, Whole Foods contended that the trial court erred by concluding that neither CCI nor Levco was required to indemnify it.

The Houston (First) Court of Appeals held that Whole Foods failed to prove any conduct by either CCI or Levco triggering the indemnity provision in the general contract. The Houston court reasoned that Whole Foods did not allege willful misconduct by either CCI or Levco. Further, the trial court's findings that Whole Foods, not CCI, breached the general contract were supported by legally and factually sufficient evidence. Finally, Whole Foods pointed to no negligent act by either CCI or Levco that gave rise to their claims. Rather, the evidence at trial supported the trial court's findings that Whole Foods alone was the cause of the problems that gave rise to CCI's and Levco's claims. Thus, because it was Whole Foods' own failures and breach of the general contract that caused the disputes at issue in this case, Whole Foods could not establish that it was entitled to indemnity from either CCI or Levco. Accordingly, the trial court did not err in concluding that neither CCI nor Levco was required to indemnify Whole Foods pursuant to the indemnity provision in the general contract.

E. Waiver of Nonwaiver Provision

In *Shields Limited Partnership v. Bradberry*, 526 S.W.3d 471 (Tex. 2017), the Texas Supreme Court considered whether a party's rights under a contractual nonwaiver provision may be waived and, if so, whether the waiver can be rooted in the same conduct that the parties specifically agreed would *not* give rise to a waiver.

Boo Nathaniel Bradberry and 40/40 Enterprises, Inc. leased commercial property from Shields Limited Partnership. The parties' lease agreement contained the following nonwaiver provision:

> All waivers must be in writing and signed by the waiving party. Landlord's failure to enforce any provisions of this Lease or its acceptance of late installments of Rent shall not be a waiver and shall not estop Landlord from enforcing that provision or any other provision of this Lease in the future.

Bradberry regularly violated the lease terms by paying rent past the due date and cure period. Without fail, Shields accepted the rent when tendered without protest or assessment of late fees. Bradberry timely notified Shields of his intent to exercise the option to extend the lease for another term, but was subsequently late on another rental payment. Once again, Shields accepted the late rental payment without protest.

Months later, after sending default notices for late rent, Shields offered Bradberry a new lease at a much higher monthly rental rate. Bradberry rejected the offer, and Shields informed him he had to vacate the premises within 30 days, claiming he had converted to a month-to-month tenancy. When Bradberry refused to surrender possession, Shields instituted eviction proceedings. Both the justice court and the county court ruled in Bradberry's favor, with the latter rendering a take-nothing judgment against Shields. The court of appeals affirmed. Before the Texas Supreme Court, Shields contended that acceptance of late payments, without more, can never effect a waiver of either the nonwaiver provision of the lease or Shields' contractual right to enforce strict compliance with the requirements to exercise the option.

The Texas Supreme Court held that, as a matter of law, accepting late rental payments did not waive the nonwaiver provision in the underlying lease or, correspondingly, the contractual requirement that rent is due on the first of the month, without prior demand, and no later than the

tenth day of the month. Moreover, Shields did not act inconsistently with its right to accept untimely rent without waiving the nonwaiver provision. The Supreme Court first considered whether a party's rights under a contractual nonwaiver provision may be waived. On that point, the Supreme Court explained:

> We consider the force and effect of a nonwaiver provision in light of Texas's public policy that "strongly favors freedom of contract." We have repeatedly reaffirmed that competent parties "'shall have the utmost liberty of contract, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice.'" This "'paramount public policy'" mandates that courts "'are not lightly to interfere with this freedom of contract.'" "Absent compelling reasons, courts must respect and enforce the terms of a contract the parties have freely and voluntarily entered," and "[a]s a rule, parties have the right to contract as they see fit as long as their agreement does not violate the law or public policy." Given Texas's strong public policy favoring freedom of contract, there can be no doubt that, as a general proposition, nonwaiver provisions are binding and enforceable. This acknowledgment accords with our treatment of nonwaiver agreements in the insurance context.

Thus, the Supreme Court "affirm[ed] that party's rights under a nonwaiver provision may indeed be waived expressly or impliedly."

The Supreme Court next considered whether Shields could waive the nonwaiver provision by engaging in the very conduct disclaimed as a basis for waiver—accepting late rental payments—and ultimately held that Shields could not. While it agreed with Bradberry's position that a nonwaiver provision absolutely barring waiver in the most general of terms might be wholly ineffective, the Supreme Court could not agree that a nonwaiver provision is wholly ineffective in preventing waiver through conduct the parties explicitly agreed will never give rise to waiver. According to the Supreme Court, such a contract-enforcement principle would be "illogical," since the very conduct which the clause is designed to permit without effecting a waiver would be turned around to constitute waiver of the clause permitting a party to engage in the conduct without effecting a waiver. Thus, the Supreme Court held that engaging in the very conduct disclaimed as a basis for waiver was insufficient as a matter of law to nullify the nonwaiver provision in the parties' lease agreement.

F. Forum-Selection Clauses

In *Pinto Technology Ventures, L.P. v. Sheldon*, 526 S.W.3d 428 (Tex. 2017), the Texas Supreme Court considered whether statutory and common-law tort claims fell within the scope of a forum-selection clause, and whether nonsignatories were entitled to enforce the forum-selection clause under the transaction-participant theory or the concerted-misconduct doctrine.

Jeffery Sheldon and Andras Konya are shareholders in IDev Technologies, Inc. Sheldon and Konya filed suit against, among other defendants, IDev's majority shareholders, IDev's CEO, and IDev's CFO, asserting claims for fraud, breach of fiduciary duty, minority-shareholder oppression, Texas Blue Sky Law violations, and conspiracy. Essentially, Sheldon and Konya alleged that a series of transactions in 2010 manipulated, diluted, and devalued their holdings in IDev, depriving them of a significant payout in connection with IDev's impending acquisition by another company at a considerable sum. The defendants moved to dismiss Sheldon's and Konya's claims based upon a forum-selection clause in IDev's 2010 Amended Shareholders Agreement, which recited as follows:

> [T]he Delaware state courts of Wilmington, Delaware (or, if there is exclusive federal jurisdiction, the United States District Court for the District of Delaware) shall have exclusive jurisdiction and venue over any dispute arising out of this Agreement, and the parties hereby consent to the jurisdiction of such courts.

The trial court granted the defendants' motion to dismiss, and dismissed Sheldon's and Konya's claims with prejudice to refiling in Texas. In a split decision, the court of appeals reversed. Before the Texas Supreme Court, the defendants contended that Sheldon's and Konya's claims fell within the scope of the forum-selection clause, and that IDev's CEO and CFO were entitled to enforce the forum-selection clause as nonsignatories under the transaction-participant theory or the concerted-misconduct doctrine.

The Texas Supreme Court held that the parties' dispute "aris[es] out of" the 2010 Amended Shareholders Agreement and, therefore, Sheldon's and Konya's statutory and common-law tort claims fell within the scope of the forum-selection clause. Pursuant to the forum-selection clause, the parties agreed to resolve "any dispute arising out of this Agreement" in Delaware. Therefore, Sheldon's and Konya's claims fell within the scope of the forum-selection clause so long as (1) the existence or terms of the 2010 Amended Shareholders Agreement were operative facts in the dispute, and (2) "but for" that Agreement, Sheldon and Konya would not be aggrieved. Engaging in a common-sense examination of the substance of the claims made and the terms of the forum-selection clause, the Supreme Court concluded that Sheldon's and Konya's claims fell within the clause's scope. Reviewing the allegations in the live pleadings, the Supreme Court reasoned that the dispute substantively concerns (1) the elimination of preemptive rights and designated shareholder statuses, (2) the dilution of equity, (3) various misrepresentation or omissions of required disclosures, and (4) actions taken without notice as required by the Shareholders Agreement. According to the Supreme Court, in examining the foregoing disputes, a but-for relationship between the disputes and the 2010 Amended Shareholders Agreement was evident. Further, many of the statutory and common-law tort claims asserted involve that same operative facts that would be implicated in a parallel breach-of-contract claim, had one been pursued. Accordingly, Sheldon's and Konya's statutory and common-law tort claims fell within the scope of the forum-selection clause.

The Supreme Court next considered whether IDev's CEO and CFO, as nonsignatories to the 2010 Amended Shareholders Agreement, could enforce the forum-selection clause under the transaction-participant theory or the concerted misconduct doctrine, ultimately concluding that they could not. The Supreme Court first addressed the transaction-participant theory, observing that although it had not previously addressed the matter, other courts have held that "transaction participants" may enforce a valid forum-selection clause even if they are not actual signatories to the contract. A "transaction participant" includes "an employee of one of the contracting parties who is individually named by another contracting party in a suit arising out of the contract containing the forum selection clause." The Supreme Court explained the theory as follows:

> As articulated by our intermediate appellate courts, the transaction-participant theory is similar to the doctrine federal courts employ to bind nonsignatories to forum-selection clauses when they are "closely related to the contractual relationship." In such circumstances, enforcement is permitted if the relationship between a nonsignatory and a signatory to the contract is close enough that the nonsignatory's enforcement of the forum-selection clause would be "foreseeable" to the opposing party. The rationale supporting enforcement in such circumstances is that signatories have already "assented to a forum selection clause and thus have agreed to litigate disputes relating to the contract in the

> chosen forum" such that enforcing the provision "comports with the 'legitimate expectations of the parties, [as] manifested in their freely negotiated agreement.'"

The Supreme Court ultimately concluded that it need not decide whether a transaction participant may enforce a forum-selection clause, or under what circumstances, because the 2010 Amended Shareholders Agreement's terms barred application of the theory in this case. The 2010 Amended Shareholders Agreement expressly limited the rights and remedies of nonparties to the Agreement as follows:

> This Agreement…shall inure to the benefit of and be binding upon, the successors, permitted assigns, legatees, distributees, legal representatives and heirs of each party and *is not intended to confer upon any person, other than the parties and their permitted successors and assigns, any rights or remedies hereunder*.

Therefore, the Agreement's plain language disclaimed any intent to extend the Agreement's benefits to nonparties, and allowing IDev's CEO and CFO to enforce the forum-selection clause as "transaction participants" would contravene the parties' expressed intent. Accordingly, IDev's CEO and CFO could not rely upon the transaction-participant doctrine to enforce the forum-selection clause against Sheldon and Konya.

Finally, the Supreme Court addressed the concerted-misconduct doctrine, explaining that under this equitable-estoppel doctrine, nonsignatories may enforce a forum-selection clause "when a signatory to the contract containing the forum selection clause raises allegations of substantially interdependent and concerted misconduct by both non-signatories and one or more signatories to the contract." The Supreme Court reasoned that, in *G.T. Leach Builders, LLC v. Sapphire V.P., LP*, 58 S.W.3d 502 (Tex. 2015), first reported in the 2015 case law update, it observed that it had previously declined to adopt the concerted-misconduct doctrine in an arbitration case, *In re Merrill Lynch Trust Co. FSB*, 235 S.W.3d 185, 191-92 (Tex. 2007) (orig. proceeding), and would not reconsider the matter because the parties neither addressed nor distinguished *Merrill Lynch*. "We do the same in this case for the same reason." Accordingly, IDev's CEO and CFO were not entitled to enforce the forum-selection clause against Sheldon and Konya, and the trial court erred in granting their motion to dismiss.

II. CONSTRUCTION LITIGATION

A. Insurance

This paper will not address recent developments in insurance matters affecting the construction industry, as this topic is addressed in depth in another paper from this seminar.

B. Sovereign Immunity

1. Sovereign/governmental immunity does not equate to a lack of subject-matter jurisdiction for all purposes.

In *Engelman Irrigation District v. Shields Brothers, Inc.*, 514 S.W.3d 746 (Tex. 2017), the Texas Supreme Court considered whether sovereign[3] immunity equates to a lack of subject-

[3] The Supreme Court clarified that its references to "sovereign" immunity referred to the related doctrines of sovereign immunity and governmental immunity. 514 S.W.3d at747 n.1.

matter jurisdiction for all purposes, such that a decades-old final judgment can be challenged by collateral attack in a later proceeding.

In 1992, Shields Brothers, Inc. sued the Engelman Irrigation District, alleging that Engelman had breached a contract to deliver water to Shields. Engelman contended that the trial court lacked subject-matter jurisdiction because Engelman had governmental immunity. The trial court denied Engelman's immunity defense and ultimately rendered judgment for Shields, awarding it damages, fees, and interest. Engelman appealed this judgment (the *Engelman I* judgment), and the court of appeals affirmed. Citing *Missouri Pacific Railroad Co. v. Brownsville Navigation District*,[4] the court of appeals held that Engelman's immunity was waived by a then-applicable Water code provision which provided that water districts may "sue and be sued." The Texas Supreme Court denied review, and the *Engelman I* judgment became final. Engelman, however, did not pay the *Engelman I* judgment; instead, it sought authorization to file for bankruptcy under the Water Code. The authorization was denied, Engelman appealed, and the court of appeals in *Engelman II* affirmed. However, while *Engelman II* was pending on appeal, the Supreme Court decided *Tooke v. City of Mexia*, which overruled *Missouri Pacific*'s holding that "sue and be sued" language waived immunity.

Thus, in 2010, Engelman brought a new suit (*Engelman III*) seeking a declaratory judgment that the *Engelman I* judgment was void under *Tooke*. According to Engelman, it was always immune from Shields's breach-of-contract claim, and its immunity from suit deprived the trial court in *Engelman I* of subject-matter jurisdiction, thus rendering the *Engelman I* judgment void and subject to collateral attack in the pending lawsuit. The trial court denied Engelman's claim for declaratory relief, and Engelman appealed. The court of appeals affirmed, concluding that the *Engelman I* judgment was not void and could not be attacked collaterally, notwithstanding the holding in *Tooke*.

The Texas Supreme Court held that, although it "implicates" the trial court's subject-matter jurisdiction, sovereign immunity does not equate to a lack of subject-matter jurisdiction for all purposes, nor does sovereign immunity so implicate subject-matter jurisdiction that it allows collateral attack on a final judgment. The Supreme Court explained,

> It is one thing to characterize sovereign immunity as jurisdictional so as to provide a defendant with certain procedural advantages in an ongoing case, such as avoiding a waiver of the defense or allowing a challenge of the immunity ruling by interlocutory appeal. In today's case, however, we are asked to jettison the foundational principle of res judicata, by allowing Engelman to reopen a final judgment that would otherwise operate as claim preclusion. We decline to allow this result. Such a result is not compelled by our precedent, and goes against the trend in our State and elsewhere of limiting the vulnerability of final judgments to attack on grounds that the trial court lacked subject-matter jurisdiction. Further, such a result undermines respect for the finality of judgments, an anchoring principle of any functioning and efficient judicial system.

The Supreme Court further reasoned that its decision did not offend separation-of-powers principles by denying the Legislature its authority to waive sovereign immunity, explaining that sovereign immunity is a common-law creation, and it remains *the judiciary's* responsibility to

[4] 453 S.W.2d 812, 813 (Tex. 1970) (holding that statutes stating a governmental entity may "sue and be sued" resulted in a waiver of sovereign immunity), *overruled by Tooke v. City of Mexia*, 197 S.W.3d 325 (Tex. 2006).

define the boundaries of the doctrine. Finally, the Supreme Court rejected Engelman's plea on the equities, reasoning that "recognizing the continuing validity of the *Engelman I* judgment is hardly so inequitable or contrary to the public interest as to compel abandoning principles of res judicata and allowing Engelman to avoid that judgment" and "[r]equiring a party to comply with its contractual obligations, under the law prevailing at the time, does not strike us as a result so unfair as to demand an abdication of the ordinary rules of finality." Thus, although sovereign immunity implicates a court's subject-matter jurisdiction, "their contours are not co-extensive." Accordingly, the Supreme Court held that the *Engelman I* judgment could not be upended via collateral attack in a later proceeding.

2. Neither Section 551.142 of the Texas Open Meetings Act nor Section 252.061 of the Texas Local Government Code waives immunity from suit for declaratory relief, including a declaration that a construction contract is void because it was awarded in violation of statutory competitive-bidding requirements.

In *City of New Braunfels v. Carowest Land, Ltd.*, — S.W.3d — , 2017 WL 2857142 (Tex. App.—Austin 2017, no pet.), the Austin Court of Appeals considered whether a city was immune from suit on claims for declaratory relief, including a declaration that a construction contract was void because it was awarded in violation of competitive-bidding and other statutory requirements.

The City of New Braunfels undertook two construction projects, the South Tributary Regional Flood Control Project and the North Tributary Regional Flood Control Project, to address periodic flooding caused by the rivers flowing through New Braunfels. The projects involved construction of a drainage channel through land owned by Carowest Land, Ltd. The construction contract for the South Tributary Project was awarded to YC Partners, Ltd. d/b/a Yantis Company. Yantis also had submitted a sealed bid for the construction contract for the North Tributary Project. A dispute later arose, leading Carowest to file suit against the City and Yantis. In the ensuing litigation, the City and Yantis entered into a Rule 11 agreement whereby Yantis agreed to release the City from Yantis' asserted delay claim on the South Tributary Project if the City awarded Yantis the construction contract for the North Tributary Project. The Rule 11 agreement further provided that the offer would be withdrawn if the construction contract was not awarded to Yantis at the City Council meeting scheduled for that evening.

Not surprisingly, the contract for the North Tributary Project was awarded to Yantis, leading Carowest to amend its pleadings to assert claims for declaratory relief against both the City and Yantis. Carowest sought declarations that the construction contract for the North Tributary Project was void based upon the City's alleged violations of the Texas Open Meetings Act (TOMA), Chapter 551 of the Texas Government Code, as well as the competitive-bidding requirements in Section 252.043 of the Texas Local Government Code, requiring the contract to be awarded to the "lowest responsible bidder." Carowest asserted standing to complain about the contract award based upon Carowest's status as a "property tax paying resident" under Section 262.061(a) of the Local Government Code, and as a third-party beneficiary of the contract because the City had agreed to provide Carowest with fill from the North Tributary Project. Following a jury trial and then a bench trial on fees, costs, and expenses, the trial court entered a declaratory judgment in favor of Carowest declaring that the process by which the City awarded the contract for the North Tributary Project was improper, illegal, and in violation of the Texas Open Meetings Act, several provisions of the Local Government Code, several provisions of the Texas Penal Code, and public policy, and that the North Tributary contract was void. The trial

court also awarded Carowest attorney's fees, costs, and expenses jointly and severally against the City and Yantis. The City and Yantis appealed.

The Austin Court of Appeals held that, although both provisions provide an express statutory waiver of immunity, neither TEX. GOV'T CODE §551.142(a) nor TEX. LOC. GOV'T CODE §252.061 waives immunity from suit for declaratory relief. In *Zachry Construction Corp. v. Port of Houston Authority of Harris County*, 449 S.W.3d 98, 109-10 (Tex. 2014), the Texas Supreme Court clarified that the types of relief expressly made available by statute operate as the boundaries for a statute's waiver of immunity. Section 551.142(a) of TOMA authorizes "an interested person" to bring an action "by mandamus or injunction" to stop, prevent, or reverse a violation or threatened violation of this chapter by members of a governmental body. Similarly, Section 252.061 of the Local Government Code authorizes any property tax paying resident of the municipality to seek "injunctive relief" from the performance of a contract that is made "without compliance with this chapter." Thus, instructed by the Supreme Court's directive in *Zachry* in determining the scope of an express waiver, the Austin court concluded that Section 551.142 of TOMA and Section 252.061 of the Local Government Code set the boundaries of their waivers of immunity to the express relief provided in the statutes—injunctive and mandamus relief—and that neither statute extends the scope of waiver to include the declaratory relief that Carowest sought and the trial court awarded.

The Austin court further held that the "redundant remedies doctrine" served as a further bar to Carowest's claims for declaratory relief. In *Patel v. Texas Department of Licensing & Regulation*, 469 S.W.3d 69, 79 (Tex. 2015), the Texas Supreme Court explained that under the redundant remedies doctrine, courts do not have jurisdiction over a claim brought under the UDJA against a governmental entity "when the same claim could be pursued through different channels." The Austin court reasoned that, because the Legislature expressly waived immunity under Chapter 252 of the Local Government Code and TOMA, the "underlying nature" of Carowest's claims could have been brought directly against the City under those statutes, but Carowest chose not to avail itself of the available statutory channels for pursuing its claims, relying instead solely on the UDJA. Therefore, in this procedural context, the redundant remedies doctrine constituted an additional bar to Carowest's claims for declaratory relief against the City.

Finally, the Austin court also held that, because the trial court lacked subject-matter jurisdiction over Carowest's claims for declaratory relief against the City, the trial court also lacked jurisdiction to proceed solely against Yantis concerning the validity or legality of the North Tributary contract. The Austin court reasoned that, because the City is a party to the North Tributary contract, under Texas Rule of Civil Procedure 39 the City was an indispensable party to Carowest's claims for declaratory relief. Thus, it followed that the trial court lacked jurisdiction to enter declaratory judgment solely against Yantis as to the validity or legality of the North Tributary contract because the City "was an indispensable party in whose absence suit could not proceed." Further, a declaratory judgment requires a justiciable controversy as to the rights and status of parties actually before the court for adjudication, and the declaration sought must actually resolve the controversy. Without the City as a party, the trial court's declarations that the City violated TOMA and Chapter 252 of the Local Government Code would be advisory. Finally, Carowest did not have "taxpayer standing" to bring claims against Yantis, a private party; nor did the trial court have subject-matter jurisdiction to declare that Yantis had violated the Texas Penal Code to support the trial court's ultimate declaration that the North Tributary contract was void. Thus, the trial court lacked subject-matter jurisdiction over Carowest's claims for declaratory relief against both the City and Yantis.

3. Chapter 271 of the Texas Local Government Code does not waive immunity from suit seeking specific performance of a contract.

In *City of San Antonio v. Hays Street Bridge Restoration Group*, No. 04-14-00886-CV, 2017 WL 776112 (Tex. App.—San Antonio Mar. 1, 2017, pet. filed) (mem. op.), the San Antonio Court of Appeals considered whether a city was immune from suit on claims seeking specific performance of a contract to develop a park.

In response to discussions about demolishing and replacing or relocating the Hays Street Bridge, a number of community groups and leaders formed the Hays Street Bridge Restoration Group, whose goal was to restore and preserve the Bridge for community use. The Group entered into discussions with the City of San Antonio about restoring the Bridge and also developing property near the Bridge, called the "Cherry Street Property," as a park. The City and the Group later entered into a Memorandum of Understanding outlining the parties' responsibilities with regard to fundraising for the bridge-restoration project. The Group subsequently focused on raising funds to fulfill its obligations under the Memorandum, and the Group's efforts included obtaining the Cherry Street Property for park use. The Property's owner donated the Cherry Street Property to the City, but the City sold the Property to Alamo Beer Company for commercial use. The City took the position that the Cherry Creek Property was not part of the Hays Street Bridge project; rather, the project was solely for purposes of restoring the Bridge, not for developing a park.

The Hays Street Bridge Restoration Group filed suit against the City, alleging that the City breached the Memorandum of Understanding by failing to develop the Cherry Street Property as a park, and seeking specific performance. The City filed a plea to the jurisdiction, asserting that its immunity from suit had not been waived because Chapter 271 of the Local Government Code does not waive immunity from suit on a breach-of-contract claim seeking specific performance. The trial court denied the plea to the jurisdiction and, following a jury trial, rendered judgment against the City ordering specific performance in accordance with the Memorandum of Understanding. The City appealed.

The San Antonio Court of Appeals held that Chapter 271 of the Texas Local Government Code does not waive immunity from suit on a breach-of-contract claim seeking specific performance. In *Zachry Construction Corp. v. Port of Houston Authority of Harris County*, 449 S.W.3d 98, 109 (Tex. 2014), the Texas Supreme Court held that the scope of the waiver of immunity in Section 271.152 of the Local Government Code is limited by the damages provided in Section 271.153. The San Antonio court reasoned that Section 271.153 of the Local Government Code plainly defines the type of awards a party may recover (i.e., for which immunity is waived): subsection (a) sets out the types of awards available to a party, while subsection (b) excludes the types of awards available to a party. "There is nothing in the plain language of section 271.153 that provides for a waiver of immunity from a suit seeking to impose specific performance for breach of a contract."[5] Resolving any ambiguities in favor of immunity, the San Antonio court concluded that by not permitting the recovery of specific performance,

[5] The San Antonio court clarified that it applied the version of TEX. LOC. GOV'T CODE §271.153 in effect at the time the Group filed suit against the City, in December 2012. 2017 WL 776112, at *4. Notably, in 2013, the statute was amended to allow for the recovery of specific performance in breach-of-contract claims concerning the sale or delivery of certain reclaimed waters. *Id*. at n.3. However, that amendment was inapplicable to this case because it took effect on June 14, 2013, and applies only to contracts executed on or after that date. *Id*.

Chapter 271 of the Local Government Code does not clearly or unambiguously waive immunity from suit for claims seeking specific performance of a contract.

The San Antonio court further held that the Group was not entitled to amend its petition, as repleading could not cure the jurisdictional defect. Citing *Wasson Interests, Ltd. v. City of Jacksonville*, 489 S.W.3d 427 (Tex. 2016), which held that a city does not have immunity from suit for proprietary acts, the Group argued it should be afforded an opportunity to demonstrate how the City's functions under the Memorandum of Understanding were proprietary. The San Antonio court disagreed, explaining that the Texas Tort Claims Act lists 36 functions as governmental, including "bridge construction and maintenance" and "community development or urban renewal activities." The San Antonio court concluded that these functions described the City's obligations as set forth in the Memorandum of Understanding. The City agreed to ensure the funds generated by the Group were dedicated to the Hays Street Bridge project—in other words, the restoration of the Hays Street Bridge, even assuming that project included park development. Accordingly, the mere pleading of more facts would not overcome the governmental nature of the City's functions under the Memorandum. Therefore, because its functions under the Memorandum were purely governmental, the City was immune from suit.

4. Section 252.061 of the Texas Local Government Code waives immunity from suit for claims for injunctive relief brought by an aggrieved bidder, but only if the contract is for the construction of a public work.

In *City of Austin v. Utility Associates, Inc.*, 517 S.W.3d 300 (Tex. App.—Austin 2017, pet. denied), the Austin Court of Appeals considered whether a city and city manager were immune from suit on claims seeking injunctive relief and declaratory relief, including a declaration that a procurement contract was void because it was awarded in violation of competitive-bidding requirements.

After requesting and evaluating proposals through what it represented to be an objective, competitive process, the City of Austin awarded and later executed a $12.2 million contract to Taser International, Inc. for the provision of body-worn cameras for use by the Austin Police Department. One of the other bidders for the contract, Utility Associates, Inc., accused City staff of manipulating or corrupting the selection process to favor Taser. Utility unsuccessfully protested the award through the City's internal administrative process, and then filed suit against the City and the City Manager in her official capacity. A resident City taxpayer, V. Bruce Evans, later joined the lawsuit as a plaintiff. Utility and Evans asserted claims for injunctive relief and declaratory relief; essentially, they sought to establish that the contract award to Taser was void due to the City's violation of the competitive-bidding requirements set forth in Chapter 252 of the Texas Local Government Code, and that the procurement contract should instead be awarded to Utility as the highest scoring responsible offeror once the award to Taser was invalidated. Utility and Evans then obtained a temporary injunction barring the City Defendants from performing any of their obligations arising under or in furtherance of the contract with Taser.

The City Defendants filed pleas to the jurisdiction, asserting that their immunity from suit barred Utility's and Evans's claims for both injunctive relief and declaratory relief. The City Defendants further asserted that, to the extent they were not already barred by governmental immunity, Utility's and Evans's claims seeking declaratory relief were jurisdictionally barred as remedies redundant of the relief available under Section 252.061 of the Local Government Code. The trial court granted the City Defendants' plea to the extent of dismissing all of Utility's and Evans's claims seeking declaratory relief. However, the trial court denied the City Defendants' plea as to Utility's and Evans's claims seeking injunctive relief. Both sides appealed. On appeal,

Utility and Evans asserted that their claims for declaratory relief fell within the *ultra vires* doctrine and, therefore, did not implicate the City Defendants' governmental immunity; and that Section 252.061 of the Local Government Code waived the City Defendants' immunity from suit in any event.

The Austin Court of Appeals held that the sole claim coming within the waiver of immunity set forth in Section 252.061 of the Texas Local Government Code was Evans's claim seeking an injunction barring the City Defendants from performing any aspect of the contract with Taser. The Austin court first considered whether Utility's and Evans's claims implicated governmental immunity, holding that even if Utility and Evans had asserted facts that would constitute conduct *ultra vires* of the City Defendants' decision-making authority, their claims nevertheless implicated the City Defendants' governmental immunity because they sought relief that was retrospective in nature—they sought effectively to undo a contract award previously approved by the City Council, invalidate an already-executed contract between the City and Taser, reopen the previously concluded procurement process, and compel the City Defendants to re-award the contract to Utility instead. Accordingly, Utility and Evans could establish the trial court's subject-matter jurisdiction only through reliance on a legislative waiver of immunity.

The Austin court next considered the extent to which Utility's and Evans's claims for injunctive relief fell within the waiver of immunity set forth in Section 252.061 of the Local Government Code. Section 252.061 creates a right of action that is made subject to three requirements and limitations:

- *first*, Section 252.061 authorizes a claim for relief on grounds that "the contract [was] made without compliance with this chapter";
- *second*, Section 252.061 authorizes the action to be brought only by two categories of potential plaintiffs: (1) "any property tax paying resident of the municipality" or (2) "a person who submitted a bid for a contract for which the competitive sealed bidding requirement applies, regardless of residency, if the contract is for the construction of public works"; and
- *third*, assuming an eligible plaintiff can prove that "the contract [was] made without compliance with this chapter," Section 252.061 prescribes that said contract is "void" and authorizes the following remedy: "the performance of the contract, including the payment of any money under the contract, may be enjoined."

The Austin court held that only Evans's claim seeking an injunction barring the City Defendants from performing under the contract with Taser was within the scope of the waiver. Although Evans satisfied the resident taxpayer "standing" requirement set forth in the statute, the injunctive relief authorized by Section 252.061 extends only to barring performance of an improperly procured contract, and makes no mention of a further remedy of re-awarding the contract to another bidder. Further, Utility lacked standing to pursue even the injunctive relief expressly permitted by Section 252.061—Utility was neither a resident taxpayer, nor was the contract at issue "for the construction of public works." Accordingly, the remainder of Evans's claims for injunctive relief, as well as all claims for injunctive relief asserted by Utility, were barred by governmental immunity.

Finally, the Austin court considered whether the trial court had jurisdiction over Utility's and Evans's claims for declaratory relief, ultimately holding that it did not. As noted, Section 252.061 expressly authorizes only injunctive relief, not declaratory relief. Further, the declarations sought by Utility and Evans were each legal conclusions already subsumed in the

cause of action for injunctive relief that Section 252.061 creates and, therefore, Evans was not permitted to use the UDJA as a means of obtaining attorney's fees incident to his permissible claim under Section 252.061 for an injunction. Thus, the Austin court held that Utility's and Evans's claims for declaratory relief were all barred by governmental immunity.

5. A building inspector who performs inspection services on a part-time basis for a city may qualify as a governmental employee entitled to immunity from suit under the election-of-remedies provision of the Texas Tort Claims Act, CPRC §101.106(f).

In *Fryday v. Michaelski*, — S.W.3d — , 2017 WL 6045567 (Tex. App.—Houston [14th Dist.] 2017, no pet. h.), the Houston (Fourteenth) Court of Appeals considered whether a building inspector who performed inspection services on a part-time basis for a city was a city employee entitled to immunity from suit under the election-of-remedies provision of the Texas Tort Claims Act, CPRC §101.106(f).

A homeowner sued Jack Fryday d/b/a Fryday Consulting Services, Inc. after Fryday allegedly performed faulty building inspection work when he inspected her rental home. The homeowner asserted claims for negligence and DTPA violations, alleging that Fryday was hired by the City of Clear Lake Shores to inspect her rental home and that, because of Fryday's faulty inspection, she incurred expenses to comply with higher building-standard requirements, she was deprived of rental income for the lower level of her rental home, and the value of her rental home decreased. Fryday filed a motion to dismiss, contending that he was entitled to immunity from suit as an employee of a governmental unit pursuant to the election-of-remedies provision of the Texas Tort Claims Act, CPRC §101.106(f). The homeowner opposed the motion to dismiss, disputing Fryday's status as an employee of the City, and asserting that he was merely an independent contractor. The trial court denied Fryday's motion to dismiss, and Fryday appealed.

A divided panel of the Houston (Fourteenth) Court of Appeals held that the evidence conclusively established that Fryday was an employee of the City as defined by the Texas Tort Claims Act and, therefore, he was entitled to dismissal pursuant to CPRC §101.106(f). Justice Boyce authored the majority opinion, joined by Justice Brown. The majority first examined the election-of-remedies provision of the Texas Tort Claims Act, CPRC §101.106(f), which provides as follows:

> If a suit is filed against an employee of a governmental unit based on conduct within the general scope of that employee's employment and if it could have been brought under [the Texas Tort Claims Act] against the governmental unit, the suit is considered to be against the employee in the employee's official capacity only. On the employee's motion, the suit against the employee shall be dismissed unless the plaintiff files amended pleadings dismissing the employee and naming the governmental unit as defendant on or before the 30th day after the date the motion is filed.

CPRC §101.001(2) further defines the term "employee" as follows:

> a person, including an officer or agent, who is in the paid service of a governmental unit by competent authority, but does not include an independent contractor, an agent or employee of an independent contractor, or a person who performs tasks the details of which the governmental unit does not have the legal right to control.

Because all other relevant issues were undisputed[6], the majority considered only whether Fryday was a City employee at the time he inspected the homeowner's rental home.

The majority ultimately held that the evidence, chiefly consisting of Fryday's declaration, conclusively established that he was "in the paid service of a governmental unit" in August 2014 when he inspected the rental home, as required by CPRC §101.001(2). The majority reasoned that Fryday's declaration showed the City had paid him between August 2009 and May 2016 for his services as a City Building Official performing building inspection services and reviewing building permit applications for the City; that he submitted timesheets and was paid for the hours he worked; that the City neither hired nor paid his company "J Fryday Consulting Services"; and that Fryday did not have a "contract to work as an independent contractor for the City."

The majority further held that, even if the City did not have the legal right to control all of Fryday's work as a City Building Official performing building-inspection services, that did not necessarily exclude him from the statutory definition of "employee." Citing *Murk v. Scheele*, 120 S.W.3d 865, 867 (Tex. 2003) (per curiam), the majority explained that the Tort Claims Act's definition of "employee" does not require that a governmental unit control *every* detail of a person's work. Fryday's declaration stated that, because the work did not require his full time, he "performed all of the responsibilities of the office of Building Official" whenever he was called upon or instructed to do so, and he "reported directly to the City Administrator if any issues arose." Fryday's declaration additionally established that he maintained an office at City Hall and shared an assistant with the City Secretary. Fryday further explained in his declaration that he advised the City of his opinion regarding "whether plans or proposals complied with applicable building codes, regulations, or ordinances" but that his "review and interpretations were subject to review by the Board of Adjustment, and the City Council." Thus, according to the majority, Fryday's evidence conclusively established that he was an employee of the City as defined by the Texas Tort Claims Act, and the trial court erred in denying his motion to dismiss under CPRC §101.106(f).

Justice Jamison authored a dissenting opinion, explaining that Fryday's declaration merely provided *some* evidence related to his employment status, and failed to conclusively establish whether he performs tasks the details of which the City does not have a legal right to control. She would have affirmed the denial of Fryday's motion to dismiss on that basis.

6. A governmental employee's right to dismissal under the election-of-remedies provision of the Texas Tort Claims Act, CPRC §101.106(e), is not impaired by later amendments to the plaintiff's pleadings or to the defendant's motion to dismiss.

In *University of Texas Health Science Center v. Rios*, — S.W.3d — , 2017 WL 6396028 (Tex. 2017), the Texas Supreme Court considered whether a governmental employee's right to dismissal under the election-of-remedies provision of the Texas Tort Claims Act, CPRC §101.106(e), is impaired by later amendments to the plaintiff's pleadings or to the defendant's motion to dismiss.

[6] According to the majority, it was undisputed that the City is a governmental unit; that the homeowner's claims could have been brought against the City under the Texas Tort Claims Act; and that, if Fryday was determined to be a City employee, then his conduct was within the scope of his employment with the City to provide building-inspection services. 2017 WL 6045567, at *3.

A first-year resident at the University of Texas Health Science Center at Houston filed suit against the Center and four faculty physicians (the "Doctors"), alleging that together they had taken steps to discredit his reputation and harm his future as a doctor and had published false and misleading statements about him to the Texas Medical Board. The plaintiff asserted tort claims against all defendants, alleging that the Center, separately and through the Doctors, had tortiously interfered with his contract with the Center and with future business relationships; and that the Center and the Doctors had defamed him. The plaintiff also asserted a breach-of-contract claim against the Center. The Center and the Doctors filed a motion to dismiss all but the tort claims against the Center, asserting that the breach-of-contract claim against the Center was barred by sovereign immunity, and that the tort claims against the Doctors were required to be dismissed under CPRC §101.106(e) because the plaintiff had sued both a governmental unit and its employees.

The plaintiff subsequently amended his petition to nonsuit his tort claims against the Center, leaving the Doctors as the only tort defendants. The Center and the Doctors then amended their motion to dismiss to refer to the plaintiff's amended petition, but they did not alter in substance their argument for dismissal of the tort claims against the Doctors under CPRC §101.106(e). The trial court dismissed the plaintiff's breach-of-contract claim against the Center, but denied dismissal of the tort claims against the Doctors. On interlocutory appeal, a divided panel of the court of appeals affirmed. Before the Texas Supreme Court, the plaintiff argued that by amending their motion to dismiss, the Doctors lost their right to seek dismissal of the tort claims originally asserted against both them and the Center.

The Texas Supreme Court held that a governmental employee's right to dismissal under CPRC §101.106(e) is not impaired by later amendments to the plaintiff's pleadings or to the defendant's motion to dismiss. The Supreme Court first considered the effect of the plaintiff's amended petition on the Doctors' original motion to dismiss. CPRC §101.106(e) states:

> "If a suit is filed under [the Texas Tort Claims Act] against both a governmental unit and any of its employees, the employees shall immediately be dismissed on the filing of a motion by the governmental unit."

Thus, under CPRC §101.106(e), when the Doctors filed their original motion to dismiss, they were entitled to dismissal of the tort claims asserted against both them and the Center. Further, the filing of an amended petition did not affect the Doctors' right to dismissal under CPRC §101.106(e). Citing *Austin State Hospital v. Graham*, 347 S.W.3d 298, 301 (Tex. 2011) (per curiam), the Supreme Court reasoned that a plaintiff's nonsuit following a motion to dismiss does not operate to deny the movant a ruling on its motion. Thus, following the plaintiff's amended petition, the Doctors remained entitled to dismissal of the tort claims asserted against the Doctors in the original petition, as requested in the Doctors' original motion to dismiss.

The Supreme Court next considered the effect of the Doctors' amended motion to dismiss. Relying upon Rule 65 of the Texas Rules of Civil Procedure, the plaintiff argued that when the Doctors filed an amended motion to dismiss, their original motion "ceased to exist"; at that point, the plaintiff's only tort claims were those in his amended petition, which were no longer asserted against the Center and, thus, not subject to dismissal under CPRC §101.106(e). The Supreme Court disagreed; assuming, without deciding, that Rule 65 applies to motions, the Supreme Court held that Rule 65 does not affect the right to dismissal under CPRC §101.106(e) for two reasons. First, it is *the filing* of a motion to dismiss, not its content, that triggers the right to dismissal under CPRC §101.106(e). Second, if Rule 65 is inconsistent with CPRC §101.106(e), the statute prevails. Accordingly, the filing of the original motion to dismiss

accrued the Doctors' right to dismissal from the lawsuit. The plaintiff could not avoid this result by amending his petition to drop the tort claims against the Center; nor did the Doctors' amended motion to dismiss vitiate their already-triggered statutory right to dismissal under CPRC §101.106(e).

7. A contract for the construction of wastewater systems constitutes a contract for goods or services covered by the statutory waiver of immunity set forth in Chapter 271 of the Texas Local Government Code.

In *NBL 300 Group Ltd. v. Guadalupe-Blanco River Authority*, — S.W.3d — , 2017 WL 3495132 (Tex. App.—San Antonio 2017, no pet.), the San Antonio Court of Appeals considered whether a contract between a local governmental entity and a contractor entailed the provision of goods or services to the local governmental entity and, therefore, was covered by the statutory waiver of immunity found in Chapter 271 of the Texas Local Government Code.

NBL 300 Group Ltd., a developer, was in the process of developing a group of properties. As part of the development process, NBL and Guadalupe-Blanco River Authority (GBRA) entered into an agreement for the construction of wastewater systems; specifically, a "wet well" and "lift station." Pursuant to the contract, NBL was to provide and oversee/arrange for the engineering, design, and construction of various improvements to the properties in question. In return, GBRA was to provide reimbursements for connections made to the wet well and lift station, and to establish the rates for connection to the wastewater project. NBL later filed suit against GBRA, asserting a claim for breach of contract, among other claims. GBRA filed a plea to the jurisdiction, asserting that NBL failed to demonstrate a valid legislative waiver of immunity. The trial court granted GBRA's plea to the jurisdiction and dismissed NBL's claims in their entirety, and NBL appealed.

The San Antonio Court of Appeals held that the contract between GBRA and NBL entailed the provision of goods or services to GBRA and, therefore, was covered by the statutory waiver of immunity found in Chapter 271 of the Texas Local Government Code. Section 271.152 of the Local Government Code provides as follows:

> A local governmental entity that is authorized by statute or the constitution to enter into a contract and that enters into a contract subject to this subchapter waives sovereign immunity to suit for the purpose of adjudicating a claim for breach of the contract, subject to the terms and conditions of this subchapter.

For a contract to be subject to the waiver of immunity set forth in Section 271.152, it (1) must be in writing, (2) state the essential terms of the agreement, (3) provide for goods or services, (4) to the local governmental entity, and (5) be executed on behalf of the local governmental entity. Citing *Kirby Lake Development, Ltd. v. Clear Lake City Water Authority*, 320 S.W.3d 829, 836 (Tex. 2010), the San Antonio court reasoned that although Chapter 271 provides no definition for the term "services," the term is generally "broad enough to encompass a wide array of activities." In ordinary usage the term "services" has a rather broad and general meaning, and it includes "generally any act performed for the benefit of another under some arrangement or agreement whereby such act was to have been performed." Here, the contract between GBRA and NBL outlined NBL's obligations to construct a wastewater collection system; contemplated that NBL would propose a master plan, including design, permitting, acquisition, and construction of the facilities; and made NBL responsible for engineering and permitting fees. Citing several opinions involving construction contracts, the San Antonio court concluded that, on its face, the parties'

contract set forth goods or services.[7] Accordingly, the trial court erred in granting GBRA's plea to the jurisdiction in relation to NBL's breach-of-contract claim.

8. Contract for property-restoration services stated all essential terms, such that it qualified as a contract subject to the statutory waiver of immunity set forth in Chapter 271 of the Texas Local Government Code.

In *Clear Creek Independent School District v. Cotton Commercial USA, Inc.*, 529 S.W.3d 569 (Tex. App.—Houston [14th Dist.], 2017, pet. filed), the Houston (Fourteenth) Court of Appeals considered whether a contract for property-restoration services stated all essential terms, such that it qualified as a contract subject to the statutory waiver of immunity set forth in Chapter 271 of the Texas Local Government Code.

Clear Creek ISD entered into a Restoration Service Agreement with Cotton USA to perform restoration and remediation services following Hurricane Ike. The Restoration Agreement stated that Cotton would provide a "scope of services" in a written estimate, but Cotton never did so. In addition, the Restoration Agreement authorized the use of subcontractors Cotton deemed necessary for completion of the work. Cotton subcontracted with Cottonwood Debris Company, LLC, a company owned by Cotton's principals, to provide debris-removal services. A payment dispute arose regarding the debris-removal services that were performed under the Restoration Agreement, leading CCISD to file suit against Cotton Commercial USA, Inc., the surviving entity after Cotton and Cottonwood merged, asserting claims for fraud and money had and received. Cotton Commercial moved to compel arbitration based upon the arbitration agreement in the Restoration Agreement, and stated it would assert a breach-of-contract counterclaim against CCISD in the arbitration proceeding, which it did. After a prior interlocutory appeal, the parties proceeded to arbitration as to their respective claims against one another. The arbitrator ultimately issued an award in favor of Cotton Commercial, awarding Cotton Commercial damages and interest for CCISD's breach of the Restoration Agreement.

Cotton Commercial filed a motion to confirm the arbitration award, while CCISD moved to vacate the award and filed a plea to the jurisdiction. The trial court denied CCISD's motion to vacate and plea to the jurisdiction, confirmed the arbitration award, and entered judgment in Cotton Commercial's favor. On appeal, CCISD asserted that the trial court lacked subject-matter jurisdiction to confirm the arbitration award because the statutory waiver of immunity set forth in Section 271.152 of the Texas Local Government Code did not apply. According to CCISD, the Restoration Agreement lacked an essential term because it contained no scope of work and, therefore, the Restoration Agreement was not a "contract subject to this subchapter" under Section 271.151(2).

[7] 2017 WL 3495132, at *3 (citing *Ben Bolt-Palito Blanco Consol. Indep. Sch. Dist. v. Tex. Political Subdiv. Prop./Cas. Joint Self-Ins. Fund*, 212 S.W.3d 320, 327 (Tex. 2006) (concluding that constructing, developing, leasing, and bearing all risk of loss or damage to the facilities provides a service); *Town of Flower Mound v. Rembert Enters., Inc.*, 369 S.W.3d 465, 473-74 (Tex. App.—Fort Worth 2012, pet. denied) (concluding services included constructing road; designing and constructing the Right-Turn Lane; and working with TxDOT concerning the location, alignment, design, and construction); *City of N. Richland Hills v. Home Town Urban Partners, Ltd.*, 340 S.W.3d 900, 908-09 (Tex. App.—Fort Worth 2011, no pet.) (holding agreement to hire third-party contractors, among other things, constituted provision of services to city).

The Houston (Fourteenth) Court of Appeals held that the Restoration Agreement was a contract subject to Chapter 271 of the Texas Local Government Code and, therefore, CCISD's immunity from suit was waived for the purpose of adjudicating Cotton Commercial's counterclaim for breach of the Restoration Agreement. Section 271.152 of the Local Government Code waives governmental immunity from suit for certain breach-of-contract claims. Section 271.151(2)(A) provides that a contract must, among other requirements, state the essential terms of the agreement to qualify as a contract subject to Section 271.152's waiver of immunity. According to CCISD, the Restoration Agreement lacked an essential term because it did not include "a written description of the work to be performed," but the Houston court disagreed. The Houston court held that the "service to be rendered" is an essential term of a contract for the purposes of Section 271.151(2)(A) of the Local Government Code. Because the statutory waiver cannot apply unless the purported agreement is one for "goods or services," the Houston court explained "it is essential that the performance to be provided is stated in the agreement."

The Houston court additionally held that the services described in the Restoration Agreement were sufficiently definite to make the Restoration Agreement an enforceable contract. Drawing guidance from the Texas Supreme Court's decision in *Fischer v. CTMI, L.L.C.*, 479 S.W.3d 231 (Tex. 2016), the Houston court reasoned that, despite its lack of detailed specificity, the Restoration Agreement nevertheless met the "low threshold" of an agreement for services that states all essential terms and is therefore enforceable. The Restoration Agreement outlined the parties, the subject matter, and the parties' basic obligations, including a "sufficiently definite" description of the services to be provided, such that a court could understand the parties' obligations. Accordingly, the Houston court held that the trial court possessed subject-matter jurisdiction to confirm the arbitration award.

9. Section 271.153 of the Texas Local Government Code authorizes the award of pre- and postjudgment interest in a breach-of-contract suit against a governmental entity.

In *Clear Creek Independent School District v. Cotton Commercial USA, Inc.*, 529 S.W.3d 569 (Tex. App.—Houston [14th Dist.], 2017, pet. filed), the Houston (Fourteenth) Court of Appeals also considered whether Section 271.153 of the Texas Local Government Code authorizes the award of pre- and postjudgment interest in a breach-of-contract suit against a governmental entity.

As noted above, the arbitrator issued an award in favor of Cotton Commercial, awarding Cotton Commercial damages and both pre- and postjudgment interest for CCISD's breach of the Restoration Agreement. On appeal, CCISD argued that the trial court lacked subject-matter jurisdiction to confirm the portion of the arbitrator's award regarding interest. According to CCISD, even if its immunity from suit for breach of contract had been waived, its immunity from suit for an award of pre- and post-judgment interest had not been waived.

The Houston (Fourteenth) Court of Appeals held that Section 271.153 of the Texas Local Government Code authorizes the award of pre- and postjudgment interest in a breach-of-contract suit against a governmental entity. Section 271.153(a) of the Local Government Code provides that the total amount of money awarded in an adjudication brought against a local governmental entity for breach of contract is limited to the balance owed under the contract (plus any amount owed for additional work performed), attorneys' fees, and "interest as allowed by law." CCISD argued that, because neither the Restoration Agreement nor a specific statute expressly permits an award of interest, the award of interest must sound in equity, and because a school district is immune to equitable claims, the award of interest is barred by immunity. But the Houston court

disagreed, explaining "Section 271.153 waives CCISD's immunity to an award of interest in breach of contract suits because such interest is allowed by law."

The Houston court additionally observed that, in *Dallas Area Rapid Transit v. Agent Systems, Inc.*, No. 02-12-00517-CV, 2014 WL 6686331, at *16 (Tex. App.—Fort Worth Nov. 26, 2014, pet. denied) (mem. op.), the Fort Worth Court of Appeals rejected the argument made by CCISD here, and held that Section 271.153 authorizes pre-judgment interest in breach-of-contract suits against a governmental entity. Citing *Zachry Construction Corp. v. Port of Houston Authority*, 449 S.W.3d 98, 110 (Tex. 2014) and other opinions[8], the Houston court expressly agreed with the Fort Worth court. Accordingly, the Houston court held that the trial court possessed subject-matter jurisdiction to confirm the portion of the arbitrator's award regarding pre- and postjudgment interest.

10. Even though an economic development corporation is not a political subdivision of the state (and, thus, is not inherently entitled to immunity *from suit*), an economic development corporation may be entitled to immunity *from liability* if it performs the governmental functions of a Type B corporation.

In *City of Leon Valley Economic Development Corp. v. Little*, 522 S.W.3d 6 (Tex. App.—San Antonio 2017, pet. filed), the San Antonio Court of Appeals considered whether an economic development corporation had performed the governmental functions of a Type B corporation in its dealings with a commercial real estate developer and, therefore, was entitled to immunity from liability under Section 505.106(a) of the Texas Local Government Code.

Leon Valley Economic Development Corporation (LVEDC) is a Type B economic development corporation created by the City of Leon Valley to promote economic growth and development in the City. The City and LVEDC began considering the development of a "Town Center" to attract and retain business in the City, and LVEDC started discussions with a local commercial real estate developer, Larry Little, about the Town Center project. LVEDC and the Leon Valley city council thereafter approved a project plan for Little to develop the property, and LVEDC and Little engaged in negotiations over the terms of a Development Agreement. However, the Development Agreement was never finalized and signed, and the Town Center project eventually fell through.

Little filed suit against LVEDC for breach of contract, alleging that he and LVEDC reached enforceable oral agreements that LVEDC would acquire and give him three parcels of property, and that he would develop and own the entire Town Center project. In a prior interlocutory appeal, the San Antonio Court of Appeals held that, because an economic development corporation is not a political subdivision of the state, it is not inherently entitled to governmental immunity from suit; and that Section 505.106 of the Texas Local Government Code does not grant a Type B economic development corporation immunity from suit.[9] Thus, the trial court subject-matter jurisdiction over the case because LVEDC was not immune from suit. On remand, Little's breach-of-contract claims were tried to a jury, and the trial court ultimately

[8] 529 S.W.3d at 586-87 (citing *City of San Antonio v. Hays Street Bridge Restoration Grp.*, No. 04-14-00886-CV, 2017 WL 776112, at *5 (Tex. App.—San Antonio Mar. 1, 2017, pet. filed) (mem. op.); *County of Galveston v. Triple B Servs., LLP*, 498 S.W.3d 176, 188 (Tex. App.—Houston [1st Dist.] 2016, pet. denied)).

[9] *City of Leon Valley Econ. Dev. Corp. v. Little*, 422 S.W.3d 37, 42, 43-45 (Tex. App.—San Antonio 2013, no pet.).

entered a judgment against LVEDC awarding Little damages. On appeal, LVEDC argued that, pursuant to Section 505.106(a) of the Texas Local Government Code, it was immune from liability for all damages arising from its pursuit of the Town Center project.

The San Antonio Court of Appeals held that LVEDC had performed the governmental functions of a Type B corporation in its dealings with Little and, therefore, was entitled to immunity from liability under Section 505.106(a) of the Texas Local Government Code. Section 505.106(a) of the Local Government Code provides:

> (a) The following are not liable for damages arising from the performance of a governmental function of a Type B corporation or the authorizing municipality:
> (1) the corporation;
> (2) a director of the corporation;
> (3) the municipality;
> (4) a member of the governing body of the municipality; or
> (5) an employee of the corporation or municipality.

Thus, under Section 505.106(a), LVEDC was immune from liability for damages arising from its "performance of a governmental function of a Type B corporation." Citing *Gates v. City of Dallas*, 704 S.W.2d 737, 738-39 (Tex. 1986), the San Antonio court explained that an entity performs governmental functions when it acts "as the agent of the State in furtherance of general law for the interest of the public at large." The San Antonio court concluded that actions undertaken by a Type B economic development corporation pursuant to the Development Corporation Act of 1979[10] to develop projects authorized by the Act are governmental functions. The San Antonio court further concluded that LVEDC was performing the governmental functions of a Type B corporation in its dealings with Little that were directed toward bringing the Town Center project to fruition, reasoning that the Town Center project and proposed expenditures were authorized by the Development Corporation Act; the project was approved by resolution of the Leon Valley city council; the proposed funding of the property purchases and repayment of the loan with 4B sales tax proceeds were authorized by law; and the specifics of LVEDC's commitment to and interest in the project and Little's obligations to develop the project were being negotiated in a written Development Agreement, all as expressly provided for in various provisions of the Development Corporation Act.

The San Antonio court additionally rejected Little's argument that LVEDC was not performing governmental functions of a Type B corporation because it was not acting in the public interest, but rather primarily for the good of a private individual because LVEDC was to give him property and he, a private individual, would have reaped the financial benefit from the project. Little's argument failed to consider that one of the purposes of the Development Corporation Act is to promote and encourage business enterprises and economic development because, although it may benefit private interests, it also benefits the general public welfare. The Town Center project was intended and expected to revitalize the specific Town Center area, create jobs, and expand the tax base. Moreover, the Development Corporation Act expressly provides that a corporation may provide direct financial incentives to a private business enterprise, provided there is a performance agreement to ensure performance and protect the development corporation's investment.

[10] TEX. LOC. GOV'T CODE §§501.001-507.202.

Likewise, the San Antonio court rejected Little's argument that LVEDC was performing a proprietary, not governmental, function in its dealings with him because Section 505.102 of the Local Government Code did not authorize LVEDC to contract with an individual. Although Section 505.102 authorizes contracts with other economic development corporations, it does not prohibit contracting with individuals. Moreover, other sections of the Development Corporation Act clearly contemplate that economic development corporations will have business dealings and enter into contracts with "users," "business enterprises," and "persons." Therefore, because LVEDC was performing the governmental functions of a Type B corporation in its dealings with Little regarding the Town Center project, the San Antonio court held that LVEDC was immune from any liability arising from the performance of those functions.

11. Compliance with pre-suit notice provisions incorporated into a contract pursuant to Section 271.154 of the Texas Local Government Code is an affirmative defense to the merits of the suit, not a matter that deprives the trial court of subject-matter jurisdiction.

In *Romulus Group, Inc. v. City of Dallas*, No. 05-16-00088-CV, 2017 WL 1684631 (Tex. App.—Dallas May 2, 2017, pet. filed) (mem. op.), the Dallas Court of Appeals considered whether compliance with a pre-suit notice provision incorporated into the contract pursuant to Section 271.154 of the Texas Local Government Code constituted a jurisdictional prerequisite to the filing of suit.

The City of Dallas contracted with Romulus Group, Inc. to provide temporary clerical and professional labor. The parties' contract incorporated the notice provisions of section 2-86 of the Dallas City Code, which provides that

> A person may not file or maintain a lawsuit…to recover damages for the city's breach of a city contract unless, as a condition precedent and a jurisdictional prerequisite to the filing of the lawsuit…the person files a notice of claim…not later than 180 days after the date of occurrence of the event that gives rise to the breach of contract claim….

A dispute later arose, leading the City to terminate its contract with Romulus. When the City failed to pay Romulus for its services, Romulus filed suit against the City for breach of contract. The City filed a plea to the jurisdiction asserting, among other grounds, that Romulus failed to demonstrate it complied with the "jurisdictional prerequisite" of giving timely notice of its breach-of-contract claim and, therefore, the trial court lacked subject-matter jurisdiction over the claim. The trial court granted the City's plea to the jurisdiction, and Romulus appealed. On appeal, Romulus asserted that its compliance with the pre-suit notice provision was merely an affirmative defense to its breach-of-contract claim as opposed to a jurisdictional requirement.

The Dallas Court of Appeals held that Romulus' compliance with the pre-suit notice provision was not a jurisdictional requirement, but rather an affirmative defense to the merits of its breach-of-contract claim. The notice provision was incorporated into the contract pursuant to Section 271.154 of the Texas Local Government Code, which provides as follows:

> Adjudication procedures, including requirements for serving notices or engaging in alternative dispute resolution proceedings before bringing a suit or an arbitration proceeding, that are stated in the contract subject to this subchapter or that are established by the local governmental entity and expressly incorporated

> into the contract or incorporated by reference are enforceable except to the extent those procedures conflict with the terms of this subchapter.

Citing its prior decision in *City of Mesquite v. PKG Contracting, Inc.*, 263 S.W.3d 444, 447 (Tex. App.—Dallas 2008, pet. denied), the Dallas court reasoned that the notice provision in Section 271.154 of the Local Government Code is an affirmative defense to the merits of the suit, not a matter that deprives the trial court of subject matter jurisdiction.

The Dallas court additionally rejected the City's argument that *Zachry Construction Corp. v. Port of Houston Authority of Harris County*, 449 S.W.3d 98 (Tex. 2014) rendered the holding in *City of Mesquite* invalid. In *Zachry*, the Supreme Court explained that the "subject to the terms and conditions" phrase in Section 271.152 of the Local Government Code incorporates other provisions of the Act to define the scope of its waiver of immunity. As the Supreme Court wrote:

> The waiver does not extend to tort suits, suits in federal court, or allow recovery beyond that permitted in Section 271.153. But Section 271.152, as qualified by this "subject to" phrase also does not preclude other defenses or other contractual procedures, or confer immunity or suggest joint enterprise.

According to the Dallas court, the "contractual procedures" language is a reference to Section 271.154 of the Local Government Code, which provides for enforcement of contractual adjudication procedures. "In other words, the waiver of immunity is not dependent on compliance with section 271.154 as it is for sections 271.157 (no immunity to suit for tort liability), 271.156 (no waiver of immunity to suit in federal court), and 271.153 (limitations on adjudication awards)."

The Dallas court further rejected the City's argument that Section 311.034 of the Texas Government Code rendered the notice provision jurisdictional. Section 311.034 of the Government Code provides that "[s]tatutory prerequisites to suit, including the provision of notice, are jurisdictional in all suits against a governmental entity." Here, however, the notice provision is not a *statutory* requirement; rather, it is contained in the city code. Accordingly, the Dallas court concluded that the notice provision was not a jurisdictional requirement, and the trial court erred to the extent it granted the City's plea to the jurisdiction based upon the notice issue.

12. An interlocutory appeal may be taken from an order denying a second plea to the jurisdiction or its functional equivalent, so long as the filing constitutes a new and distinct motion (as opposed to a mere motion for reconsideration).

In *City of Magnolia 4A Economic Development Corp. v. Smedley*, 533 S.W.3d 297 (Tex. 2017) (per curiam), the Texas Supreme Court considered whether an interlocutory appeal could be taken from an order denying a motion for summary judgment which served as the functional equivalent of a second plea to the jurisdiction.

David Smedley's property was flooded with surface water following the completion of two construction projects adjoining his property. He filed suit against the municipal development corporations (MDCs) that oversaw construction of the Magnolia Stroll, a municipal hiking and walking path, alleging that negligent construction of the path caused further damming of water and damage to his property. He sought both damages and injunctive relief under theories of

negligence, a taking under Article I, Section 17 of the Texas Constitution, and a violation of Section 11.086 of the Texas Water Code.

The MDCs filed a Rule 91a motion to dismiss and plea to the jurisdiction, arguing that Smedley had not alleged any facts that, if proven true, would constitute a claim against them and that Smedley had not alleged facts showing that the MDCs owned or controlled the property in question, which would be necessary for the MDCs to comply with any injunctive relief awarded to Smedley. The trial court granted the motion to dismiss and plea to the jurisdiction as to Smedley's negligence claim and all claims for money damages, but denied relief as to all other claims. The MDCs subsequently filed a motion for summary judgment on Smedley's remaining claims for injunctive relief, asserting there was a lack of evidence as to Smedley's takings claim and Water Code claim and that there was affirmative evidence showing that the MDCs do not own or control the Magnolia Stroll issue and, therefore, the MDCs could not perform the injunctive relief sought. The trial court denied the summary-judgment motion, and the MDCs appealed. The court of appeals dismissed the MDCs' appeal for lack of appellate jurisdiction, holding that the motion for summary judgment was little more than a motion for reconsideration because it raised "essentially the same immunity-based arguments" as the MDCs' initial motion to dismiss and plea to the jurisdiction. Because the MDCs' notice of appeal was not filed within 20 days of the denial of their initial motion to dismiss and plea to the jurisdiction, the court of appeals held it lacked appellate jurisdiction.

The Texas Supreme Court held that the MDCs' motions were sufficiently different based upon both their substance and procedural nature, such that the MDCs' motion for summary judgment was not a mere motion for reconsideration, but rather a distinct motion that merits an independent 20-day interlocutory appeal period. The Supreme Court reasoned that, even though the two motions were grounded in many of the same underlying jurisdictional theories and each functioned as a plea to the jurisdiction, the differences between the two procedural vehicles employed informed its analysis. The original motion was a pleadings challenge; its primary emphasis was Smedley's failure to allege facts. The second motion, in contrast, was evidence-based; its primary emphasis was that in light of the discovered evidence, there was no evidence as to Smedley's takings claim and Water Code claim, and there was affirmative evidence that the MDCs did not own or control the Magnolia Stroll, preventing them from being able to perform the requested injunctive relief. Further, according to the Supreme Court, "the MDCs' motion for summary judgment is easily distinguishable from their original plea to the jurisdiction based on the extensive evidence that the trial court considered for the first time…" Accordingly, based upon the substance of the two motions, the Supreme Court concluded that the MDCs' motion for summary judgment could not be considered a mere motion for reconsideration of the initial plea to the jurisdiction. Thus, the MDCs timely filed their interlocutory appeal.

Author's Note: In a footnote, the Supreme Court clarified that "procedural vehicles are not alone a dispositive end to the [Court's] analysis. The analysis must also involve an inquiry into the substance of the motions."

C. Certificates of Merit

1. The "knowledge" requirement set forth in CPRC §150.002(a)(3) requires explication or evidence reflecting the expert's familiarity or experience with the practice area at issue in the litigation.

In *Levinson Alcoser Associates, L.P. v. El Pistolón II, Ltd.*, 513 S.W.3d 487 (Tex. 2017), the Texas Supreme Court considered whether the "knowledge" requirement set forth in CPRC

§150.002(a)(3) may be satisfied solely from the expert's licensure or active engagement in the practice.

El Pistolón II, Ltd. contracted with Levinson Alcoser Associates, L.P. and Levinson Associates, Inc. to design and oversee construction of a commercial retail project. El Pistolón was dissatisfied with Levinson's work and filed suit for breach of contract and negligence in the project's design and development. In an effort to satisfy the requirements of CPRC §150.002, El Pistolón obtained an affidavit from a licensed architect which set forth the expert's professional opinion on Levinson's work. In regard to the expert's qualifications, however, the affidavit included only the following information:

> "I am a professional architect who is registered to practice in the State of Texas, license number 11655. I have been a registered architect in Texas since 1980, and have an active architecture practice in the State of Texas today."

Levinson filed a motion to dismiss, arguing that the affidavit did not satisfy the "knowledge" or "factual-basis" requirements for a certificate of merit. The trial court denied Levinson's motion to dismiss, and Levinson appealed. The court of appeals affirmed the trial court's order in part and reversed it in part, holding that the affidavit satisfied statutory requirements as to the negligence claim, but not the breach-of-contract claim. Notably, the court of appeals held that CPRC §150.002 "merely requires that the expert be knowledgeable in the defendant's *general* area of practice, which includes architecture, engineering, landscape architecture, or land surveying."[11]

The Texas Supreme Court held that CPRC §150.002(a)(3)'s "knowledge" requirement is not synonymous with the expert's licensure or active engagement in the practice; rather, it requires some additional explication or evidence reflecting the expert's familiarity or experience with the practice area at issue in the litigation. Although the Supreme Court generally agreed such knowledge may be inferred from record sources other than the certificate of merit itself, nothing in the record reflected that the expert was knowledgeable in the specific practice area at issue in the litigation: "the design of shopping centers or other similar commercial construction." Therefore, dismissal was required.

Justice Brown authored a concurring opinion, explaining that the majority reached the correct result but for the wrong reason. Justice Brown would have held that the certificate of merit was deficient because it was conclusory and, thus, failed to satisfy the "factual-basis" requirement set forth in CPRC §150.002(b). He further disagreed with the majority's interpretation of CPRC §150.002(a)(3), reasoning that the statute imposes no particular requirements or limitations as to how the trial court ascertains whether the expert possesses the requisite knowledge.

[11] *Levinson Alcoser Assocs., L.P. v. El Pistolón II, Ltd.*, 500 S.W.3d 431, 436 (Tex. App.—Corpus Christi 2015) (emphasis added)).

2. CPRC §150.002(a)(3)'s "knowledge" requirement does NOT require the expert to establish his/her knowledge through testimony that would be competent or admissible as evidence.

CPRC §150.002(b)'s "factual-basis" requirement does NOT require the certificate of merit to address the elements of each cause of action asserted by the plaintiff.

In *Melden & Hunt, Inc. v. East Rio Hondo Water Supply Corp.*, 520 S.W.3d 887 (Tex. 2017), the Texas Supreme Court considered two issues concerning the requirements of CPRC §150.002: first, whether CPRC §150.002(a)(3)'s "knowledge" requirement requires the expert to establish his/her knowledge through testimony that would be competent or admissible as evidence; and second, whether CPRC §150.002(b)'s "factual-basis" requirement requires the certificate of merit to address the elements of each cause of action asserted by the plaintiff.

East Rio Hondo Water Supply Corp. contracted with Melden & Hunt, Inc. to provide engineering-design and project-supervision services for the construction of a new water-treatment plant. East Rio later sued Melden and others involved with the construction for breach of contract, breach of express and implied warranties, negligence, and negligent misrepresentation. To satisfy the requirements of CPRC §150.002, East Rio obtained an affidavit from a registered professional engineer which set forth the expert's professional opinion on Melden's work. In regard to his qualifications, the expert averred that he:

- holds a B.S. in civil engineering from Texas A&M University,
- is a registered professional engineer in Texas and eight other states,
- is the president and principal of LNV Engineering,
- has 23 years' experience in "master planning, detailed design and construction management,"
- has experience designing and analyzing water-treatment plants like East Rio's, and
- is familiar with the standard of care an engineer of ordinary knowledge and skill should employ when designing such a project.

Melden moved to dismiss East Rio's claims, arguing that neither CPRC §150.002(a)(3)'s "knowledge" requirement nor CPRC §150.002(b)'s "factual-basis" requirement had been satisfied. The trial court denied Melden's motion to dismiss, and Melden appealed. The court of appeals affirmed, holding that the expert was qualified to render a certificate of merit, and that the certificate of merit's content was sufficient to meet statutory requirements.

The Texas Supreme Court first addressed CPRC §150.002(a)(3)'s "knowledge" requirement, holding that the trial court did not abuse its discretion in determining the expert qualified to render a certificate of merit. Melden challenged the expert's averments on the grounds that they were conclusory and, thus, no evidence that the expert was knowledgeable in the relevant practice area, and that the expert's averments should be judged for competency and admissibility like the testimony of any other expert witness. The Supreme Court disagreed, explaining that Texas appellate courts "have generally rejected the notion that chapter 150 imposes the same level of scrutiny as that imposed on the admissibility of expert-opinion testimony for summary-judgment or trial purposes."[12] The Supreme Court additionally drew

[12] 520 S.W.3d at 890 (citing *Benchmark Eng'g Corp. v. Sam Houston Race Park*, 316 S.W.3d 41, 47 (Tex. App.—Houston [14th Dist.] 2010, pet. granted, judgm't vacated w.r.m.); *Gaertner v. Langhoff*, 509 S.W.3d

guidance from *M-Eng'rs, Inc. v. City of Temple*, 365 S.W.3d 497, 503 (Tex. App.—Austin 2012, pet. denied), holding that "Chapter 150 does not require that an affiant establish his or her knowledge through testimony that would be competent or admissible as evidence." The expert's averments about his education and experience, including the "design and analysis of water treatment plants, including clarifiers, pumps, filters, piping, controls, and chemical fees systems," were factual statements supporting the conclusion that the expert was knowledgeable in Melden's area of practice.

The Supreme Court additionally held that CPRC §150.002(b)'s "factual-basis" requirement does not require a certificate of merit to address the elements of each cause of action asserted by the plaintiff. After discussing the 2005 and 2009 amendments to CPRC §150.002, the Supreme Court explained that the effect of the latter was merely to clarify the statute's application to any action arising out of the provision of professional services, regardless of the legal theory, rather than enlarging the "factual-basis" requirement or otherwise changing its existing relationship within the statute. CPRC §150.002(b), read as a whole, reveals a "core focus" on ascertaining and verifying the existence of errors and omissions in the professional services provided by a "licensed or registered professional." Thus, the Supreme Court explained:

> We accordingly reject Melden's interpretation of the statute, which would require the expert's affidavit to address the elements of the plaintiff's various theories or causes of action…. Chapter 150 requires only that a similarly licensed professional, knowledgeable of the defendant's area of practice, provide a sworn written statement certifying that the defendant's professional actions or omissions were negligent or otherwise erroneous and the factual basis for such claims.

The trial court then determines whether the expert's affidavit sufficiently demonstrates that the plaintiff's complaint is not frivolous.

The Supreme Court ultimately held that the certificate of merit satisfied the requirements of CPRC §150.002(b), as the expert noted his review of available documents, including the engineering plans, construction documents, and equipment specifications of the plant, and his on-site inspections and tests; concluded that Melden failed to use ordinary care in the performance of its professional duties relating to the plant's design and filtration system; identified Melden's negligence and other errors to include five specific "failures"; and then explained each of the "failures" in greater detail. Thus, the trial court did not abuse its discretion in denying Melden's motion to dismiss.

3. CPRC §150.002(e) does not require dismissal with prejudice when a plaintiff does not file a certificate of merit with its original petition.

In *Pedernal Energy, LLC v. Bruington Engineering, Ltd.*, — S.W.3d — , 2017 WL 1737920 (Tex. 2017), first reported in the 2013 and 2014 case law updates, the Texas Supreme Court considered whether CPRC §150.002(e) requires dismissal with prejudice when a plaintiff does not file a certificate of merit with its original petition.

Bruington Engineering, LLC was hired as project engineer in connection with fracturing operations on a gas well. Pedernal Energy, LLC later sued Bruington and others for damages to

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392, 398 (Tex. App.—Houston [1st Dist.] 2014, no pet.); *Hardy v. Matter*, 350 S.W.3d 329, 333 (Tex. App.—San Antonio 2011, pet. dism'd)).

the gas well and the formation. Pedernal, however, did not file a certificate of merit as to Bruington with its original petition, so Bruington moved for dismissal of the claims against it with prejudice. Before the trial court heard Bruington's motion to dismiss, Pedernal non-suited its claims against Bruington without prejudice. Pedernal later amended its petition to reassert the same claims against Bruington, and attached a certificate of merit to the amended petition. Bruington again moved for dismissal of the claims against it with prejudice. The trial court denied Bruington's motion to dismiss, and Bruington appealed. The court of appeals reversed, holding that dismissal was required because Pedernal did not file a certificate of merit with its original petition, and remanded for the trial court to determine whether the dismissal should be with or without prejudice.

On remand, the trial court ordered that Pedernal's claims should be dismissed without prejudice, finding that Pedernal's claims against Bruington had merit and that Pedernal's failure to file a certificate of merit with its original petition was neither intentional nor done with conscious indifference, and Bruington appealed. The court of appeals reversed, holding that the trial court was required to dismiss Pedernal's claims with prejudice.

The Texas Supreme Court held that, while CPRC §150.002(e) requires dismissal if the plaintiff fails to file a certificate of merit contemporaneously with the complaint, the trial court's decision whether to dismiss with or without prejudice in that circumstance is discretionary, subject to the prohibition on arbitrary or reasonable decisions without reference to guiding rules or principles. However, because the language of CPRC §150.002 provides no "guiding rules or principles" for a trial court's exercise of discretion, the Supreme Court held that courts should consider "various factors…given the facts and circumstances of the particular case" in determining whether to dismiss with or without prejudice.

Applying the abuse-of-discretion standard to the trial court's ruling, the Supreme Court next considered whether the circumstances presented to the trial court at the time of the dismissal demonstrated that (1) Pedernal's claims were meritless, or otherwise required dismissal with prejudice, or (2) the trial court's action in dismissing without prejudice violated any guiding rules or principles so that its actions were arbitrary and unreasonable and an abuse of discretion. The Supreme Court ultimately found no abuse of discretion in the trial court's dismissal of Pedernal's claims without prejudice, reasoning that the record did not conclusively demonstrate that Pedernal's claims lacked merit, or that the trial court's decision violated any guiding rules and principles and therefore was an abuse of discretion.

Justice Devine authored a concurring opinion, disagreeing with the majority on procedural grounds. Justice Devine would have remanded for the trial court to consider Bruington's motion to dismiss "unburdened by what [he] perceive[d] to be an erroneous, intervening mandate from the court of appeals" rather than merely reinstating the trial court's dismissal order.

Author's Note: In *Thomas v. EFI Global, Inc.*, No. 02-16-00379-CV, 2017 WL 5494254 (Tex. App.—Fort Worth Nov. 16, 2017, no pet. h.) (mem. op.), the Fort Worth Court of Appeals upheld the dismissal of the pro se plaintiff's claims with prejudice for her failure to file a certificate of merit. Although the plaintiff's appeal challenged only the fact of dismissal (and not the type of dismissal), *Thomas* illustrates circumstances which may support a dismissal with prejudice under CPRC §150.002(e).

4. A stipulation that the plaintiff and its counsel were unaware of the statutory requirements of CPRC §150.002 or its applicability to the case may support a dismissal without prejudice.

In *CDI Corp. v. TOTAL Specialties USA, Inc.*, 528 S.W.3d 802 (Tex. App.—Houston [14th Dist.] 2017, no pet.), the Houston (Fourteenth) Court of Appeals considered whether the trial court abused its discretion in dismissing the plaintiff's claims without prejudice for its failure to file a certificate of merit with its original petition.

TOTAL Specialties USA, Inc. contracted with CDI Corp. in connection with the construction of a hydro de-aromatization unit at TOTAL's refinery. TOTAL later filed suit against CDI, asserting claims for breach of contract, negligence, gross negligence, and fraud related to the construction. TOTAL, however, did not file a certificate of merit contemporaneously with its original petition. Thus, CDI filed a motion to dismiss under CPRC §150.002, seeking dismissal of TOTAL's claims with prejudice. TOTAL later filed a notice of nonsuit and a request for dismissal without prejudice. In the notice of nonsuit, TOTAL explained that it intended to refile its claims in a new lawsuit with a certificate of merit, which TOTAL attached as an exhibit to the notice. The trial court signed an order on TOTAL's nonsuit, dismissing TOTAL's claims without prejudice. CDI then sought a hearing on its motion to dismiss. In advance of the hearing, the parties stipulated to several facts, including that (1) no certificate of merit had been prepared as of the date on which the original petition was filed, and (2) TOTAL and its attorneys (a) did not know that a certificate of merit must be filed with a petition seeking damages arising out of the provision of professional services by a corporation in which registered professional engineers practice, and (b) were not aware of the requirements in that regard under CPRC §150.002. At the conclusion of the hearing, the trial court ruled that the dismissal of TOTAL's claims would remain a dismissal without prejudice, and denied CDI's motion to dismiss with prejudice. CDI appealed.

The Houston (Fourteenth) Court of Appeals held that, considering the facts and circumstances of the case, the trial court did not abuse its discretion in dismissing TOTAL's claims without prejudice. As the Texas Supreme Court recently held in *Pedernal*, a trial court has discretion to dismiss either with or without prejudice under CPRC §150.002(e). Here, CDI stipulated that TOTAL's counsel was unaware of the statutory requirements of CPRC §150.002 or its applicability to the case when counsel filed the petition, thus conceding that TOTAL's conduct was not intentional or for an improper purpose. Further, a certificate of merit was obtained and filed with TOTAL's notice of nonsuit within four months after CDI's motion to dismiss notified TOTAL's counsel of the mistake. TOTAL's notice of nonsuit attached the 36-page certificate of merit and indicated that TOTAL intended to refile its lawsuit to remedy the mistake, which the Houston court held constituted "some evidence that the claims have merit." Finally, the trial court refused to strike the certificate of merit, as CDI had requested, and CDI did not challenge that ruling on appeal. Thus, the trial court did not abuse its discretion in dismissing TOTAL's claims without prejudice.

5. The certificate-of-merit requirement does not apply to a third-party petition filed by an original plaintiff seeking contribution from a third-party defendant.

In *Engineering & Terminal Services, L.P. v. TARSCO, Inc.*, 525 S.W.3d 394 (Tex. App.—Houston [14th Dist.] 2017, pets. denied), the Houston (Fourteenth) Court of Appeals considered whether the certificate-of-merit requirement in CPRC §150.002 applies to a third-party petition filed by an original plaintiff seeking contribution from a third-party defendant.

Buckeye Partners, L.P. contracted with Engineering & Terminal Services, L.P. (ETS) to provide engineering design and support services for a construction project. ETS, in turn, subcontracted with TARSCO, Inc. to provide on-site engineering and design services for part of the project; and separately subcontracted with Orcus Fire Protection, L.L.C. to provide fire-protection engineering consulting services. ETS later sued Buckeye for breach of contract based upon Buckeye's alleged failure to pay for ETS's engineering services. In response, Buckeye filed counterclaims against ETS, alleging that ETS's engineering designs contained errors, omissions, and other deficiencies. Buckeye complained, in part, about work that ETS had subcontracted to TARSCO and Orcus. ETS, as a third-party plaintiff, then filed a third-party petition against TARSCO and Orcus, seeking contribution from TARSCO and Orcus to the extent ETS was liable to Buckeye.

ETS did not file a certificate of merit with its third-party petition against TARSCO and Orcus, so they filed motions to dismiss under CPRC §150.002. Citing *Jaster v. Comet II Construction, Inc.*, 438 S.W.3d 556 (Tex. 2014), first reported in the 2014 case law update, ETS asserted that third-party plaintiffs are exempt from the certificate-of-merit requirement in CPRC §150.002. The trial court granted the motions to dismiss, and ETS appealed.

The Houston (Fourteenth) Court of Appeals held that the certificate-of-merit requirement in CPRC §150.002 did not apply to ETS's third-party petition. The Houston court first examined *Jaster*, observing that five justices in *Jaster* who joined in the Supreme Court's judgment agreed that a third-party plaintiff is not required to file a certificate of merit, and reasoning that lower courts are bound by that legal principle. The Houston court further rejected TARSCO's and Orcus's argument that a third-party contribution claim filed by an original plaintiff is something fundamentally different than a third-party contribution claim filed by a defendant/third-party defendant, concluding that ETS's status as the original plaintiff was not a fact that distinguished the present case from *Jaster* in a legally meaningful way. Thus, according to the Houston court, "the principle identified in *Jaster* applies equally to plaintiffs, defendants, or counter-defendants acting as third-party plaintiffs." Here, ETS was not "the plaintiff" who initiated an action for damages arising out of the provision of professional services. Instead, ETS was "the plaintiff" who initiated an action against Buckeye for breach of contract based upon a failure to pay for services. Acting as a third-party plaintiff in this same suit, ETS filed third-party claims against TARSCO and Orcus. The Houston court held that, under these circumstances, the certificate-of-merit requirement did not apply to ETS's third-party petition. Accordingly, the trial court erred by dismissing ETS's third-party claims against TARSCO and Orcus under CPRC §150.002.

6. An intervenor may qualify as "the plaintiff" required to file a certificate of merit in support of his claims.

In *Macina, Bose, Copeland & Associates v. Yanez*, No. 05-17-00180-CV, 2017 WL 4837691 (Tex. App.—Dallas Oct. 26, 2017, no pet. h.) (mem. op.), the Dallas Court of Appeals considered several issues pertaining to CPRC §150.002, including whether an intervenor qualified as "the plaintiff" within the meaning of CPRC §150.002(a) and, therefore, was required to file a certificate of merit in support of his claims.

Jose Manuel Lopez and his coworker, Samuel Mejia, were seriously injured during the construction of an apartment complex. Lopez's wife, Erika Yanez, subsequently filed suit against numerous defendants for negligence and gross negligence, and amended her petition to assert claims against several engineering defendants and two architectural defendants involved in the construction. Mejia later intervened in the suit as a plaintiff, bringing claims nearly identical to Yanez's against the engineering defendants and the architectural defendants, but he did not file a

certificate of merit. The engineering defendants and the architectural defendants filed motions to dismiss under CPRC §150.002, arguing that Mejia was required, but failed, to file a certificate of merit. Citing *Jaster v. Comet II Construction, Inc.*, 438 S.W.3d 556 (Tex. 2014), Mejia argued he was not required to file a certificate of merit because he was not "the plaintiff" within the meaning of CPRC §150.002(a). Rather, according to Mejia, Yanez was "the plaintiff" because she initiated the lawsuit and he later intervened in it. The trial court denied the defendants' motions to dismiss, and they appealed.

The Dallas Court of Appeals held that Mejia was required to file a certificate of merit in compliance with CPRC §150.002. The Dallas court first examined *Jaster*, observing that the plurality expressly did not reach "the issue of whether section 150.002 requires each individual plaintiff in a multi-plaintiff suit and those added as plaintiffs by joinder or intervention to file separate certificates of merit."[13] Because there was no majority for any broader holding, the Dallas court held that *Jaster* should be limited to its stated holding regarding a party's duty to file an affidavit under CPRC §150.002: "the certificate-of-merit requirement in section 150.002 of the Civil Practice and Remedies Code applies to 'the plaintiff' who initiates an action for damages arising out of the provision of professional services by a licensed or registered professional, and does not apply to a defendant or third-party defendant who asserts such claims."[14]

The Dallas court next examined whether, under the rubric of *Jaster*, Mejia was a party who initiates an "action" or suit (and, thus, was required to file a certificate of merit) or whether Mejia instead was merely a "party who asserts claims or causes of action within the suit" (and, thus, was not required to file one).[15] Unlike the third-party plaintiffs and cross-claimants in *Jaster*, Mejia's claim was an independent suit for damages that he chose to bring under the same cause number as Yanez's suit by intervening in her suit. Had Mejia filed his suit under a new cause number as a separate lawsuit, there is no question that he would have been "the plaintiff" and required to file a certificate of merit. The Dallas court reasoned:

> Thus, this case is two lawsuits filed under one cause number, each seeking separate damages. Each lawsuit has its own "the plaintiff" under section 150.002: Yanez is "the plaintiff" in *Yanez v. Macina Bose, et al.*, and Mejia is the plaintiff in *Mejia v. Macina Bose, et al*. Because each is "the plaintiff" of a separate "action…for damages arising out of the provision of professional services," each is required to comply with section 150.002.

Accordingly, the trial court abused its discretion in concluding that Mejia was not required to file a certificate of merit, and in denying the defendants' motions to dismiss Mejia's claims.

7. A certificate of merit is deficient if it fails to distinguish between the acts, errors, and omissions of each defendant, and instead collectively assigns the negligence and errors to multiple defendants.

In *Macina, Bose, Copeland & Associates v. Yanez*, No. 05-17-00180-CV, 2017 WL 4837691 (Tex. App.—Dallas Oct. 26, 2017, no pet. h.) (mem. op.), the Dallas Court of Appeals also considered whether a certificate of merit satisfied the requirements of CPRC §150.002(b) even though it failed to distinguish between the acts, errors, and omissions of two defendants.

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[13] 2017 WL 4837691, at *8 (quoting *Jaster*, 438 S.W.3d at 568 n.15).
[14] *Id*. (quoting *Jaster*, 438 S.W.3d at 571).
[15] *Id*. (quoting *Jaster*, 438 S.W.3d at 565; *id*. at 572 (Willett, J., concurring)).

Sage Group, Inc. and Sage Architecture, Inc. were hired as architects for the construction of an apartment complex. A worker was seriously injured during the course of construction, and his wife subsequently filed suit against numerous defendants for negligence and gross negligence. In her second amended petition, the plaintiff added Sage Group and Sage Architecture as defendants, and filed a certificate of merit in support of her claims against them. However, the certificate of merit did not differentiate between the two companies' actions; instead, the affiant referred to Sage Group and Sage Architecture collectively as "the Defendant Architectural Firms," including as follows:

> 21. It is my professional opinion that the errors and/or omissions listed above constitute negligence in that the Defendant Architectural Firms failed to exercise that degree of care which would have been exercised by a reasonably prudent architect and architectural firm under the same or similar circumstances. The Defendant Architectural Firms also failed to meet the applicable work product standards of design professionals with regard to the design of the retaining wall and guardrail system in a manner that safely accommodates the use for which the property was intended.

Sage Group and Sage Architecture subsequently filed motions to dismiss, asserting that the certificate of merit did not satisfy the requirements of CPRC §150.002(b). Citing *Robert Navarro & Assocs. Engineering, Inc. v. Flowers Baking Co. of El Paso, LLC*, 389 S.W.3d 475 (Tex. App.—El Paso 2012, no pet.), they contended that the certificate of merit was deficient because it did not differentiate between their work. The trial court denied the motions to dismiss, and Sage Group and Sage Architecture appealed.

The Dallas Court of Appeals held that the certificate of merit failed to satisfy the requirements of CPRC §150.002(b) because it did not distinguish between the acts, omissions, and errors of each defendant; rather, it collectively assigned the negligence and errors to both Sage Group and Sage Architecture. Although the Dallas court found *Navarro* to be factually distinguishable because the certificate of merit identified both Sage Group and Sage Architecture as engaging in the negligent conduct (whereas the certificate of merit in *Navarro* stated the failures at issue constituted professional negligence by Navarro "and/or" Bath), the Dallas court expressly agreed with the statement in *Navarro* that "the statutory language does not allow for collective assertions of negligence." The Dallas court further analogized the requirements of CPRC §150.002(b) to the requirements for expert reports set forth in CPRC §74.351(r), which courts have interpreted as requiring the report to discuss each defendant's actions individually.[16] Here, the affiant made no distinction in the work performed by Sage Group and Sage Architecture; thus, "there was no way for a court to determine which acts or omissions should be ascribed to each company." Nor did the affiant state that both companies were involved in all aspects of the work, that either Sage Group or Sage Architecture was vicariously liable for the other's conduct, or that they were the alter ego of one another. Accordingly, the Dallas court held that the trial court abused its discretion in denying Sage Group's and Sage Architecture's motions to dismiss.

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[16] 2017 WL 4837691, at *7 (citing *Univ. of Tex. Med. Branch v. Railsback*, 259 S.W.3d 860, 864 (Tex. App.—Houston [1st Dist.] 2008, no pet.) ("When a plaintiff sues more than one defendant, the expert report must set forth the standard of care for each defendant and explain the causal relationship between each defendant's individual acts and the injury, i.e., '[c]ollective assertions of negligence against various defendants are inadequate.'" (quoting *Taylor v. Christus Spohn Health Sys. Corp.*, 169 S.W.3d 241, 244 (Tex. App.—Corpus Christi 2004, no pet.))).

8. A plaintiff may reassert claims dismissed without prejudice under CPRC §150.002 by filing an amended pleading with a revised certificate of merit in the same lawsuit, instead of filing an original petition with a proper certificate in a separate lawsuit.

In *Macina, Bose, Copeland & Associates v. Yanez*, No. 05-17-00180-CV, 2017 WL 4837691 (Tex. App.—Dallas Oct. 26, 2017, no pet. h.) (mem. op.), the Dallas Court of Appeals also considered whether, following a dismissal without prejudice under CPRC §150.002, the plaintiff may reassert its claims by filing an amended petition in the same lawsuit rather than bringing them in a separate lawsuit.

Jordan & Skala Engineers, Inc. was hired to perform engineering services for the construction of an apartment complex. A worker was seriously injured during the course of construction, and his wife subsequently filed suit against numerous defendants for negligence and gross negligence. In her first amended petition, the plaintiff added Jordan & Skala as a defendant, and filed a certificate of merit in support of her claims against it. Jordan & Skala subsequently filed a motion to dismiss under CPRC §150.002, which the trial court granted and dismissed the plaintiff's claims without prejudice. The plaintiff later filed an amended petition reasserting her claims against Jordan & Skala, along with a new certificate of merit concerning its conduct. Jordan & Skala then filed another motion to dismiss under CPRC §150.002. Citing *TIC N. Cent. Dallas 3, L.L.C. v. Envirobusiness, Inc.*, 463 S.W.3d 71 (Tex. App.—Dallas 2014, pet. denied), first reported in the 2014 case law update, Jordan & Skala asserted that the plaintiff could refile her claims only by bringing them in a second, separate lawsuit and not by filing an amended petition in the same lawsuit. The trial court denied Jordan & Skala's motion to dismiss, and Jordan & Skala appealed.

The Dallas Court of Appeals held that the plaintiff properly refiled her claims against Jordan & Skala in an amended petition instead of a separate lawsuit. The Dallas court framed the issue as follows:

> The question before us is whether the following procedure complies with section 150.002: a plaintiff sues multiple defendants in a suit containing claims subject to section 150.002, the plaintiff files an inadequate affidavit, a professional defendant objects to the affidavit and moves to dismiss, the trial court dismisses the claims against the professional defendant without prejudice, and the plaintiff then files an amended pleading with a revised affidavit asserting the same claims against the professional defendant as those that were dismissed.

The Dallas court reasoned that in *TIC*, it did <u>not</u> hold that the only way a plaintiff may reassert claims dismissed under section 150.002 was to bring them in a separate lawsuit. Further, in an ordinary case, a plaintiff that has sued other defendants may bring in additional defendants by amending its petition, and there is no requirement that additional parties be brought into the suit by filing a separate suit that is then transferred to and consolidated with the original suit. Likewise, the Dallas court saw no reason to require a separate suit to be brought in the context of a dismissal without prejudice under CPRC §150.002. "Instead, a plaintiff whose claims are dismissed by the trial court without prejudice because the affidavit did not meet the requirements of section 150.002 should be able to reassert those claims through any appropriate procedure for asserting claims previously dismissed without prejudice." Accordingly, the Dallas court held that the trial court did not abuse its discretion in denying Jordan & Skala's motion to dismiss.

9. Before a defendant moves for dismissal, a plaintiff may cure its failure to file a certificate of merit that complies with statutory requirements by nonsuiting its claims and then refiling the claims through an amended petition with a revised certificate.

In *Macina, Bose, Copeland & Associates v. Yanez*, No. 05-17-00180-CV, 2017 WL 4837691 (Tex. App.—Dallas Oct. 26, 2017, no pet. h.) (mem. op.), the Dallas Court of Appeals also considered whether a plaintiff may cure its failure to file a certificate of merit that complies with the requirements of CPRC §150.002 by nonsuiting its claims and then refiling the claims through an amended petition with a revised certificate.

Jordan & Skala Engineers, Inc., Macina Bose, Copeland and Associates, Inc., and McCord Engineering, Inc. were all hired as engineers for the construction of an apartment complex. A worker was seriously injured during the course of construction, and his wife subsequently filed suit against numerous defendants for negligence and gross negligence. In her first amended petition, the plaintiff added Jordan & Skala, Macina Bose, and McCord as defendants, and filed a certificate of merit in support of her claims against them. Jordan & Skala filed a motion to dismiss under CPRC §150.002, which the trial court granted and dismissed the plaintiff's claims against Jordan & Skala without prejudice. At that time, neither Macina Bose nor McCord had moved for dismissal under CPRC §150.002. The plaintiff then nonsuited her claims against Macina Bose and McCord without prejudice, and later filed an amended petition reasserting her claims against Jordan & Skala, Macina Bose, and McCord, along with a revised certificate of merit concerning their conduct.

Macina Bose and McCord filed motions to dismiss under CPRC §150.002. Citing *Bruington Engineering Ltd. v. Pedernal Energy L.L.C.*, 403 S.W.3d 523 (Tex. App.–San Antonio 2013, no pet.), first reported in the 2013 case law update, Macina Bose and McCord asserted that the plaintiff violated CPRC §150.002 when she nonsuited her claims against them and then refiled the claims through an amended petition with a revised certificate of merit. The trial court denied Macina Bose's and McCord's motions to dismiss, and they appealed.

The Dallas Court of Appeals held that the revised certificate of merit complied with CPRC §150.002's requirement that the certificate be filed with the first-filed petition. The Dallas court found *Bruington* distinguishable, reasoning that unlike the situation in *Bruington*, the plaintiff's nonsuit did not thwart an attempt by Macina Bose and McCord to have the plaintiff's claims dismissed with prejudice. Rather, at the time of the nonsuit, neither Macina Bose nor McCord had moved for dismissal under CPRC §150.002. The Dallas court further reasoned that a plaintiff has an absolute right to nonsuit its claims before it rests in a trial on the merits so long as doing so does not prejudice the rights of other parties to be heard on pending claims for affirmative relief. However, because Macina Bose and McCord had not moved for dismissal before the plaintiff's nonsuit, they had no claims for affirmative relief that were prejudiced by the nonsuit. Instead, when the plaintiff nonsuited her claims, the parties were returned to the positions they were in before the plaintiff filed suit against them. Therefore, when the plaintiff filed her amended petition bringing claims against Macina Bose and McCord after the nonsuit, that amended petition became the first-filed petition as to Macina Bose and McCord. Accordingly, the trial court did not abuse its discretion in concluding that the plaintiff complied with the requirements of CPRC §150.002 as to Macina Bose and McCord, and in denying their motions to dismiss.

10. Evidence that the movant is registered with the Texas Board of Professional Engineers, standing alone, is insufficient to establish that the movant is a "licensed or registered professional" as defined by Chapter 150.

In *CH2M Hill Engineers, Inc. v. Springer*, No. 09-16-00479-CV, 2017 WL 6210837 (Tex. App.—Beaumont Dec. 7, 2017, no pet. h.) (mem. op.), the Beaumont Court of Appeals considered whether the movant met its burden to establish that it is a "licensed or registered professional" as defined by CPRC Chapter 150.

The City of Beaumont entered into an "agreement for professional services" with CH2M Hill Engineers, Inc., whereby CH2M was to evaluate the City's water-distribution and sewer-collection services. In accordance with the agreement, CH2M produced a written report summarizing its findings and offering recommendations for improving the City's operations. After receiving CH2M's report, the City made personnel changes to its water-utility staff, including the demotion, termination, or forced resignation of the plaintiffs.

The plaintiffs subsequently filed suit against CH2M, alleging that their claims arose out of false and intentionally misleading statements published in the report, and seeking damages for defamation and tortious interference with contract. CH2M filed a motion to dismiss under CPRC §150.002, asserting that the plaintiffs were required, but failed, to file a certificate of merit in support of their claims. The plaintiffs opposed the motion and disputed CH2M's status as a "licensed or registered professional" within the meaning of CPRC Chapter 150. The trial court denied CH2M's motion, and CH2M appealed.

The Beaumont Court of Appeals held that CH2M failed to meet its burden to establish that it is a "licensed or registered professional" as defined by Chapter 150. CPRC §150.001(1-a) defines "licensed or registered professional" to include a "licensed professional engineer…or any firm in which such licensed or registered professional practices…." The Beaumont court reasoned that, although the record contained evidence that CH2M is registered with the Texas Board of Professional Engineers, the record did not contain any evidence that a "licensed or registered professional" practices within CH2M. Further, neither CH2M's contract with the City nor the report issued by CH2M to the City was shown to have been signed by a "licensed or registered professional." CH2M failed to even identify a single licensed professional engineer who performed professional engineering services for the firm. Accordingly, the Beaumont court held that the trial court did not abuse its discretion in denying CH2M's motion to dismiss.

11. A certificate of merit is not required for claims against a "certified professional contractor" arising out of the contractor's construction of a swimming pool.

In *Lee v. 149 Pool, LLC*, No. 14-15-00953-CV, 2017 WL 1750105 (Tex. App.—Houston [14th Dist.] May 4, 2017, no pet.) (mem. op.), the Houston (Fourteenth) Court of Appeals considered whether a certificate of merit was required for claims against a "certified professional contractor" arising out of the contractor's construction of a swimming pool.

The Lees contracted with 149 Pool, LLC to construct a swimming pool designed by Gessner Engineering, LLC. 149 Pool, however, allegedly failed to construct a pool structure with gunite to achieve a minimum strength of 4,000 PSI, as required by the parties' contract. The Lees subsequently sued 149 Pool, asserting claims for negligence, breach of contract, breach of warranty, and DTPA violations. The Lees did not file a certificate of merit in support of their

claims, so 149 Pool filed a motion to dismiss under CPRC §150.002. The Lees opposed 149 Pool's motion, arguing that CPRC §150.002 was inapplicable because they had not alleged claims against a licensed or registered professional, nor had they claimed that their damages arose out of the provision of professional services. The trial court granted 149 Pool's motion to dismiss, and the Lees appealed.

The Houston (Fourteenth) Court of Appeals held that 149 Pool is not a "licensed or registered professional" as defined by Chapter 150 and, therefore, the Lees were not required to file a certificate of merit to support their claims. To determine whether a certificate of merit is required under CPRC §150.002, the court must decide whether the defendant is a "licensed or registered professional" under the statute, and if so, whether the plaintiff's claimed damages arose from the defendant's provision of professional services. Under CPRC §150.001(1-a), "licensed or registered professional" is defined to mean

> a licensed architect, licensed professional engineer, registered professional land surveyor, registered landscape architect, or any firm in which such licensed or registered professional practices, including but not limited to a corporation, professional corporation, limited liability corporation, partnership, limited liability partnership, sole proprietorship, joint venture, or any other business entity.

Although 149 Pool acknowledged that it is a "certified professional contractor," the Houston court reasoned that "a certified professional contractor" is not a "licensed or registered professional" as defined by Chapter 150. Thus, the Lees were not required by CPRC §150.002 to file a certificate of merit with their original petition, and the trial court abused its discretion in granting 149 Pool's motion to dismiss.

D. Designation of RTPs

In *In re Coppola*, — S.W.3d — , 2017 WL 6390965 (Tex. 2017) (per curiam), the Texas Supreme Court considered whether mandamus relief is available for the erroneous denial of a motion for leave to designate a responsible third party, and whether a motion for leave to designate a responsible third party is timely if it is filed after the initial trial setting but more than 60 days before the new trial setting.

The Coppolas sold a piece of unimproved property to Nancy Adams and Adams Investment Properties, LLC. Adams intended to use the property to build a veterinary clinic and pet-boarding facility, and hired two transactional attorneys to furnish legal advice in connection with the sale. At closing, the Coppolas provided Adams with a survey showing the property bore a 15-foot right-of-way. Adams, however, subsequently learned that local ordinances require a 25-foot right-of-way for any commercial improvement. Adams sued the Coppolas for fraud and DTPA violations, alleging they failed to disclose right-of-way limitations that render the property unusable for its intended purpose. After the initial trial setting, but 76 days before the third trial setting, the Coppolas filed a motion for leave to designate the two transactional attorneys as responsible third parties, alleging that they breached their duty of care to Adams by failing to disclose the right-of-way ordinance's effect in relation to her intended use of the property. The trial court summarily denied the Coppolas' motion without granting leave to replead, and the court of appeals denied mandamus relief.

The Texas Supreme Court held that mandamus relief is available for the erroneous denial of a motion for leave to designate a responsible third party. The Supreme Court reasoned that

allowing a case to proceed to trial despite the erroneous denial of a responsible-third-party designation "would skew the proceedings, potentially affect the outcome of the litigation, and compromise the presentation of [the relator's] defense in ways unlikely to be apparent in the appellate record." Here, the denial of mandamus review impairs—and potentially denies—a litigant's significant and substantive right to allow the fact finder to determine the proportionate responsibility of all responsible parties. Accordingly, the Supreme Court held that, ordinarily, a relator need only establish a trial court's abuse of discretion to demonstrate entitlement to mandamus relief with regard to a trial court's denial of a timely-filed motion under CPRC §33.004(a).

The Supreme Court further held that, applying CPRC §33.004(a) according to its plain language, the Coppolas' motion for leave to designate a responsible third party was timely filed. CPRC §33.004(a) recites, "[t]he motion must be filed on or before the 60th day before the trial date unless the court finds good cause to allow the motion to be filed at a later date." The Supreme Court found nothing in the proportionate responsibility statute supporting a construction of CPRC §33.004(a) as limiting the phrase "the trial date" to an *initial* trial setting rather than the trial date at the time a motion to designate is filed.

Finally, the Supreme Court held that, even with a timely filed objection, the trial court *must* allow the designation of a responsible third party unless the objecting party establishes (1) the defendant did not plead sufficient facts concerning the person's alleged responsibility, and (2) the pleading defect persists after an opportunity to replead. Thus, even if the Coppolas failed to plead sufficient facts, as Adams claimed, the trial court lacked discretion to deny the Coppolas' motion for leave to designate without affording them an opportunity to replead. Accordingly, the Coppolas were entitled to mandamus relief for the trial court's erroneous denial of their motion for leave to designate the attorneys as responsible third parties.

E. Discovery

1. Discovery of electronically stored information

In *In re State Farm Lloyds*, 520 S.W.3d 595 (Tex. 2017), the Texas Supreme Court clarified that neither the requesting nor the producing party has a unilateral right to specify the format of discovery of electronically stored information under Texas Rule of Civil Procedure 196.4, and provided guidance regarding the application of Rule 192.4's proportionality factors in the electronic-discovery context.

Multiple homeowners sued State Farm Lloyds alleging underpayment of insured hail-damage claims. The homeowners requested production of electronically stored information (ESI) in its native form (e.g., XLS for Microsoft Excel spreadsheets and DOC for Microsoft Word documents), while State Farm offered to produce ESI in searchable, but "static" form (*e.g.*, PDF, JPEG, and TIFF files). The trial court ordered State Farm to produce all ESI in its native or near-native format, regardless of whether a more convenient, less expensive, and "reasonably usable" format was readily available. The court of appeals denied State Farm mandamus relief, holding that Rule 196.4 incorporates the same procedure applicable to other forms of discovery—that is, the responding party is required to produce the information in the form requested unless the party serves timely objections or assertions of privilege.

The Texas Supreme Court held that neither the requesting nor the responding party has a unilateral right to specify the format of discovery under Texas Rule of Civil Procedure 196.4. Thus, if the responding party objects that electronic data cannot be retrieved in the form requested

through "reasonable efforts" and asserts that the information is readily "obtainable from some other source that is more convenient, less burdensome, or less expensive," the trial court is obligated to consider whether production in the form requested should be denied in favor of a "reasonably usable" alternative form. In line with Texas Rule of Civil Procedure 192.4, the trial court must consider and balance the following *non-exclusive* proportionality factors: (1) the likely benefit of the requested discovery; (2) the needs of the case; (3) the amount in controversy; (4) the parties' resources; (5) the importance of the issues at stake in the litigation; (6) the importance of the proposed discovery in resolving the litigation; and (7) any other articulable factor bearing on proportionality. If the burden or cost is unreasonable compared to the countervailing factors, the trial court may order production in (1) the form the responding party proffers, (2) another form that is proportionally appropriate, or (3) the form requested if (i) there is a particularized need for otherwise unreasonable production efforts and (ii) the court orders the requesting party to "pay the reasonable expenses of any extraordinary steps required to retrieve and produce the information." The Supreme Court emphasized that the determination requires a case-by-case balancing of jurisprudential considerations, and is geared toward the ultimate objective of "obtain[ing] a just, fair, equitable and impartial adjudication" for the litigants "with as great expedition and dispatch at the least expense...as may be practicable." The Supreme Court further observed that its application of proportionality principles in this context aligns electronic-discovery practice under the Texas Rules of Civil Procedure with electronic-discovery practice under the Federal Rules of Civil Procedure.

2. Discovery of attorney-billing information.

In *In re National Lloyds Insurance Co.*, 532 S.W.3d 794 (Tex. 2017), the Texas Supreme Court considered whether a party's attorney-billing information was discoverable when the party challenged an opposing party's attorney-fee request as unreasonable, yet the party neither used its own attorney's fees as a comparator nor sought to recover any portion of its own attorney's fees.

Following multiple hail storms, insured homeowners sued National Lloyds Insurance Co., Wardlaw Claims Service, Inc., and Ideal Adjusting, Inc. for statutory, contractual, and extra-contractual claims related to the alleged underpayment of insured property-damage claims. The lawsuits were consolidated into a single multidistrict litigation court for pretrial proceedings and discovery. In addition to seeking damages, the homeowners sought the attorney's fees they incurred prosecuting their statutory and contractual claims. The insurers argued that the homeowners' claims for attorneys' fees were excessive based upon the complexity and locality of the case. Two months before trial, the homeowners requested a continuance and sought leave to request additional discovery related to the insurers' attorney-billing information—even though the insurers were not seeking their attorney's fees—contending that the information was discoverable and relevant to the attorney-fee dispute. Specifically, the additional discovery consisted of (1) three interrogatories requesting hourly rates, total amount billed, and total reimbursable expenses; and (2) four requests for production seeking all of the insurers' billing invoices, payment logs, ledgers, and payment summaries, as well as audits and any documents related to flat-rate billing. The insurers argued the discovery requests sought information that was irrelevant and protected by the attorney-client and work-product privileges.

The MDL pretrial court ordered the insurers to respond to the discovery requests, and the insurers sought mandamus relief from the court of appeals. The court of appeals denied the insurers' mandamus petition, holding that the discovery order was not an abuse of discretion because (1) an opposing party's attorney's fees are relevant to whether attorney's fees are reasonable and necessary; (2) the requested information was within the permissible scope of expert-witness discovery under Texas Rule of Civil Procedure 192.3(e); and (3) the insurers

failed to establish that redaction of its records would be insufficient to protect its privileges. The insurers sought mandamus relief in the Texas Supreme Court, arguing that information about their attorney-fee expenditures was wholly irrelevant to the homeowners' attorney-fee claim, and that the information was privileged. The homeowners countered that attorney-billing information is not privileged as a matter of law and, alternatively, redaction of privileged material would provide sufficient protection of any privileged information.

The Texas Supreme Court first addressed whether the requested information was privileged, holding that requests to produce all billing invoices, payment logs, payment ledgers, payment summaries, documents related to flat-rate billing, and audits invade a party's work-product privilege because, collectively, billing records represent a mechanical compilation of information that, at least incidentally, reveals an attorney's legal strategy and thought processes. The Supreme Court explained that when a party neither seeks to recover its own attorney's fees nor attempts to use its attorney-billing records to challenge the opposing party's attorney's fees, the party's attorney should not be restricted in the preparation or presentment of his/her billing records by the prospect that they might have to be revealed in their entirety. The Supreme Court further held that, as a matter of law, redacting privileged information from billing records would be inadequate to protect the attorney's legal strategies and thought processes. Although a party may waive its work-product privilege by using its billing records offensively—such as to contest the reasonableness of the opposing counsel's attorney's fees or to recover its own attorney's fees—the insurers had not done either in this case.

Additionally, the Supreme Court held that information related to an opposing party's hourly rates, total amount billed, and total reimbursable expenses is generally irrelevant and, thus, not discoverable, because it does not establish or tend to establish the reasonableness or necessity of the attorney's fees the opposing party has incurred, and a comparison of opposing parties' litigation expenditures is inappropriate because plaintiffs and defendants may assign a different value to litigating a particular matter, due to countless party-specific interests. Finally, the Supreme Court held that, although attorney-billing information may be discoverable as a result of a party designating its counsel as a testifying expert, the methods for obtaining such information are limited to disclosures, expert reports, and oral depositions of expert witnesses. Therefore, the homeowners' discovery requests—interrogatories and requests for production—were not permissible methods of obtaining such information. Accordingly, the Supreme Court granted mandamus relief for the insurers.

Justice Johnson authored a dissenting opinion, joined by Justices Lehrmann and Boyd. The dissenting justices would have held that the trial court did not abuse its discretion by allowing the discovery it ordered. They agreed that some of the requested information was protected by the work-product privilege, but would have held that redaction of any privileged information would have provided sufficient protection of the insurers' privileges. Moreover, the dissent would have held that the requested information, at a minimum, might be relevant to the reasonableness and necessity of the homeowners' attorneys' fees.

F. Expungement of Lis Pendens

In *Sommers v. Sandcastle Homes, Inc.*, 521 S.W.3d 749 (Tex. 2017), the Texas Supreme Court considered how much notice is "erased" or "destroyed" when a notice of lis pendens is expunged.

Jay Cohen, as trustee of JHC Trusts I & II, sued Matthew Dilick for fraudulent transfer of real property, and filed notices of lis pendens on the various pieces of property involved in the

suit. The trial court granted the defendant's emergency motions to expunge the notices of lis pendens. Cohen then sought mandamus relief in the court of appeals, and obtained a stay of the trial court's expungement order. While the matter was pending at the court of appeals, Dilick sold one of the tracts involved in the suit to Sandcastle Homes, Inc. The court of appeals granted mandamus relief for Cohen, but the trial court again ordered expunction of the lis pendens. Cohen filed another mandamus petition and a motion to stay in the court of appeals, but the court denied his requests. Dilick then sold another tract involved in the lawsuit to NewBiss Property, LP. Both Sandcastle and NewBiss were added as defendants to the suit by Cohen, seeking to set aside their purchases from Dilick.

Sandcastle and NewBiss claimed bona-fide-purchaser status and filed motions for summary judgment, claiming they relied on the expungement order from the trial court, which voided any notice derived from the lis pendens. The trial court granted both summary-judgment motions. Cohen appealed, arguing that neither Sandcastle nor NewBiss could conclusively establish their bona-fide-purchaser affirmative defense because they had obtained actual notice of the claim on the property independent of the lis pendens filing, and independent actual notice is not extinguished by the expunction statute, Section 12.0071 of the Texas Property Code. Section 12.0071(f) of the Property Code allows a lis pendens to be expunged and details the expunction's effects as follows:

> After a certified copy of an order expunging a notice of lis pendens has been recorded, the notice of lis pendens and any information derived from the notice:
> (1) does not:
> (A) constitute constructive or actual notice of any matter contained in the notice or of any matter relating to the proceeding;
> (B) create any duty of inquiry in a person with respect to the property described in the notice; or
> (C) affect the validity of a conveyance to a purchaser for value or of a mortgage to a lender for value; and
> (2) is not enforceable against a purchaser or lender described in Subdivision (1)(C), regardless of whether the purchaser or lender knew of the lis pendens action.

A divided court of appeals disagreed with Cohen, holding that the expunction statute extinguishes *any* notice of the claims involved in the underlying suit covered by the lis pendens.

A divided Texas Supreme Court held that Section 12.0071 of the Texas Property Code does not eradicate notice arising independently of the recorded instrument expunged. Justice Brown authored the majority opinion, joined by Justices Green, Johnson, Guzman, and Boyd. The majority explained that Section 12.0071(f) of the Property Code provides that a purchaser cannot be charged with record notice, actual or constructive, following a proper expungement. According to the majority, however, the extent of that protection is expressly limited to "the notice of lis pendens" and "any information derived from the notice." Thus, by negative implication, expunction is given no effect with respect to the universe of other information, not included in the scope of Section 12.0071(f), that is neither (a) the "notice of lis pendens" itself nor (b) "information derived from the notice" of lis pendens. The majority concluded:

> We decline to construe the provision to mean that any information coextensive with the information contained in the notice or the underlying litigation that may be obtained independently is also legally eradicated. Such separate means of

> notice is necessarily unrelated to the actual expungement and exceeds the reach expressed by the statutory language.
>
> Accordingly, to the extent the recorded lis pendens puts a potential buyer on inquiry notice to look to the actual lawsuit before the notice's expunction, that buyer could claim protection under the statute. Any actual awareness obtained by review of the facts referred to in the lis pendens cannot be used to rebut that purchaser's status as a bona-fide purchaser or to continue to burden the property. But that does not mean the expunction statute can be read so far as to eradicate notice arising independently of the recorded instrument expunged. We are confined by a statute's text as written.

Thus, there was an unresolved fact issue as to whether Sandcastle and NewBiss had actual, independent knowledge of the issues covered by the notice of lis pendens and, therefore, summary judgment was inappropriate.

Justice Lehrmann authored a concurring and dissenting opinion. Justice Lehrmann would have held that all subsequent purchasers may rely equally on the expunction order, regardless of how they learned of the underlying lis pendens action. She agreed with the court of appeals and would have affirmed its judgment as to NewBiss. However, she agreed with the majority that the court of appeals' judgment as to Sandcastle should be reversed, because when it purchased its tract of land, it was relying on the trial court's expunction order that had been stayed.

Justice Willett authored a dissenting opinion, joined by Chief Justice Hecht and Justice Devine. Justice Willett disagreed with the majority's interpretation of the expunction statute—believing that the majority's reading would effectively repeal TEX. PROP. CODE §12.0071(f)(2)—and would have held that both Sandcastle and NewBiss had bona-fide-purchaser status under the expunction statute.

Author's Note: The Legislature has since amended TEX. PROP. CODE §12.0071(f). As amended, the statute now delimits the expungement of a notice of lis pendens to "the notice of lis pendens and any information derived *or that could be derived* from the notice" (emphasis added).

G. Economic Loss Rule

In *Levco Construction, Inc. v. Whole Foods Market Rocky Mountain/Southwest L.P.*, — S.W.3d — , 2017 WL 3429939 (Tex. App.—Houston [1st Dist.] 2017, no pet.), the Houston (First) Court of Appeals also considered whether a subcontractor's claim against an owner for common-law fraud, premised upon the owner's failure to disclose during the bidding process that the plans and specifications for the project were not complete, was barred by the economic loss rule.

Whole Foods contracted with Cleveland Construction, Inc. ("CCI") to construct a Whole Foods store in Houston. CCI, in turn, entered into a subcontract with Levco Construction, Inc. to perform site, concrete, and utility work on the project. Notably, the subcontract expressly incorporated the general contract by reference; and the general contract contained a disclaimer of any warranty regarding the accuracy of the "Contract Documents," including the drawings and specifications, and provided that any deficiency in the Contract Documents "shall not create a cause of action against [Whole Foods] for breach of express or implied warranty, misrepresentation, or fraud." Both the general contract and the subcontract additionally set out

detailed procedures for addressing claims and disputes between Whole Foods, CCI, and CCI's subcontractors, including Levco.

Construction was hindered by numerous delays and problems, most of which stemmed from Whole Foods' failure to obtain the requisite permits for the project, as well as defects in the plans and specifications. A payment dispute later arose, leading Levco to file suit against CCI and Whole Foods. At trial, Levco asserted only a claim against Whole Foods for common-law fraud based upon Whole Foods' failure to disclose during the bidding process that the plans and specifications for the project were not complete. Following a bench trial, the trial court found that Levco had established the elements of a claim for common-law fraud against Whole Foods, but ultimately determined that Levco was not entitled to any damages from Whole Foods on that claim. On appeal, Levco contended that the trial court erred in not awarding damages on its fraud claim, while Whole Foods countered that Levco's fraud claim was barred by the economic loss rule.

The Houston (First) Court of Appeals held that Levco's claim for common-law fraud against Whole Foods was barred by the economic loss rule. The Houston court reasoned that, in determining whether the economic loss rule applies to bar a particular claim, courts examine the source of the defendant's duty and the nature of the claimed injury, and are not bound by the plaintiff's characterization of its cause of action. Here, the source of Whole Foods' duty to provide construction documents to Levco flowed exclusively from Whole Foods' contractual relationship with CCI and with CCI's subcontractors like Levco. Levco's claim seeking to hold Whole Foods liable for misrepresentations or inaccuracies in its Contract Documents was essentially a complaint that Whole Foods violated specific contractual obligations to CCI and to Levco as CCI's subcontractor. The subject matter of the dispute—the accuracy of the Contract Documents and remedy for expenses or delays caused by deficiencies in the Contract Documents—was addressed in the parties' contracts. According to the Houston court, "[t]his indicates that Levco's claims are barred by the economic loss rule." Further, the nature of Levco's alleged injury also indicated that the claim sounds in contract. Levco sought to recover damages it incurred in performing its obligations under its subcontract with CCI; thus, Levco's alleged damages likewise flowed from the contractual relationships among the parties, and those contracts provided a method for addressing increased expenses or performance delays caused by errors or inaccuracies in the Contract Documents. Moreover, Levco never submitted evidence that it had properly given CCI notice, pursuant to the subcontract, of any claim Levco had against Whole Foods for delay damages. Accordingly, the trial court did not err in failing to award Levco damages on its fraud claim against Whole Foods.

H. Limitations

In *Town of DISH v. Atmos Energy Corp.*, 519 S.W.3d 605 (Tex. 2017), the Texas Supreme Court considered whether a town's and property owners' claims for trespass and nuisance were barred by the applicable two-year statute of limitations.

Four independently owned natural-gas compressor stations were built adjacent to one another just outside the Town of DISH.[17] The first compressor station came online in February 2005, when its construction was complete; and the fourth compressor station came online in May 2008, when its construction was complete. Although residents first complained about the noise

[17] Apparently, the Town of Clark changed its name to the Town of DISH in 2005 in exchange for complimentary satellite television services for its residents provided by the DISH Network. 519 S.W.3d at 606 n.1.

and odor emanating from the compressor stations in 2006, the town and 18 of its residents did not file suit against the energy companies that owned the compressor stations until February 28, 2011, asserting claims for trespass and nuisance. The trial court granted summary judgment for the energy companies, holding that the plaintiffs' claims were barred by the applicable two-year statute of limitations. The court of appeals reversed, holding that the energy companies failed to prove as a matter of law that the plaintiffs' trespass and nuisance claims accrued before February 28, 2009. Before the Texas Supreme Court, the plaintiffs argued that their claims did not accrue until the summer of 2009, when the residents noticed a significant change in the noise and odor from the compressor stations.

The Texas Supreme Court held that limitations began to run on the plaintiffs' trespass and nuisance claims no later than May 2008, when construction of the final compressor station was complete and the compressor station came online. Citing *Schneider National Carriers, Inc. v. Bates*, 147 S.W.3d 264, 279 (Tex. 2004), the Supreme Court reasoned that claims for nuisance "normally do not accrue when a potential source is under construction," but "once operations begin and interference occurs, limitations runs against a nuisance claim just as any other." Trespass claims are no different. The Supreme Court further reasoned that, although completion of construction is not dispositive of an accrual date, it is a logical starting point, as "plaintiffs will usually know of unreasonable discomfort or annoyance promptly." Here, the evidence showed that if limitations did not begin to run when construction of the fourth, and final, compressor station was complete in May 2008, it began to run before. In fact, the residents first held town meetings to discuss noise and odor complaints in 2006, and they began making complaints directly to the owners beginning in 2007. However, the plaintiffs waited more than two and one-half years, until February 2011, to file suit against the energy companies.

The Supreme Court additionally rejected the plaintiffs' argument that the accrual date of a nuisance claim turns on "the sensibilities" of the parties and "their perceptions," holding that an accrual date must be based upon *objective* evidence, "not bare, subjective attestations." The Supreme Court reasoned that a condition is a nuisance when it substantially interferes with "the use and enjoyment of land by causing unreasonable discomfort or annoyance to persons of ordinary sensibilities attempting to use and enjoy it." And "unreasonableness must be determined based on an objective standard of persons of ordinary sensibilities, not on the subjective response of any particular plaintiff." Thus, the Supreme Court held that the plaintiffs' trespass and nuisance claims had accrued no later than May 2008—more than two years before they filed suit—and, therefore, those claims were barred by limitations.

I. CPRC Chapter 82 Indemnity

In *RDJRLW, Inc. v. Miller*, No. 02-16-00132-CV, 2017 WL 2590568 (Tex. App.—Fort Worth June 15, 2017, no pet.) (mem. op.), the Fort Worth Court of Appeals considered whether a concrete supplier owed a general contractor statutory indemnity under CPRC Chapter 82.

The Dankels contracted with Miller Construction to build a driveway and to extend an existing concrete slab on their property. Miller Construction bought the concrete from the predecessor of RDJRLW, Inc. (RDJ). After Miller Construction demolished the existing gravel driveway and prepared the site with rebar and wooden framing, RDJ delivered the concrete to the Dankels' property. Under Miller Construction's direction, RDJ poured the concrete, and the Miller Construction crew spread and smoothed it. The concrete was discolored, and it did not set properly and cracked.

The Dankels sued Miller Construction for breach of contract and DTPA violations. Miller Construction, in turn, filed a third-party action against RDJ for statutory indemnity under CPRC Chapter 82. The jury found in favor of the Dankels on their breach-of-contract and DTPA claims against Miller Construction. The jury also found that RDJ was required to indemnify Miller Construction for its losses. The trial court entered judgment on the jury's verdict, awarding the Dankels judgment against Miller Construction for $215,000 in damages, plus $25,210.96 in prejudgment interest and $36,000 in attorney's fees; and awarding Miller Construction judgment against RDJ for $277,215.96, plus $40,000 in attorney's fees. On appeal, RDJ contended that there was legally and factually insufficient evidence to support the jury's finding that RDJ owed Miller Construction statutory indemnity because (1) the Dankels neither pleaded nor obtained jury findings supporting a "products liability action" under CPRC Chapter 82, and (2) the jury's liability findings against Miller Construction conclusively established its own liability, thereby triggering the exception to a manufacturer's indemnity obligation set forth in CPRC §82.002(a).

The Fort Worth Court of Appeals held that the Dankels' pleadings activated RDJ's duty to indemnify Miller Construction, and that RDJ failed to establish that Miller Construction's conduct independently caused the loss. The Fort Worth court explained that the Texas Products Liability Act, CPRC Chapter 82, requires a manufacturer of an allegedly defective product to indemnify an innocent seller for any loss arising out of a products-liability action unless the seller independently caused the loss. This duty is triggered by allegations in the injured claimant's pleadings of a defect in the manufacturer's product, regardless of any adjudication of the manufacturer's liability directly to the claimant. Pursuant to CPRC §82.002(a), the manufacturer may "escape this duty to indemnify" by proving that the seller's "acts or omissions independent of any defect in the manufactured product cause[d] injury." Here, the Dankels alleged that the concrete itself was "defective." They pleaded claims against Miller Construction for breach of contract, DTPA violations (unconscionability and breach of implied warranty), negligence, and negligent misrepresentation—all based upon Miller Construction's pouring "defective concrete," which they alleged caused them such damages as the "[c]ost to remove and replace the defective concrete." "Once poured and thus affixed to the Dankels' land, the defective concrete became a part of their real property." Based upon this principle, the Fort Worth court concluded that the Dankels' removal and replacement costs were in fact damages arising out of property damage allegedly caused by the defective concrete. Accordingly, the Dankels pleaded a "products liability action" under the Act, thereby triggering RDJ's duty to indemnify Miller Construction.

The Fort Worth court additionally rejected RDJ's argument that the Dankels were required to obtain jury findings supporting a "products liability action." Because it is simply *the allegations* in an injured claimant's petition that trigger a manufacturer's indemnification duty, the Fort Worth court held that the Dankels did not have to obtain jury findings supporting a "products liability action."

Finally, the Fort Worth court held that the jury's liability findings against Miller Construction for breach of contract and DTPA violations did not conclusively establish Miller Construction's liability and that CPRC §82.002(a) therefore applies. According to the Fort Worth court, CPRC §82.002(a)'s exception to a manufacturer's duty to indemnify applies only upon a finding that the seller was independently liable for the loss. Here, there was no such finding; in fact, the jury impliedly found the opposite. The jury was instructed that RDJ must indemnify Miller Construction unless the jury found that the Dankels' loss was caused by Miller Construction's "negligence, intentional misconduct, or other act or omission, such as negligently modifying or altering the product." Thus, in finding that RDJ was indeed required to indemnify Miller Construction, the jury implicitly found that Miller Construction did not cause the Dankels'

loss, and so RDJ did not establish CPRC §82.002(a)'s exception to its indemnification duty. Accordingly, the jury's finding that RDJ owed Miller Construction statutory indemnity under CPRC Chapter 82 was supported by legally and factually insufficient evidence.

J. Effect of "As Is" Clause

In *Lutfak v. Gainsborough*, No. 01-15-01068-CV, 2017 WL 2180716 (Tex. App.—Houston [1st Dist.] May 18, 2017, no pet.) (mem. op.), the Houston (First) Court of Appeals considered whether an "as is" clause in an earnest money sales contract precluded a homeowner's fraud, DTPA, and negligent-misrepresentation claims.

Jeff Gainsborough was very interested in purchasing a townhome owned by Gilad Luftak. The parties met several times to discuss the sale of the home, during which Gilad made several representations, including that he and his brother were the "builders" of the townhome, that it was "brand new," and that certain water damage near one of the windows was the result of a burst pipe that had been taken care of. The parties entered into a standard Texas Real Estate Commission One to Four Residential Resale Contract, wherein Gainsborough agreed to buy the home in "its present condition." Prior to closing, Gainsborough had the home inspected, and numerous problems were discovered. The parties subsequently amended the sales contract to include the inspection report and required that all issues in the report be addressed and repaired. Soon thereafter, Gainsborough and Gilad supplemented the contract by entering into a written escrow agreement, wherein Gainsborough agreed to put money in escrow and Gilad agreed to make the necessary repairs designated in the inspection report.

At closing, Gainsborough accepted and signed a special warranty deed, which provided that Gainsborough purchased the property:

> AS IS, WHERE IS, AND WITH ALL FAULTS, AND WITHOUT ANY REPRESENTATIONS OR WARRANTIES WHATSOEVER, EXPRESS OR IMPLIED, WRITTEN OR ORAL, IT BEING THE INTENTION OF GRANTOR AND GRANTEE TO EXPRESSLY REVOKE, RELEASE, NEGATE, AND EXCLUDE ALL REPRESENTATIONS AND WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY AND ALL EXPRESS OR IMPLIED REPRESENTATIONS AND WARRANTIES....

Gilad never made the necessary repairs after closing. Gainsborough moved in and discovered several problems throughout the home, and hired contractors to make repairs. Gainsborough later filed suit against Gilad, asserting claims for fraud, DTPA violations, and negligent misrepresentation arising out of the sale of the home. The jury found in Gainsborough's favor on all three of those claims. The trial court rendered judgment in favor of Gainsborough, awarding him damages, attorney's fees, and prejudgment interest. On appeal, Gilad argued that the sales contract contained an "as is" clause and precluded Gainsborough from establishing the elements of producing cause and reliance for his fraud, DTPA, and negligent-misrepresentation claims as a matter of law.

The Houston (First) Court of Appeals held that the "as is" clause in the sales contract precluded a judgment in Gainsborough's favor on his fraud, DTPA, and negligent misrepresentation claims. The Houston court explained that a buyer who purchases property "as is" chooses "to rely entirely upon his own determination" of the property's value and condition without any assurances from the seller. Thus, the buyer assumes the responsibility of assessing the property's value and condition as well as the resulting risk that the property is worth less than

the price paid. This evaluation on the part of the buyer constitutes a new and independent basis for the purchase, one that disavows any reliance on representations made by the seller. Thus, a valid "as is" clause negates the elements of producing cause and reliance for DTPA, fraud, or negligence claims relating to the value or condition of the property.

The Houston court reasoned that Gainsborough conducted his own inspection of the home, which revealed several potential defects in the home and caused him to renegotiate the sales contract with Gilad. However, neither the amendment nor the escrow agreement superseded the "as is" clause. Instead, the amendment and escrow agreement only imposed a new requirement that Gilad make necessary repairs to receive the money in escrow. The Houston court further held that Gainsborough failed to demonstrate that he was fraudulently induced into signing the sales contract. As a result, the Houston court explained that the "as is" provision precluded Gainsborough from establishing the elements of causation and reliance for the purposes of his fraud, DTPA, and negligent-misrepresentation claims. Thus, the Houston court reversed and rendered judgment that Gainsborough take nothing on those claims.

K. Residential Construction Liability Act

In *Vision 20/20, Ltd. v. Cameron Builders, Inc.*, 525 S.W.3d 854 (Tex. App.—Houston [14th Dist.] 2017, no pet.), the Houston (Fourteenth) Court of Appeals considered whether physical damage to a home caused by a burst water supply line constitutes a "construction defect" for the purposes of the Residential Construction Liability Act (RCLA), Chapter 27 of the Texas Property Code, and whether a homeowner may recover damages under RCLA if the homeowner does not provide proper notice to the contractor before performing repairs.

Cameron Builders, Inc. built a home for Vision 20/20, Ltd. in 2005. About six years later, a plumbing failure in an upstairs bathroom caused significant water damage at the home, both to the structure itself and to furnishing and other personal possessions. Vision's insurer hired Rimkus Consulting to investigate what happened, and Rimkus reported that the water damage was the result of the failure of a hot water supply lavatory connector which was improperly routed and installed. After all remediation and repair efforts at the home had been completed, Cameron was sent a demand letter alleging that it was responsible for the water damage to the home, and Cameron denied liability.

Vision filed suit against Cameron, asserting claims for negligence, breach of warranty, and DTPA violations, seeking damages for the cost of repairing the real-property damage, as well as for the value of damaged personal property. Cameron filed a motion for summary judgment, arguing that Vision's claims were barred by the operation of RCLA §27.003(a)(2). The trial court granted Cameron's summary-judgment motion as to Vision's claims for damages related to real property, but denied Cameron's motion as to Vision's claims for damages related to personal property. The parties subsequently nonsuited their remaining claims, and Vision appealed. On appeal, Vision contended that the definition of "construction defect" as used in RCLA §27.003(a)(2) did not include any damages to the home caused by the failed water line beyond repair of the line itself. Notably, RCLA §27.001(4) defines "construction defect," in relevant part, as:

> a matter concerning the design, construction, or repair of a new residence...on which a person has a complaint against a contractor. The term may include any physical damage to the residence, any appurtenance, or the real property on which the residence and appurtenance are affixed proximately caused by a construction defect.

Vision additionally contended that, before Cameron could rely upon RCLA §27.003(a)(2), it needed to show that it was prejudiced by the lack of pre-repair notice and that Cameron failed to demonstrate any such prejudice.

The Houston (Fourteenth) Court of Appeals held that the term "construction defect" as used in RCLA §27.003(a)(2) includes any physical damage as listed in RCLA §27.001(4), including water damage from a failed water supply line. The Houston court explained that the definition of "construction defect" uses the phrase "may include," which demonstrates the Legislature's intent to broaden the definition by providing the list including physical damage. Furthermore, the RCLA is written broadly to encompass "any action to recover damages or other relief arising from a construction defect." Similarly, "construction defect" is broadly defined. A construction of the statute that could exclude physical damage is contrary to the very purpose of the statute.

The Houston court next considered Vision's argument that, before Cameron could rely upon RCLA §27.003(a)(2), Cameron needed to show that it was prejudiced by the lack of pre-repair notice. It was undisputed that Vision failed to provide the requisite statutory notice to Cameron prior to making repairs; thus, Cameron was not provided an opportunity to inspect the residence and make an offer to fix the problem. Without the opportunity to inspect and investigate the nature and cause of the defect and the nature and extent of necessary repairs, Cameron was prejudiced in determining whether it might be liable for the damages and whether to offer to repair the damages or make a monetary offer of settlement as permitted under the RCLA. As a result, Cameron was not liable for the water damage to the home, and the Houston court affirmed the summary judgment in favor of Cameron.

L. Texas Citizens Participation Act

In *Urban Engineering v. Salinas Construction Technologies, Ltd.*, No. 13-16-00451-CV, 2017 WL 2289029 (Tex. App.—Corpus Christi May 25, 2017, pet. filed) (mem. op.), the Corpus Christi Court of Appeals considered whether an engineer was protected under the Texas Citizens Participation Act (TCPA), CPRC Chapter 27, after the engineer was sued in response to recommendations it provided concerning the award of a construction contract.

Urban Engineering was hired by the City of Corpus Christi to serve as the engineer on a public construction project, and was tasked with analyzing and evaluating bids and making recommendations to the City concerning the award of the construction contract. Salinas Construction Technologies, Ltd. submitted the lowest bid on the project. However, Urban recommended to the City that it not award the contract to Salinas for several reasons, including that Salinas's current projects with the City and the Texas Department of Transportation were behind schedule; Salinas was in pending litigation with another municipality; a "failure to perform" complaint had been filed with the bonding company on a project; and Salinas had a lack of experience and a lack of demonstrated resources to perform the required work on schedule. Salinas denied all of Urban's allegations, but the City still rejected Salinas's low bid and awarded the construction contract to the second-lowest bidder.

Salinas filed suit against Urban for defamation and business disparagement, and Salinas obtained a certificate of merit from an engineer and attached it to its petition. The expert's affidavit recited, in pertinent part, as follows:

> In my professional opinion, [Urban] was negligent and breached the applicable standard of care of an engineer under the same or similar circumstances.

The expert opined that Urban did not engage in a reasonable investigation and was not objective and truthful. As a result, the expert averred that Urban failed to meet the normal and applicable standard of care, which caused harm and injury to Salinas and damaged its business reputation. Urban filed an answer asserting qualified privilege as a defense. Urban also filed a motion to dismiss pursuant to the TCPA, arguing that its communications with the City were an exercise of free speech because they were made in connection with a matter of public concern. Urban also contended that it relied on information provided by references to be factual, while Salinas maintained that Urban's statements were false and misleading. The trial court denied Urban's motion to dismiss, and Urban filed an interlocutory appeal.

The Corpus Christi Court of Appeals held that Urban was protected under the TCPA, and that Salinas's action of filing suit was based on, related to, or in response to Urban's exercise of its right to free speech. The Corpus Christi court further held that Urban's statements to the City were protected by a qualified privilege because Urban made the statements at issue pursuant to its contractual duties to the City to analyze and evaluate the bids and make recommendations concerning the award of the construction contract. As a result, Salinas had the burden of establishing by clear and specific evidence a prima facie case for each essential element of its defamation and business-disparagement claims, including that Urban's statements were made with actual malice. However, there was no evidence that Urban either knew its statements to be false or entertained serious doubts as to the truth of the statements at the time of publication and, therefore, Salinas failed to meet its burden. Accordingly, Urban was entitled to dismissal of Salinas's defamation and business-disparagement claims under the TCPA, and the trial court erred in denying Urban's motion to dismiss.

M. Actual Damages

1. CPRC §18.091 does not apply to benefit-of-the-bargain damages sought for breach of a construction contract.

In *Star Operations, Inc. v. Dig Tech, Inc.*, No. 03-15-00423-CV, 2017 WL 3263352 (Tex. App.—Austin July 27, 2017, pet. filed) (mem. op.), the Austin Court of Appeals also considered whether a subcontractor was required to comply with CPRC §18.091 in proving up the damages sought for breach of a construction contract.

Central Texas Highway Constructors, LLC was hired as the design-build contractor for the construction of SH 130 toll-road Segments 5 and 6 southeast of Austin. Central Texas hired Star Operations, Inc. as a subcontractor to build infrastructure for the illumination, signal, intelligent-transportation, and toll-collection systems for the project. Central Texas also separately hired Dig Tech, Inc. as a subcontractor to relocate and adjust electric-distribution facilities. Star later entered into an oral subcontract with Dig Tech to perform hole-boring work for the installation of electrical conduit on Star's portion of the project. When Star failed to pay Dig Tech for the work it performed, Dig Tech filed suit against Star and its surety, asserting claims for breach of contract and quantum meruit. Following a jury trial, the trial court entered judgment in favor of Dig Tech, awarding it damages and attorney's fees for Star's breach of the oral subcontract.

On appeal, Star contended that the trial court erred in awarding damages to Dig Tech without any evidence of Dig Tech's actual damages presented in the form of a net loss after reduction for income-tax payments or unpaid income-tax liability, which Star contended was required by CPRC §18.091. Star argued that the language of CPRC §18.091 is broad and is not expressly limited to personal-injury cases. Dig Tech countered that CPRC §18.091 applies only

to personal-injury cases, not contract cases, because damages received in a breach-of-contract case are taxable, and application of the statute would effectively result in double taxation on such contract plaintiffs.

The Austin Court of Appeals held that Dig Tech was not required to comply with CPRC §18.091 in proving up the damages sought for Star's breach of its oral subcontract with Dig Tech. CPRC §18.091 states:

> § 18.091. Proof of Certain Losses; Jury Instruction
>
> (a) Notwithstanding any other law, if any claimant seeks recovery for loss of earnings, loss of earning capacity, loss of contributions of a pecuniary value, or loss of inheritance, evidence to prove the loss must be presented in the form of a net loss after reduction for income tax payments or unpaid tax liability pursuant to any federal income tax law.
>
> (b) If any claimant seeks recovery for loss of earnings, loss of earning capacity, loss of contributions of a pecuniary value, or loss of inheritance, the court shall instruct the jury as to whether any recovery for compensatory damages sought by the claimant is subject to federal or state income taxes.

The Austin court reasoned that the language of the statute expressly points the analysis to the type of damages sought to be recovered, rather than the type of liability claims (contract or personal injury) in question. Here, Dig Tech sought recovery of breach-of-contract damages from Star based upon the amount of the unpaid invoices in question. Dig Tech did not seek recovery of "loss of earnings" as that phrase is typically used in the Texas Pattern Jury Charge and Texas case law, nor was the jury charged to assess such an element of damages.

According to the Austin court, "[p]resumably, the purpose of [CPRC §18.091] is to prevent a plaintiff from obtaining a windfall by being awarded pretax income on awards that are not subject to taxation." In contrast, a corporation such as Dig Tech would be required to report breach-of-contract damages from a court award as ordinary income. Further, Dig Tech did not seek recovery of loss of earnings, and the evidence did not demonstrate that it lost earnings or suffered a loss of the opportunity or ability to obtain earnings. Instead, Dig Tech failed to receive its benefit of the bargain—payment—after it had performed the work. The Austin court reasoned that, based upon the facts of the business dispute presented by this case, Star's assertion "would require us to stretch the interpretation of Section 18.091 to fit a category of damages to which it seemingly was not intended to apply and in which there is no discernable potential for a plaintiff to obtain a windfall of tax-free damages. We decline to do so." Accordingly, the Austin court held that the trial court did not err in awarding damages to Dig Tech for Star's breach of the oral subcontract.

2. In a breach-of-contract case, the one-satisfaction rule may apply to reduce the plaintiff's damages award by the amounts the plaintiff received in settlements with other defendants.

In *Elness Swenson Graham Architects, Inc. v. RLJ II-C Austin Air, LP*, 520 S.W.3d 145 (Tex. App.—Austin 2017, pet. filed) (en banc), the Austin Court of Appeals considered whether the trial court properly applied the one-satisfaction rule to reduce a party's damages award by the amounts it received in its settlements with two other defendants.

A hotel owner filed suit against multiple defendants involved in the design and construction of the hotel, alleging that the defendants' work caused the hotel to have a defective foundation that caused building movement and further damage. Specifically, the hotel owner sued the architectural firm (Elness Swenson Graham Architects, Inc.), the general contractor (EBCO General Contractor, Ltd. and EBCO/Warrior Management, LLC), and the geotechnical engineering firm (Terracon Consultants, Inc.); as trial neared, the only claims remaining were breach-of-contract claims against each defendant. The hotel owner entered into a settlement agreement with Terracon before trial and a settlement agreement with EBCO during trial. Thus, the only defendant remaining when the case was submitted to the jury was Elness.

The jury found that Elness failed to comply with the contract and awarded the hotel owner $785,000 in damages. Elness then filed a motion asking the trial court to apply settlement credits to the damages award based upon the payments the owner received from its settlements with Terracon and EBCO. The trial court granted Elness' motion. The parties agreed to submit the issue of attorney's fees to the trial court, which ultimately awarded the hotel owner $901,650.96 in attorney's fees. In its final judgment, the trial court applied the settlement credits (a total of $1,170,000) to the amounts awarded in damages and attorney's fees, and ordered that the hotel owner recover the remaining amount, which was $516,650.96. On appeal, the hotel owner contended that the trial court erred in applying the one-satisfaction rule to reduce the damages award by the amounts the hotel owner received in its settlements with Terracon and EBCO.

The Austin Court of Appeals sitting en banc held that the trial court properly applied the one-satisfaction rule by applying settlement credits to the jury's damages award. The Austin court explained that the one-satisfaction rule applies both when several defendants commit the same act and when multiple defendants commit technically different acts that result in the same, single injury. Importantly, the application of the rule is not limited to tort claims, and whether the rule may be applied depends not on the cause of action asserted, but rather on the injury sustained. The fact that more than one defendant may have caused the injury, or that there may be more than one theory of liability, does not modify this rule. The Austin court reasoned that all of the hotel owner's allegations and evidence regarding damages were based upon a single injury—a defective structure—that was the alleged result of all of the defendants' work. Further, none of the evidence presented to the jury was apportioned to each defendant that allegedly caused it; rather, all of the evidence focused on the totality of the damage caused to the hotel, and the hotel owner's damages expert testified on cross-examination that he did not allocate damages among the defendants. The settlement agreements with Terracon and EBCO therefore encompassed the hotel owner's claims for damages that were allegedly jointly caused—namely, the mistakes made by all of the defendants in causing a defective foundation that then caused damage to the hotel. Accordingly, because the hotel owner failed to apportion damages to each defendant, the trial court properly applied the total of the two settlement amounts, which was $1,170,000, to the jury's awards of damages.

The Austin court additionally rejected the hotel owner's arguments that, to raise the one-satisfaction rule, Elness was required to (1) specially except to the owner's failure to allocate damages in its petition, or (2) request a jury question or instruction about damages allocation, or (3) plead the one-satisfaction rule as an affirmative defense. Rather, Elness properly invoked the one-satisfaction rule by filing a motion requesting the trial court to apply the rule by applying settlement credits to the jury's damages award. Moreover, it was the hotel owner's burden, as the plaintiff in a breach-of-contract suit, to establish damages as a result of *Elness'* breach of the hotel contract in order to be entitled to damages from Elness. Thus, the trial court did not err in applying the one-satisfaction rule in this case.

3. Tenant could not recover "loss of value" damages separate from award of lost profits for contractor's breach of contract to renovate leased space.

In *8305 Broadway Inc. v. J&J Martindale Ventures, LLC*, No. 04-16-00447-CV, 2017 WL 2791322 (Tex. App.—San Antonio June 28, 2017, no pet.) (mem. op.), the San Antonio Court of Appeals considered whether a commercial tenant was entitled to recover "loss of value" damages in addition to an award of lost profits for a contractor's breach of a renovation contract.

8305 Broadway Inc. and J&J Martindale Ventures, LLC entered into a commercial lease; Martindale intended to use the space to operate a "Growler Station" where customers are allowed to sample and take home craft beer in growlers. Renovations to the leased space were necessary to make the space suitable for Martindale's use. Thus, Martindale entered into a contract with Changing Surface, Inc., to perform the necessary renovations. Notably, 8305 Broadway (the landlord) and Changing Service (the contractor) were owned by the same owner. Martindale received its liquor license and was eligible to begin sales, but the renovations were still ongoing for approximately two weeks. After Changing Surface represented it had completed its work, city inspectors refused to issue a certificate of occupancy because Changing Surface's work was not up to city code and had been performed without the necessary permits. Martindale was forced to expend an additional $3,065.52 to complete the work and obtain the necessary permits. After Martindale finally opened for business, Changing Surface presented Martindale with a change order, claiming it was owed an additional $7,225 for the renovations. Martindale refused to pay, and Changing Surface filed a lien against the property. The following day, 8305 Broadway sent Martindale a letter stating Martindale had violated the lease agreement by causing a lien to be filed against the property.

Martindale then filed suit against 8305 Broadway and Changing Surface. Following a bench trial, the trial court found that Changing Surface breached its contract with Martindale and awarded Martindale a total of $7,229.04 in damages, consisting of: (1) $3,065.52 in damages for the costs necessary to complete the renovations; (2) $3,090.00 in "loss of value" of the contract based on Changing Surface's failure to complete the work in the timeline promised; and (3) $1,573.48 in lost profits. Notably, the "loss of value" damages were based upon the trial court's finding that Martindale was required to pay $3,090 in rent between the time when it could begin sales under its liquor license and the time when it was able to open for business. On appeal, Changing Surface did not challenge the award of reliance damages which awarded Martindale the out-of-pocket expenses it incurred in completing the renovations; instead, Changing Surface contended that the trial court could not award Martindale its "loss of value" damages separate from the award of lost profits.

The San Antonio Court of Appeals held that Martindale was not entitled to recover "loss of value" damages in addition to an award of lost profits for Changing Surface's breach of the renovation contract. The San Antonio court explained that three general damage measures exist for breach of contract claims: expectancy, reliance, and restitution. Expectancy damages award the benefit of a plaintiff's bargain, while reliance damages compensate for the plaintiff's out-of-pocket expenditures. Lost profits is one example of expectancy damages because "benefit of the bargain" damages compensate for the profits that would have been made if the bargain had been performed as promised.

The San Antonio court reasoned that lost profits are damages for the loss of net income to a business and reflect income from the lost business activity less expenses that would have been attributable to that activity. Here, the trial court's award of "loss of value" damages was based

upon the amount of rent Martindale was required to pay from the time when it could begin sales under its liquor license and the time when it was able to open for business. That expense, however, was part of the equation the trial court was required to use in calculating Martindale's lost profits. To recover lost profits, Martindale was required to prove the amount of net income it would have generated if the bargain or renovations had been performed or completed as promised. The rent Martindale paid would be one expense taken into consideration in computing any such net income. Therefore, the trial court erred in awarding Martindale $3,090 for "loss of value."

N. Exemplary Damages

1. Award of exemplary damages held to be unconstitutionally excessive despite court of appeals' remittitur.

In *Bennett v. Grant*, 525 S.W.3d 642 (Tex. 2017), the Texas Supreme Court considered whether an award of exemplary damages violated federal due process and, thus, was unconstitutionally excessive despite the court of appeals' remittitur.

Two ranchers, Thomas O. Bennett and Randy Reynolds, became involved in a long-running dispute after some of Reynolds' cattle wandered onto Bennett's land. Instead of returning the cattle to Reynolds, Bennett instructed his ranch hand, Larry Wayne Grant, to sell them. Grant took photographs of the cattle as they were sold, and he later told Bennett about the photos, causing Bennett to believe Grant was trying to blackmail him. Bennett and his company, James B. Bonham Corporation, were eventually found liable in a civil suit for the converted cattle. Bennett sued Grant for slander based upon allegations that Grant had told Reynolds the cattle belonged to Reynolds, and two years later, Bennett filed blackmail charges against Grant in four different counties, though three of the counties refused to prosecute Grant. Bennett managed to convince the district attorney in Navarro County to bring the case to the grand jury, but the grand jury refused to indict Grant. Bennett then successfully petitioned for appointment of his neighbor as a special prosecutor in Navarro County, and the special prosecutor obtained two felony indictments, but they were eventually quashed because the charges were barred by statute of limitations.

Grant subsequently filed a counterclaim in the civil suit against Bennett alleging malicious prosecution, and the jury found in Grant's favor. The trial court awarded Grant $10,703 in actual damages and $1 million each against Bennett and Bonham Corp. in exemplary damages. Bennett and Bonham Corp. appealed, arguing that the $2 million award of exemplary damages was unconstitutionally excessive. The court of appeals agreed and remitted the exemplary damages to $512,109 each against Bennett and Bonham Corp. Bennett and Bonham Corp. appealed, arguing that the remitted exemplary damages award was still excessive and unconstitutional as it violated federal due process.

The Texas Supreme Court held that the exemplary damages award remained unconstitutionally excessive, even after it was reduced by the court of appeals. The Supreme Court drew guidance from *State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408 (2003), holding that three guideposts must be considered when determining whether an exemplary damages award is unconstitutionally excessive:

> (1) the degree of reprehensibility of the misconduct; (2) the disparity between the exemplary damages award and the actual harm suffered by the plaintiff or the harm likely to result; and (3) the difference between the exemplary damages

awarded and the civil or criminal penalties that could be imposed for comparable conduct.

The Supreme Court agreed with the court of appeals' analysis as to the first and third guidepost, but disagreed with its analysis on the second guidepost, explaining that when the ratio between the exemplary damages awarded and the actual harm suffered by the plaintiff or the harm likely to result is more than a single-digit, the exemplary damages award is likely unconstitutional. The ratio between Grant's actual damages and the exemplary damages awarded was almost 48:1.

The Supreme Court explained that, to determine whether the ratio is excessive, courts must ask whether there is a reasonable relationship between the punitive damages award and *the harm likely to result* from the defendant's conduct as well as the harm that has likely occurred. This requires a three-part inquiry, looking at (1) the exemplary damages awarded; (2) the actual damages awarded; and (3) the "potential damages," which is the harm likely to result from the defendant's conduct. The court of appeals considered the consequences of Grant's wrongful imprisonment, and found that his potential damages were at least $160,000—under the statutory compensation scheme for wrongful imprisonment—which made the ratio between the remitted exemplary damages award and Grant's combined actual and potential damages 3:1. The Supreme Court held that the court of appeals erred by considering the consequences of wrongful imprisonment, because there was essentially zero likelihood of imprisonment since the claim against Grant was barred by the statute of limitations. According to the Supreme Court, the analysis of potential harm should have focused solely on the probable damages resulting from the malicious prosecution, such as attorney's fees Grant would incur defending against the charges and time taken away from his job from participating in court proceedings. Accordingly, the Supreme Court reversed and remanded the exemplary damages award to the court of appeals for a more substantial remittitur.

2. In assessing the excessiveness of exemplary damages, the disparity between the compensatory and exemplary damages awards must be analyzed on a per-defendant basis.

In *Horizon Health Corp. v. Acadia Healthcare Co.*, 520 S.W.3d 848 (Tex. 2017), the Texas Supreme Court considered whether an exemplary damages award was unconstitutionally excessive despite the court of appeals' remittitur, and whether the disparity between the compensatory and exemplary damages awards must be analyzed on a per-defendant basis or a per-judgment basis.

Horizon Health Corporation was acquired by Psychiatric Solutions, Inc. in 2007. A few years later, Horizon's upper-management team—consisting of Michael Saul, Peter Ulasewicz, Tim Palus, and Barbara Bayma—attempted to purchase Horizon multiple times, but PSI was acquired by Universal Health Services, and then Universal rejected their offer. Saul then met with Acadia Healthcare Company and presented a business plan for Acadia to create a subsidiary that would compete with Horizon and be managed by Saul, Ulasewicz, Palus, and Bayma. Acadia agreed to the proposal, and Saul's proposed management team, as well as a member of Horizon's sales team, John Piechocki, joined Acadia's new subsidiary, Psychiatric Resource Partners.

Horizon subsequently discovered that Saul, Ulasewicz, Palus, Bayma, and Piechocki made copies of several Horizon documents prior to joining PRP. Horizon notified them that their actions violated their employment agreements with Horizon and demanded that they resign from Acadia and return the copied documents. Saul, Ulasewicz, Palus, Bayma, and Piechocki ignored

Horizon's demands and began competing with Horizon and soliciting business from its prospective and existing client base, though Horizon did not lose any of its existing customers to PRP.

Horizon filed suit against Saul, Ulasewicz, Palus, Bayma, and Piechocki, alleging several claims including breach of fiduciary duty, tortious interference with existing contracts, and tortious interference with prospective business relationships. Horizon brought claims against Saul, Ulasewicz, Palus, and Bayma for breach of a non-compete agreement, breach of contract, and fraud. Horizon also brought claims against Acadia and PRP alleging that they were liable for the acts of the individuals under multiple theories, including ratification and vicarious liability. At trial, the jury found for Horizon on most of its claims, including that (1) Saul, Ulasewicz, Palus, and Bayma violated their non-compete agreements; (2) Saul, Ulasewicz, Palus, Bayma, and Piechocki breached their fiduciary duties to Horizon, intentionally interfered with the non-compete agreements, misappropriated Horizon's trade secrets, intentionally committed theft of Horizon's property and trade secrets, converted Horizon's proprietary information, and submitted fraudulent expense reports; and (3) Acadia and PRP ratified their conduct. The jury awarded Horizon a total of $6,903,049.24 in damages, which included $1,750,000 in exemplary damages. The trial court reduced Horizon's attorney's fee award but otherwise rendered final judgment awarding Horizon the damages found by the jury, and Acadia appealed.

The court of appeals reversed and rendered a take-nothing judgment in part and remanded in part, finding that Horizon was not entitled to any award on any of its contractual and tort claims, except for theft of property and trade secrets and fraudulent expense reports, which totaled $55,049.24 in damages. As a result, the court of appeals held that the $1,750,000 exemplary damages award was unconstitutionally excessive. The court of appeals suggested a remittitur of $220,196.96 for each individual defendant, or $1,100,984.80 total, and both sides sought review. Before the Texas Supreme Court, Acadia argued that the exemplary damages award, even after the court of appeals' remittitur, was unconstitutionally excessive in light of the actual damages awarded to Horizon, and that the disparity between the compensatory and exemplary damages awards should be assessed on a per-judgment basis rather than a per-defendant basis. In contrast, Horizon argued in favor of a per-defendant, joint-and-several approach. Horizon further argued that the court of appeals erred in reversing the joint-and-several exemplary damages awards against Acadia and PRP.

The Texas Supreme Court held that Horizon was entitled to exemplary damages, but the exemplary damages award was unconstitutionally excessive despite the court of appeals' remittitur. The Supreme Court explained that the court of appeals' remittitur resulted in an exemplary damages award that violated due process because the ratio of compensatory to exemplary damages was 4:1, which was not appropriate in this case. Furthermore, the court of appeals' review of the exemplary damages award was flawed, because it grouped all of the individual defendants together in its analysis, rather than analyzing each defendant individually. The Supreme Court explained that constitutional rights are personal in nature and, thus, inquiries into the constitutional excessiveness of an exemplary damages award must be defendant-specific.

The Supreme Court further held that the proper basis for assessing the constitutional excessiveness of an exemplary damages award is per-defendant rather than per-judgment. Moreover, in determining the basis for a constitutionally permissible amount of exemplary damages, courts must consider the harm each defendant actually caused and assess the punishment based on that harm—rather than on each defendant's joint and several liability for compensatory damages—because this approach most closely matches the punishment to each

defendant's misconduct. Finally, the Supreme Court held that Acadia and PRP could not be held jointly and severally liable for the exemplary damages assessed against the individual defendants.

O. Attorney's Fees

1. For the purposes of CPRC Chapter 38, presentment may be established by evidence of post-verdict settlement discussions and discovery responses.

In *Lyon v. Building Galveston, Inc.*, No. 01-15-00664-CV, 2017 WL 4545831 (Tex. App.—Houston [1st Dist.] Oct. 12, 2017, no pet. h.) (mem. op. on reh'g), the Houston (First) Court of Appeals considered whether the trial court erred by failing to award a general contractor attorney's fees under CPRC Chapter 38 in connection with the general contractor's successful breach-of-contract claim.

Building Galveston, Inc. (BGI) entered into a subcontract agreement with Lyon Construction Services whereby Lyon agreed to serve as BGI's subcontractor on a remodeling project. BGI subsequently terminated Lyon, claiming Lyon's work was defective and that Lyon had failed to correct the defects. Lyon ultimately filed suit against the property owners to foreclose on its lien. BGI intervened in the suit, asserting its own claims against Lyon for breach of contract, negligent misrepresentation, and fraud, among other claims. The owners ultimately settled with Lyon, and the parties' remaining claims were tried to a jury. The jury found that Lyon failed to comply with the subcontract and awarded damages to BGI for Lyon's breach.

By agreement of the parties, the issue of attorney's fees was submitted to the trial court post-verdict. Five months after the jury returned its verdict, but approximately one week before the attorney's fees hearing, BGI attempted to file a supplemental petition, wherein BGI alleged for the first time it had satisfied the statutory requirements for presentment. Lyon objected to the supplemental petition as untimely and argued unfair surprise and prejudice. The trial court denied BGI's motion for leave to file its supplemental petition but allowed BGI to put on testimony establishing presentment. In the final judgment, however, the trial court sustained Lyon's objection based upon BGI's failure to plead presentment and did not award BGI attorney's fees. BGI appealed.

The Houston (First) Court of Appeals held that the trial court abused its discretion by not allowing BGI to amend its pleadings to allege presentment, and that the trial court's error was harmful because BGI had offered legally sufficient evidence of presentment. Pursuant to Texas Rule of Civil Procedure 63, a party may seek leave of court to amend its pleadings after the deadline imposed by a scheduling order entered pursuant to Rule 166, and leave "shall be granted" by the trial court "unless there is a showing that such filing will operate as a surprise to the opposing party." A trial court has no discretion to refuse an amended pleading unless: (1) the opposing party presents evidence of surprise or prejudice; or (2) the amendment asserts a new cause of action or defense, and is thus prejudicial on its face, and the opposing party objects to the amendment. The Houston court reasoned that BGI's supplemental pleading did not present a new cause of action or defense; rather, it added more specific allegations concerning BGI's claim for attorney's fees under Chapter 38. Further, at the attorney's fees hearing, BGI's counsel testified that Lyon's counsel contacted him two or three times post-verdict and asked for a copy of BGI's "presentment letter," if any; and BGI responded by sending a copy of its demand letter to Lyon's counsel nine months before the hearing. According to the Houston court, in light of this testimony and the record as a whole, including the parties' agreement on the record to submit the issue of attorney's fees to the trial court, Lyon could have anticipated that BGI would amend its

pleadings to specifically plead presentment in compliance with Chapter 38 prior to the hearing on attorney's fees. Accordingly, the Houston court held that the amendment was not facially prejudicial. In addition, although Lyon alleged prejudice and surprise, the Houston court found no evidence of either. Thus, based upon the record, the Houston court concluded that the trial court erred by not allowing BGI to amend its pleadings.

The Houston court next considered whether the trial court's error was harmful. Lyon first argued that the trial court's error in not allowing BGI to amend its pleadings was harmless because Texas Rule of Civil Procedure 270 forbade receipt of evidence on the issue of presentment post-verdict, but the Houston court disagreed. Contrary to Lyon's position, the parties agreed to submit the issue of attorney's fees to the court, thereby removing the issue from the jury. Because the issue of attorney's fees was submitted to the trial court, not the jury, Rule 270 did not bar the admission of additional evidence regarding presentment.

Lyon additionally argued that the trial court's error was harmless because BGI's evidence was legally insufficient to prove presentment. Once again, the Houston court disagreed; citing prior decisions from several of its sister courts, the Houston court explained that, depending upon the precise language used, discovery responses and the opposing party's response thereto have been held sufficient to satisfy CPRC §38.002's presentment requirement.[18] The Houston court further observed that, in these cases the request for admission and response, either alone or coupled with other evidence, established that the party seeking attorney's fees had made a demand for payment on the opposing party or that a claim or debt had been asserted and the opposing party refused to pay the claim. Here, BGI's counsel testified that he spoke with Lyon's counsel prior to trial, during which time they attempted to settle their clients' claims; and that BGI identified the amount of damages it believed it was owed in its interrogatory response, which was provided to Lyon's counsel on two occasions prior to trial. Thus, although the evidence was disputed, the Houston court held that the record contained *some* evidence of presentment. Further, because BGI offered some evidence of presentment, the Houston court concluded that the trial court's error was harmful because it probably caused rendition of an improper judgment denying BGI attorney's fees on its breach-of-contract claim. Accordingly, the issue of attorney's fees was remanded to the trial court for further proceedings.

2. A party may not recover attorney's fees under CPRC Chapter 38 if it does not recover damages after the application of settlement credits.

In *Elness Swenson Graham Architects, Inc. v. RLJ II-C Austin Air, LP*, 520 S.W.3d 145 (Tex. App.—Austin 2017, pet. filed) (en banc), the Austin Court of Appeals also considered whether a party may recover attorney's fees under CPRC Chapter 38 if, after the application of settlement credits, the party does not actually recover damages.

A hotel owner filed suit against multiple defendants involved in the design and construction of the hotel, alleging that the defendants' work caused the hotel to have a defective foundation that caused building movement and further damage. Specifically, the hotel owner sued the architectural firm (Elness Swenson Graham Architects, Inc.), the general contractor (EBCO General Contractor, Ltd. and EBCO/Warrior Management, LLC), and the geotechnical

[18] 2017 WL 4545831, at *12 (citing *Busch v. Hudson & Keyse, LLC*, 312 S.W.3d 294, 301 (Tex. App.—Houston [14th Dist.] 2010, no pet.); *Lone Star Steel Co. v. Scott*, 759 S.W.2d 144, 157 (Tex. App.—Texarkana 1988, writ denied); *Gensco, Inc. v. Transformaciones Metalurgicias Especiales, S.A.*, 666 S.W.2d 549, 554 (Tex. App.—Houston [14th Dist.] 1984, writ dism'd); *Welch v. Gammage*, 545 S.W.2d 223, 226 (Tex. Civ. App.—Austin 1976, writ ref'd n.r.e.)).

engineering firm (Terracon Consultants, Inc.); as trial neared, the only claims remaining were breach-of-contract claims against each defendant. The hotel owner entered into a settlement agreement with Terracon before trial and a settlement agreement with EBCO during trial. Thus, the only defendant remaining when the case was submitted to the jury was Elness.

The jury found that Elness failed to comply with the contract and awarded the hotel owner $785,000 in damages. Elness then filed a motion asking the trial court to apply settlement credits to the damages award based upon the payments the owner received from its settlements with Terracon and EBCO. The trial court granted Elness' motion. The parties agreed to submit the issue of attorney's fees to the trial court, which ultimately awarded the hotel owner $901,650.96 in attorney's fees. In its final judgment, the trial court applied the settlement credits (a total of $1,170,000) to the amounts awarded in damages and attorney's fees, and ordered that the hotel owner recover the remaining amount, which was $516,650.96. On appeal, Elness contended that the hotel owner was not entitled to recover attorney's fees because it did not recover any damages after the application of settlement credits and was, therefore, not a prevailing party under CPRC Chapter 38.

The Austin Court of Appeals sitting en banc held that the hotel owner was not entitled to recover attorney's fees under CPRC Chapter 38 because, although it was awarded damages by the jury, the hotel owner did not actually recover damages due to the application of the settlement credits and was thus not a prevailing party. The Austin court drew guidance from *Intercontinental Group Partnership v. KB Home Lone Star L.P.*, 295 S.W.3d 650, 652 (Tex. 2009), where the Texas Supreme Court held that a plaintiff who received a jury verdict that the defendant breached a contract between the parties but also was awarded $0 in actual damages was not a "prevailing party" under the parties' contract. The Supreme Court in *Intercontinental* ultimately concluded as follows:

> We agree with the United States Supreme Court, which holds that to prevail, a claimant must obtain actual and meaningful relief, something that materially alters the parties' legal relationship. That is, a plaintiff must prove compensable injury *and secure an enforceable judgment in the form of damages or equitable relief.*

According to the Austin court, the language emphasized above "makes it clear that we must look to the judgment, not preliminary verdicts or rulings, as the critical component of our analysis regarding whether a party 'prevailed' in a suit and is thus entitled to attorney's fees." Here, the trial court properly applied settlement credits to the jury awards, leaving the hotel owner with less than $0 in damages. Thus, the hotel owner did not obtain an "enforceable judgment" against Elness for damages that modified Elness' behavior for the hotel owner's benefit by forcing Elness to pay an amount of money it otherwise would not pay. Accordingly, the trial court erred in awarding attorney's fees to the hotel owner.

3. CPRC Chapter 38 does not provide for an award of attorney's fees against an LLC.

In *Vast Construction, LLC v. CTC Contractors, LLC*, 526 S.W.3d 709 (Tex. App.—Houston [14th Dist.] 2017, no pet.), the Houston (Fourteenth) Court of Appeals again held that CPRC Chapter 38 does not provide for an award of attorney's fees against limited liability companies.

Likewise, in *8305 Broadway Inc. v. J&J Martindale Ventures, LLC*, No. 04-16-00447-CV, 2017 WL 2791322 (Tex. App.—San Antonio June 28, 2017, no pet.) (mem. op.), the San Antonio Court of Appeals joined the Dallas Court of Appeals and the Houston (Fourteenth) Court of Appeals in holding that CPRC Chapter 38 does not provide for an award of attorney's fees against limited liability companies.[19] In a parenthetical, the San Antonio court additionally observed that the same logic has been applied to hold that Chapter 38 does not provide for an award of attorney's fees against limited partnerships.[20]

4. The lodestar method may not apply to all claims for attorney's fees based upon hourly billing.

In *Kinsel v. Lindsey*, 526 S.W.3d 411 (Tex. 2017), the Texas Supreme Court affirmed the award of attorney's fees under CPRC Chapter 37 even though the attorneys' billing records were not admitted into evidence—possibly indicating that the lodestar method does not apply to all claims for attorney's fees based upon hourly billing.

The defendants appealed the trial court's award of $800,000 in attorneys' fees, challenging the sufficiency of the evidence to support the award. In evaluating the sufficiency of the evidence, the court of appeals drew guidance from *Garcia v. Gomez*, 319 S.W.3d 638 (Tex. 2010), in which an attorney testified as to his experience and opined that particular sums for trial and appeal were reasonable and necessary fees. Applying *Garcia*, the court of appeals noted that the evidence at trial on the plaintiffs' attorney's fees consisted of testimony from legal counsel (1) about their respective experience, (2) generally describing the work performed by each, (3) alluding to the hours expended in preparing, (4) alluding to fees of either $920,000 or $950,000 being reasonable through trial of the cause, (5) mentioning their respective hourly rates, (6) describing in broad terms the factors considered in concluding the fees were reasonable, and (7) opining that they lost the opportunity to work on other matters. The court of appeals concluded that, "[t]hough lacking in specifics too, the foregoing equated, at the very least, the quantum of evidence found sufficient by the Supreme Court in *Garcia*." On appeal to the Texas Supreme Court, the defendants again challenged the sufficiency of the evidence to support the amount of fees awarded. However, without substantive analysis, the Supreme Court agreed with the court of appeals that the evidence was sufficient to support the fee award.

P. Taxable Costs

In *Star Operations, Inc. v. Dig Tech, Inc.*, No. 03-15-00423-CV, 2017 WL 3263352 (Tex. App.—Austin July 27, 2017, pet. filed) (mem. op.), the Austin Court of Appeals also considered whether a subcontractor was entitled to recover the costs for copies of deposition transcripts as "taxable costs" when the subcontractor did not notice or initiate the depositions in question.

As noted above, following a jury trial, the trial court entered judgment in favor of Dig Tech, awarding it damages, attorney's fees, and costs for Star's breach of the oral subcontract. On appeal, Star contended that the trial court erred in awarding Dig Tech costs for copies of deposition transcripts because Dig Tech did not notice or initiate the depositions in question and,

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[19] 2017 WL 2791322, at *4 (citing *Varel Int'l Indus., L.P. v. PetroDrillbits Int'l, Inc.*, No. 05-14-01556-CV, 2016 WL 4535779, at *7 (Tex. App.—Dallas Aug. 30, 2016, pet. denied) (mem. op.); *Alta Mesa Holdings, L.P. v. Ives*, 488 S.W.3d 438, 452-55 (Tex. App.—Houston [14th Dist.] 2016, pet. denied)).

[20] 2017 WL 2791322, at *4 (citing *Choice! Power, L.P. v. Feeley*, 501 S.W.3d 199, 211-14 (Tex. App.—Houston [1st Dist.] 2016, no pet.)).

thus, Dig Tech was only paying for the copies, as opposed to paying the court reporter's fee for the original transcript.

The Austin Court of Appeals held that the trial court erred in awarding Dig Tech the costs for copies of deposition transcripts as "taxable costs" when Dig Tech did not notice or initiate the depositions in question. In regard to the award of costs, CPRC §31.007 provides in pertinent part:

> (b) A judge of any court may include in any order or judgment all costs, including the following:
>
> (1) fees of the clerk and service fees due the county;
>
> (2) fees of the court reporter for the original of stenographic transcripts necessarily obtained for use in the suit;
>
> (3) masters, interpreters, and guardians ad litem appointed pursuant to these rules and state statutes; and
>
> (4) such other costs and fees as may be permitted by these rules and state statutes.

Thus, CPRC §31.007(b)(2) specifically allows recovery of the court reporter's fee for the *original* stenographic transcript as a taxable court cost. The Austin court expressly agreed with the reasoning in *Gumpert v. ABF Freight System, Inc.*, 312 S.W.3d 237, 241-42 (Tex. App.—Dallas 2010, no pet.), where the Dallas Court of Appeals concluded that CPRC §31.007(b) specifically limits recovery of costs to the fees of the court reporter for the original of stenographic transcripts necessarily obtained for use in the suit and that, because no other statute or rule authorizes the recovery of costs to obtain copies of deposition transcripts, it was error to award such costs. The Austin court concluded that similarly, in this case, it was error for the trial court to award the costs of obtaining copies of deposition transcripts to Dig Tech.

Q. Statutes of Repose

1. Whether CPRC §16.009 applies to certain claims.

In *Bunch v. Woodlands Land Development Co.*, No. 09-16-00136-CV, 2017 WL 3081095 (Tex. App.—Beaumont July 20, 2017, pet. denied) (mem. op.), the Beaumont Court of Appeals considered whether homeowners' claims were barred by the statute of repose set forth in CPRC §16.009.

In 2012, the Bunches filed suit against The Woodlands Land Development Company, LP (TWLDC), asserting claims for DTPA violations, breach of warranty, negligence, fraud, and negligent misrepresentation. The Bunches alleged that TWLDC designed and developed the Woodlands, including the subdivision in which their home was located, Carlton Woods. The Bunches further alleged that they began experiencing structural problems, which their homebuilder determined were caused by the presence of a fault line. They also alleged that TWLDC knew or should have known about the existence and location of the fault line and other similar faults in the Woodlands.

TWLDC filed a motion for summary judgment, asserting that the ten-year statute of repose set forth in CPRC §16.009 barred the Bunches' claims. The Bunches opposed summary judgment on the ground, among others, that CPRC §16.009 is not intended to apply to developers who do not design or plan improvements to real property or construct or repair improvements on real property. Citing *Sonnier v. Chisholm-Ryder Co., Inc.*, 909 S.W.2d 475 (Tex. 1995), the Bunches argued that because TWLDC did not attach or affix personalty to the property, TWLDC did not construct improvements on the property. The trial court granted TWLDC's motion for summary judgment, and the Bunches appealed.

The Beaumont Court of Appeals held that the construction work for which TWLDC was responsible as general contractor resulted in an improvement to real property, thereby bringing TWLDC within the protection of CPRC §16.009. The statute of repose in CPRC §16.009 "protects a contractor who actually builds an improvement or who supervises and is contractually responsible for the proper construction of the improvement."[21] Thus, the key issue was whether TWLDC's activities in developing the land constituted an "improvement." The Beaumont court rejected the Bunches' argument that the only way property may be improved is by attaching personalty to realty, explaining that the Supreme Court's decision in *Sonnier* does not stand for that proposition. Citing *Dubin v. Carrier Corp.*, 731 S.W.2d 651, 653 (Tex. App.—Houston [1st Dist.] 1987, writ dism'd by agr.), as well as the Black's Law Dictionary definition of "improvement," the Beaumont court reasoned that the term "improvement" has a broader significance than the term "fixture," and it comprehends "all additions and betterments to the freehold." In addition, case law provides that CPRC §16.009 protects general contractors upon a proper showing.[22] Here, the evidence showed that

- Once it designed and planned a subdivision, TWLDC then undertook to construct the various improvements (e.g., streets, water, sanitary sewer, and drainage facilities, residential lots and commercial areas, mailbox pads, and underground utilities, including electricity, cable, gas, and telephone);
- TWLDC served as its own general contractor, retaining subcontractors such as engineers, architects, geotechnical labs, inspectors, clearing contractors, paving contractors, and utility contractors to design, construct, and inspect the infrastructure for the creation of developed property; and
- As general contractor, TWLDC managed and oversaw the construction of these improvements through subcontractors and coordinated all the work. TWLDC bore ultimate responsibility for the construction of these improvements.

The evidence further showed that construction of the improvements to the Bunches' subdivision was substantially complete by December 2000, more than ten years before they filed suit. Accordingly, TWLDC established its entitlement to summary judgment on the basis of the statute of repose found in CPRC §16.009, and the trial court's grant of summary judgment was proper.

2. CPRC §16.009(e)(3)'s willful-misconduct exception.

In *Brooks v. CalAtlantic Homes of Texas, Inc.*, No. 05-16-01203-CV, 2017 WL 4479651 (Tex. App.—Dallas Oct. 9, 2017, no pet. h.) (mem. op.), the Dallas Court of Appeals considered whether a defendant moving for summary judgment on the basis of the statute of repose in CPRC

[21] 2017 WL 3081095, at *5 (citing *Reames v. Hawthorne-Seving, Inc.*, 949 S.W.2d 758, 764 (Tex. App.—Dallas 1997, writ denied); TEX. CIV. PRAC. & REM. CODE §16.009).
[22] *Id*. (citing *Jenkins v. Occidental Chem. Corp.*, 415 S.W.3d 14, 25-26 (Tex. App.—Houston [1st Dist.] 2013), *overruled on other grounds*, 478 S.W.3d 640 (Tex. 2016); *Reames*, 949 S.W.2d at 763).

§16.009 bears the initial burden to conclusively establish the absence of willful misconduct, and whether the evidence raised a fact issue on willful misconduct.

In 1993, CalAtlantic Homes of Texas, Inc. built a retaining wall on real property that was purchased in 1998 by Charles Brooks. In 2016, Brooks sued CalAtlantic, asserting claims for DTPA violations, negligence, and breach of warranty arising out of construction of the retaining wall. CalAtlantic moved for summary judgment on the ground that Brooks's claims were barred by the ten-year statute of repose set forth in CPRC §16.009. Brooks responded that the exception in CPRC §16.009(e)(3) applied: that CalAtlantic had engaged in willful misconduct that would preclude application of the statute of repose. The trial court granted CalAtlantic's motion for summary judgment, and Brooks appealed. On appeal, Brooks contended that, because it was seeking summary judgment on an affirmative defense, CalAtlantic bore the burden as movant to conclusively prove the absence of willful misconduct as an element of its CPRC §16.009 defense.

The Dallas Court of Appeals held that CalAtlantic did not bear the burden to conclusively establish the absence of willful misconduct. In *Ryland Group, Inc. v. Hood*, 924 S.W.2d 120, 121 (Tex. 1996) (per curiam), the Texas Supreme Court explained the summary-judgment burdens in a case involving CPRC §16.009's statute of repose. Under *Ryland Group*, to obtain summary judgment, a defendant must conclusively establish that CPRC §16.009 applies and that the plaintiff did not file suit within the ten-year statutory period. The plaintiff then bears the burden to raise a genuine issue of material fact as to whether the affirmative defenses of fraudulent concealment and willful misconduct defeat the defendant's right to summary judgment. The Dallas court further observed that numerous courts have followed this rule in considering summary judgments under CPRC 16.009.[23] Accordingly, CalAtlantic did not bear the burden as summary-judgment movant to conclusively disprove that it engaged in willful misconduct.

The Dallas court next considered whether Brooks met his burden to raise a fact issue on CalAtlantic's willful misconduct. CPRC §16.009 does not define "willful misconduct," but courts discussing the CPRC §16.009(e)(3) exception have described it as including the element of intent or actual knowledge.[24] Further, in other contexts, the Dallas court has equated "willful" conduct to gross negligence. Citing *Fath v. CSFB 1999-C1 Rockhaven Place Limited Partnership*, 303 S.W.3d 1, 6 (Tex. App.—Dallas 2009, pet. denied), Brooks argued that willful misconduct under CPRC §16.009(e)(3) equates to gross negligence. CalAtlantic did not concede the point, but rather argued that Brooks's evidence failed to raise a fact issue on the elements of gross negligence in any event. The Dallas court agreed, finding no evidence that CalAtlantic was aware that deviating from the engineering plans could create property defects and dangerous conditions, or that CalAtlantic knew of any risk of harm in deviating from the plans. Further, there was nothing in the record to indicate that the retaining wall presented any risk until some 22 years after construction was completed, when Brooks first noticed deterioration. Thus, there was no evidence of CalAtlantic's "actual, subjective awareness of the risk involved" or its choice to "proceed in conscious indifference to the rights, safety, or welfare of others." Accordingly, the

[23] 2017 WL 4479651, at *3 (citing *Bunch v. Woodlands Land Dev. Co., LP*, No. 09-16-00136-CV, 2017 WL 3081095, at *8 (Tex. App.—Beaumont Jul. 20, 2017, pet. denied) (mem. op.); *Powitzky v. Tilson Custom Homes*, No. 13-15-00137-CV, 2015 WL 6594730, at *2 (Tex. App.—Corpus Christi Oct. 29, 2015, pet. denied) (mem. op.); *Brent v. Daneshjou*, No. 03-04-00225-CV, 2005 WL 2978329, at *4 (Tex. App.—Austin Nov. 4, 2005, no pet.) (mem. op.); *Suburban Homes v. Austin-Nw. Dev. Co.*, 734 S.W.2d 89, 91 (Tex. App.—Houston [1st Dist.] 1987, no writ).

[24] *Id*. at *4 (citing *Ryland Grp.*, 924 S.W.2d at 122 (willful misconduct under section 16.009(e)(3) requires proof of actual knowledge of alleged deficiency in construction); *Baskin v. Mortg. & Tr., Inc.*, 837 S.W.2d 743, 746 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (willful misconduct under section 16.009(e)(3) includes element of intent)).

trial court properly granted summary judgment for CalAtlantic on the basis of the statute of repose in CPRC §16.009.

R. Summary Judgment

In *Chavez v. Kansas City Southern Railway Co.*, 520 S.W.3d 898 (Tex. 2017) (per curiam), the Texas Supreme Court considered whether a party may utilize a presumption to satisfy its burden as the movant in a summary-judgment proceeding.

Luz Chavez filed suit against Kansas City Southern Railway Co. and its engineer for the wrongful death of her husband and son. The Railway obtained a defense verdict, but the trial court granted Chavez's motion for new trial, and counsel for both sides began settlement negotiations. They eventually reached a letter agreement, signed by counsel. However, during the hearing to approve the settlement agreement, Chavez appeared and requested time to find a new law firm, stating she no longer felt comfortable with the firm that had been representing her. The trial court reset the hearing, ultimately granted the Railway's motion to enforce the settlement agreement, and rendered judgment on the agreement. Chavez appealed. The court of appeals reversed and remanded because the settlement agreement had not been filed of record.

On remand, the Railway filed the settlement agreement, sued Chavez for breach of the agreement, and moved for summary judgment. The Railway's evidence established that Chavez was represented during settlement negotiations by the same law firm that had represented her at trial, including the lawyer who signed the settlement agreement on her behalf. But the Railway's motion and evidence did not otherwise address Chavez's law firm's authority to agree to the settlement. The trial court granted summary judgment for the Railway, and Chavez again appealed. The court of appeals affirmed, stating it would indulge every reasonable presumption to support a settlement agreement made by an attorney hired by a client, and concluding that the Railway proved as a matter of law that Chavez's lawyer possessed actual authority to bind Chavez to the settlement agreement.

The Texas Supreme Court held that the Railway failed to meet its burden, as summary-judgment movant, to conclusively establish that Chavez's law firm was authorized to execute the settlement agreement. Rather, the Railway only produced evidence that Chavez hired counsel to represent her in the litigation and that those lawyers agreed to the settlement. The Supreme Court reasoned that, although this constituted "some evidence" to satisfy the Railway's burden, the Railway was required to prove that Chavez actually authorized her counsel to enter into a settlement agreement on her behalf. In regard to the presumption applicable to an attorney's authority to enter into a settlement on the client's behalf, the Supreme Court explained:

> Assuming without deciding that an attorney retained for litigation is presumed to possess express authority to enter into a settlement agreement on behalf of the client, the presumption may be rebutted with evidence to the contrary. But a summary judgment movant may not use a presumption to shift to the non-movant the burden of raising a fact issue of rebuttal. In *Missouri-Kansas-Texas Railroad Co. v. City of Dallas*, we held that a presumption cannot shift the burden to a non-movant in a summary judgment proceeding. 623 S.W.2d at 298. "The presumptions and burden of proof for an ordinary or conventional trial," we said, "are immaterial to the burden that a movant for summary judgment must bear." *Id*. Thus, in this case, the Railway was required to establish affirmatively that there was no genuine issue of material fact that Chavez's law firm was

authorized to execute the settlement agreement—that is, that Chavez could not produce evidence to rebut a presumption of authority.

Because the Railway failed to conclusively establish each element of its claim, the trial court erred in granting summary judgment for the Railway.

III. ARBITRATION

A. Construing and Enforcing Arbitration Agreements

1. Proving the existence of a valid arbitration agreement.

i. A party may meet its burden to prove the existence of a valid arbitration agreement by presenting a copy of an unsigned contract along with an affidavit averring that the contract accurately represents the parties' signed contract containing the arbitration agreement.

In *Ladymon v. Lewis*, No. 05-16-00776-CV, 2017 WL 3097652 (Tex. App.—Dallas July 21, 2017, no pet.) (mem. op.), the Dallas Court of Appeals considered whether parties met their burden to prove the existence of a valid arbitration agreement by attaching to their motion to compel arbitration copies of unsigned contracts along with an affidavit averring that those contracts accurately represented the parties' signed contracts containing their arbitration agreement.

Homeowners contracted with Ladymon & Associates, Inc. to design a home, and contracted with Metro Townhomes Limited Partnership and Metro Townhomes and Homes, Inc. to construct the home. The Design Contract between the homeowners and Ladymon contained an arbitration agreement. Likewise, the Builder Construction Contract between the homeowners and Metro contained an arbitration agreement, as did the Limited Warranty provided by Metro to the homeowners.

The homeowners later sued Metro and Ladymon, alleging that the home was defectively designed and defectively constructed. Metro and Ladymon filed a motion to compel arbitration, arguing that the contracts between the parties all required binding arbitration. However, due to the passage of time, Metro and Ladymon were unable to produce copies of the Design Contract, the Construction Contract, or the Limited Warranty. Instead, Metro and Ladymon attached to their motion to compel arbitration copies of contracts they claimed accurately represented the contracts signed by the homeowners, along with the affidavit of Blane Ladymon, which established that Metro presented to the homeowners the construction contract attached to the motion to compel arbitration; the construction contract required arbitration of all causes of action relating to or arising from the design, construction, or sale of the home; a closing was scheduled where Ladymon signed the contract documents; and he later received a copy of the fully executed contract documents after the homeowners executed them, including the construction contract. The trial court denied Metro's and Ladymon's motion to compel arbitration, and they appealed.

The Dallas Court of Appeals held that Metro and Ladymon met their burden to prove the existence of a valid arbitration agreement. The homeowners argued there was no evidence of a signed agreement evidencing their intent to submit their claims to binding arbitration, but the Dallas court disagreed, explaining that the absence of a party's signature does not necessarily destroy an otherwise valid contract and is not dispositive of the question of whether the parties

intended to be bound by the terms of a contract. Rather, under Texas law, if a contract is not signed by a party, then other evidence may be used to establish the nonsignatory's unconditional assent to be bound by the contract, including any arbitration provision. The Dallas court reasoned that Ladymon's affidavit established the existence of a contract between Metro, Ladymon, and the homeowners containing a valid arbitration agreement governed by the FAA. Further, the evidence showed that the homeowners' claims, both as to the design and the construction of their home, were all within the scope of the arbitration agreement. Therefore, the Dallas court held that the trial court erred in denying Metro's and Ladymon's motion to compel arbitration.

ii. Parties opposing arbitration cannot object to the lack of authentication of the arbitration agreement for the first time on appeal.

In *Geo-Tech Foundation Repair v. Leggett*, No. 02-16-00289-CV, 2017 WL 1173840 (Tex. App.—Fort Worth Mar. 30, 2017, no pet.) (mem. op.), the Fort Worth Court of Appeals considered whether a party met its burden to prove the existence of a valid arbitration agreement despite its alleged failure to properly authenticate the contract containing the arbitration agreement at issue.

Terry Leggett hired Geo-Tech Foundation Repair to perform foundation work on his home. The parties' contract contained the following arbitration agreement:

> Owner and Contractor agree that any dispute, or lawsuit related in any way to this agreement or the work related thereto, shall be resolved by mandatory and binding arbitration administered by the American Arbitration Association (AAA) in accordance with this arbitration agreement and under the commercial arbitration rules of the AAA....

Leggett later sued Geo-Tech for breach of contract, and Geo-Tech moved to compel arbitration. To its motion, Geo-Tech attached a copy of the parties' contract containing the above arbitration agreement and represented that the attachment was a "true copy," but the motion was not sworn. Leggett, however, did not object to the contract attached to Geo-Tech's motion, nor did he contest Geo-Tech's assertions that the parties had entered into a contract and that the contract contained the above arbitration agreement. Instead, Leggett opposed arbitration on the ground that Geo-Tech allegedly waived its right to demand arbitration. The trial court denied Geo-Tech's motion to compel arbitration, and Geo-Tech appealed. On appeal, Leggett contended that the trial court properly denied Geo-Tech's motion to compel arbitration because the contract attached to Geo-Tech's motion was not properly authenticated and, therefore, could not serve as competent evidence of a valid arbitration agreement.

The Fort Worth Court of Appeals held that the totality of the record established the existence of a valid arbitration agreement. The Fort Worth court reasoned that Leggett never denied the existence of the arbitration agreement. Further, Leggett's sole response to Geo-Tech's motion to compel arbitration—that Geo-Tech had waived its right to demand arbitration—assumed that Geo-Tech at one point had the right to compel arbitration under the parties' contract, and acknowledged the existence of the arbitration agreement therein. The Fort Worth court held that, under "these specific circumstances," it could not affirm the trial court's order on the basis of Geo-Tech's failure to present competent evidence of an agreement to arbitrate. The Fort Worth court further distinguished Leggett's cited authority on the ground that, in each of

those cases[25], the party opposing arbitration objected in the trial court to the lack of authentication and, therefore, appeared to deny the existence of an arbitration agreement.

Author's Note: The Houston (Fourteenth) Court of Appeals sitting en banc has held that an objection to the complete absence of an authenticating affidavit or other attempt to authenticate an arbitration agreement (as opposed to a *defective* authenticating affidavit) may be raised for the first time on appeal. *In re Estate of Guerrero*, 465 S.W.3d 693, 706-08 (Tex. App.—Houston [14th Dist.] 2015, pet. denied) (en banc). The Fort Worth court in *Geo-Tech* expressly disagreed with *Guerrero* to the extent it holds that a party may challenge authentication of an arbitration agreement for the first time on appeal, even when the party never challenged the agreement in the trial court and affirmatively acknowledged the agreement's existence there.

2. Defenses to enforcement of arbitration agreement

i. Merely posting an arbitration agreement on the employer's intranet site is insufficient to give an employee notice of the arbitration agreement, rendering it invalid and unenforceable.

In *Doe v. Columbia North Hills Hospital Subsidiary, L.P.*, 521 S.W.3d 76 (Tex. App.—Fort Worth 2017, pet. filed), the Fort Worth Court of Appeals considered whether an employee had notice of her employer's arbitration policy simply because it was posted on the employer's intranet site, which the employee could (but apparently did not) access.

Columbia North Hills Hospital hired Jane Doe as a part-time employee. During the new-employee orientation, the Hospital informed Doe of its intranet website, called "Compliance 360," and instructed her that she was responsible for reviewing and familiarizing herself with any policies that were applicable to her employment. Doe signed an "Acknowledgment of Receipt of Policies" reciting, among other things, that the Hospital's Policies could be found and printed from Compliance 360, and that Doe understood she could access additional policies through Compliance 360. One of the policies posted on Compliance 360 was the Hospital's Mandatory Binding Arbitration Policy, providing that all disputes governed by the Arbitration Policy, including claims for employment discrimination, retaliation, and negligence, "shall be submitted to final and binding arbitration."

Doe was sexually assaulted while at work and filed suit against the Hospital for sexual harassment, retaliation, and negligence arising out of the assault. The Hospital moved to compel arbitration of Doe's claims. The trial court granted the Hospital's motion, and the parties proceeded to arbitration. The trial court ultimately signed a final judgment confirming the arbitration award, and Doe appealed. On appeal, Doe argued the trial court erred by compelling her claims to arbitration because she had no notice of the Arbitration Policy, rendering it unenforceable.

The Fort Worth Court of Appeals held that, as a matter of law, Doe did not have notice of the Arbitration Policy and, therefore, the trial court abused its discretion by compelling arbitration of her claims. Under Texas law, to establish that a valid arbitration agreement exists, an employer must prove that the employee received notice of the employer's arbitration policy and accepted it. The Fort Worth court reasoned that none of the evidence cited by the Hospital,

[25] 2017 WL 1173840, at *3 (citing *In re Estate of Guerrero*, 465 S.W.3d 693, 705 (Tex. App.—Houston [14th Dist.] 2015, pet. denied) (en banc); *In re Universal Fins. Consulting Grp.*, No. 14-08-00226-CV, 2008 WL 2133186, at *2 (Tex. App.— Houston [14th Dist.] May 20, 2008, orig. proceeding) (mem. op.)).

considered individually or as a whole, expressly or impliedly notified Doe of the Arbitration Policy. Although she had been informed about the Hospital's intranet site and acknowledged she could access the Hospital's "policies" from it, Doe was not specifically informed that the Hospital had a binding arbitration policy or of the policy's essential, unequivocal terms. Further, there was no evidence that Doe actually accessed the Hospital's intranet site. In finding the requisite notice lacking, the Fort Worth court expressly joined the other courts holding that merely posting an arbitration policy on an intranet site is insufficient to give an employee notice.[26] Thus, the Arbitration Policy was unenforceable, and the trial court erred in granting the Hospital's motion to compel arbitration.

Author's Note: The Hospital filed a petition for review in the Texas Supreme Court, which has requested the parties to file briefs on the merits. At present, the Supreme Court has not yet decided whether to grant or deny review of the Fort Worth court's decision. So stay tuned.

ii. An arbitration agreement is not unconscionable merely because it allows only one party to approve the arbitration firm that will administer the arbitration.

In *Albertson's Holdings, LLC v. Kay*, 514 S.W.3d 878 (Tex. App.—Tyler 2017, no pet.), the Tyler Court of Appeals considered whether an arbitration agreement was unconscionable and, thus, unenforceable because it allowed only one party to approve the arbitration firm that would administer the arbitration.

Ruth Kay was employed by Albertson's Holdings, LLC. She signed "Albertson's LLC Texas Workplace Injury Benefit Plan," which included an arbitration agreement. Regarding selection of the arbitrator, the arbitration agreement provided as follows:

> (b) **Arbitration Procedures**: Any arbitration under this Section will be administered by a regionally recognized arbitration firm approved by [Albertson's].
>
> (1) Unless otherwise agreed to in writing by the parties, the arbitrator selected by the parties in accordance with those rules (1) shall be an attorney licensed to practice in the State of Texas with experience in personal injury litigation, and (2) shall be selected from a panel of arbitrators located in Dallas and Tarrant Counties, Texas. The arbitrator will be selected from a panel of not less than 7 arbitrators provided by the arbitration firm[.] Selection of the arbitrator shall be made in accordance with the arbitration firm's standard selection process, or if otherwise agreed, by using alternating strikes with the claimant striking first, until one arbitrator remains on the list. If the arbitrator so selected becomes unable to serve for any reason, the parties shall repeat the selection process.

Ruth was injured while in the course of her employment, and she and her husband filed suit against Albertson's for negligence. Albertson's filed a motion to compel arbitration. The Kays opposed arbitration on the ground that the arbitration agreement was unconscionable and, thus, unenforceable because it gave Albertson's unilateral and exclusive control over the selection

[26] 521 S.W.3d at 82 (citing *Goad v. St. David's Healthcare P'ship, L.P.*, No. 1-16-CV-044-RP, 2016 WL 2853573, at *3 (W.D. Tex. May 13, 2016) (Order); *HSS Sys., L.L.C. v. Lucan*, No. 03-10-00761-CV, 2011 WL 2297716, at *4 (Tex. App.—Austin June 9, 2011, no pet.) (mem. op.); *Big Bass Towing Co. v. Akin*, 409 S.W.3d 835, 842 (Tex. App.—Dallas 2013, no pet.)).

of the arbitration firm while providing no mechanism for Ruth to challenge that selection. The trial court denied Albertson's motion to compel arbitration. On appeal, Albertson's argued that the trial court should not have considered the Kays' unconscionability arguments because the Kays failed to plead unconscionability as an affirmative defense in their live pleading, as required by Rule 94 of the Texas Rules of Civil Procedure, and that the arbitration agreement was not unconscionable in any event.

The Tyler Court of Appeals held that the Kays did not meet their burden to prove that the arbitration agreement was unconscionable. The Tyler court first considered the Kays' alleged failure to plead unconscionability as an affirmative defense, holding that Albertson's' reliance on Rule 94 was misplaced. Rule 94 requires a party, "[i]n pleading to a preceding pleading," to set forth affirmatively its affirmative defenses. The Tyler court reasoned that a motion—an application for an order of the court to grant relief—is not the functional equivalent of a pleading. Thus, the Kays were not required to respond to the motion with a pleading. Accordingly, the Tyler court held that the Kays' response to the motion to compel arbitration, in which the Kays argued that the arbitration agreement was unconscionable and unenforceable, adequately preserved their unconscionability arguments.

The Tyler court next considered whether the arbitration agreement was unconscionable, holding that the arbitration-selection scheme set forth therein was not unconscionable on its face. The term "unconscionability" generally describes an agreement that is unfair because of its overall one-sidedness or the gross one-sidedness of one of its terms. Citing *Venture Cotton Co-op. v. Freeman*, 435 S.W.3d 222, 231 (Tex. 2014), the Tyler court explained that the crucial inquiry in determining unconscionability is whether the arbitral forum in a particular case is an adequate and accessible substitute to litigation, a forum where the litigant can effectively vindicate his or her rights. Here, the arbitration agreement neither gave Albertson's unilateral and exclusive control over the selection of the arbitration firm, nor did it prevent Ruth from challenging that selection. Rather, the arbitration agreement merely gave Albertson's the right *to approve* an arbitration firm; it did not say that Albertson's is the only party allowed to suggest which firm was to be used. Moreover, while the arbitration agreement did not include any language stating directly how the employee can participate in the firm-selection process, neither did it include limiting language to prevent the employee's participation in that process. Finally, the Tyler court observed that the FAA expressly allows either party to request the court to appoint an arbitrator if parties are unable to agree. Because the Kays failed to prove that the arbitration agreement was so one-sided as to be unfair, nor did they present any evidence of bias in the selection of the arbitrator or in the arbitral forum as a whole, the Tyler court held that the Kays failed to meet their burden to prove that the arbitration agreement was unconscionable.

3. Whether issues are for arbitrators, or courts, to decide

i. The issue of a contract's validity is for the arbitrator to decide, unless the challenge is to the arbitration agreement itself.

In *Human Biostar, Inc. v. Celltex Therapeutics Corp.*, 514 S.W.3d 844 (Tex. App.—Houston [14th Dist.] 2017, pet. denied), the Houston (Fourteenth) Court of Appeals considered whether the validity of the contract, as a whole, containing the arbitration provision was an issue for the arbitrator, rather than a "gateway issue" for the trial court to decide.

The parties entered into a Rule 11 settlement agreement which contained a provision to arbitrate "any disagreement result[ing] from negotiation and completion of this documentation." The trial court granted Celltex's motion to compel arbitration and ultimately entered an order

confirming the arbitration award. Biostar and K-Stemcell appealed, claiming the trial court erred in granting Celltex's motion to compel arbitration without first determining whether the parties' Rule 11 settlement agreement was enforceable and in submitting the issue of arbitrability to the arbitrator.

The Fourteenth Court of Appeals held that the validity of the Rule 11 settlement agreement as a whole was an issue for the arbitrator to determine. Justice Donovan authored the majority opinion, joined by Justice Brown. The majority reasoned that, pursuant to the "separability doctrine" established in *Prima Paint Corp. v. Flood & Conklin Mfg. Co*., 388 U.S. 395, 404 (1967), an arbitration provision is separable from the rest of the contract, and the issue of the contract's validity is to be determined by the arbitrator unless the challenge is directed to the arbitration agreement itself. Although this "rule permits a court to enforce an arbitration agreement in a contract that the arbitrator later finds to be void," the majority observed, "it is equally true that [the opposite] approach permits a court to deny effect to an arbitration provision in a contract that the court later finds to be perfectly enforceable."[27] According to the majority, this dilemma is resolved by allocating such decisions to arbitration in accordance with the liberal policy favoring arbitration. Because Biostar's and K-Stemcell's challenge attacked the enforceability of the entire Rule 11 settlement agreement, rather than the arbitration agreement itself, the majority held that the trial court did not err in submitting the issue of arbitrability to the arbitrator.

Justice Jamison authored a concurring opinion, explaining that Biostar's appeal should have been analyzed under the requirements for a restricted appeal rather than as an ordinary appeal. She would not have construed Biostar's "Notice of Restricted Appeal" as a timely notice of ordinary appeal, as did the majority.

ii. Governmental immunity is an issue for the trial court to decide.

In *San Antonio River Authority v. Austin Bridge & Road, L.P.*, No. 04-16-00535-CV, 2017 WL 3430897 (Tex. App.—San Antonio Aug. 9, 2017, pet. filed) (mem. op.), the San Antonio Court of Appeals considered whether governmental immunity from suit is an issue for the arbitrator, or the trial court, to decide.

San Antonio River Authority contracted with Austin Bridge and Road, L.P. to perform repairs to the Medina Lake Dam. The general contract included the following statement at the top of the first page: "THIS CONTRACT IS SUBJECT TO ARBITRATION UNDER THE TEXAS GENERAL ARBITRATION ACT." In addition, Section 17.1 of the General Conditions included the following arbitration clause:

> All claims, disputes and other matters in question between OWNER and CONTRACTOR arising out of, or relating to the Contract Documents or the breach thereof except for claims which have been waived by the making or acceptance of final payment as provided by paragraph 14.16, shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then obtaining subject to the limitations of this Article 16. This agreement so to [sic] arbitration and any other agreement or consent to arbitrate entered into in accordance herewith as provided in this

[27] *In re Olshan Found. Repair Co., LLC*, 328 S.W.3d 883, 898 (Tex. 2010) (quoting *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445-46 (2006)).

> Article 16 will be specifically enforceable under the prevailing arbitration law of any court having jurisdiction.

After executing the general contract, Austin Bridge subcontracted with Hayward Baker, Inc. to perform portions of the repair work.

A dispute arose regarding additional costs incurred by Hayward Baker, leading it to initiate arbitration proceedings against Austin Bridge. Austin Bridge, in turn, initiated arbitration proceedings against the River Authority, alleging the River Authority breached the general contract by failing to pay for the additional labor and materials furnished by Hayward Baker for the project. The River Authority filed a motion to dismiss arbitration, asserting the defense of governmental immunity, which the arbitrator ultimately denied. The River Authority subsequently filed suit against Austin Bridge and Hayward Baker, seeking a declaratory judgment that Austin Bridge's breach-of-contract claim asserted in the arbitration was barred by governmental immunity. Both sides filed competing motions for summary judgment on, among other issues, whether the question of governmental immunity should be decided by the trial court; and the River Authority also filed a motion to stay the arbitration proceedings. The trial court granted the contractors' joint motion for summary judgment and denied the River Authority's cross-motion and its motion to stay arbitration, and the River Authority appealed.

The San Antonio Court of Appeals held that governmental immunity from suit is an issue to be determined by the trial court, not an arbitrator. The San Antonio court drew guidance from the Corpus Christi court's decision in *Kansas City Southern v. Port of Corpus Christi Authority of Nueces County*, 305 S.W.3d 296 (Tex. App.—Corpus Christi 2009, pet. denied), which reasoned that questions of governmental immunity implicate jurisdiction, and courts must have jurisdiction in order to stay arbitration proceedings. Similarly, the San Antonio court looked to federal appellate decisions to aid its analysis. In *Lower Colorado River Authority v. Papalote Creek II, L.L.C.*, 858 F.3d 916, 923-24 (5th Cir. 2017), the Fifth Circuit recently rejected the contention—asserted by Austin Bridge and Hayward Baker in this case—that the determination of whether a jurisdictional issue should be resolved by the arbitrator or the trial court turns on whether the jurisdictional issue is a question of procedural or substantive arbitrability. The Fifth Circuit reasoned the distinction need not be addressed because "it does not change the fact that the district court must have jurisdiction in the first instance to compel arbitration." Likewise, the San Antonio court explained, whether the question of immunity is a matter of procedural or substantive arbitrability does not change the fact that the trial court must have jurisdiction to stay arbitration. Thus, the San Antonio court held that the question of governmental immunity must be determined by the trial court.

Author's Note: In *Clear Creek Independent School District v. Cotton Commercial USA, Inc.*, 529 S.W.3d 569 (Tex. App.—Houston [14th Dist.], 2017, pet. filed), summarized elsewhere in this paper, the Houston (Fourteenth) Court of Appeals likewise held that governmental immunity from suit is a question for the trial court, not an arbitrator. The Houston court identified three reasons which supported its conclusion. *First*, the existence and boundaries of governmental immunity in the first instance are the judiciary's province. *Second*, a governmental defendant's assertion of immunity raises a jurisdictional question, and courts decide jurisdictional questions. *Third*, the parties failed to identify any authority stating that an arbitration proceeding is the proper forum to address whether the governmental immunity of an arbitration participant has been waived, nor did the parties cite cases in which an arbitrator has, in fact, decided that question.

iii. If an arbitration agreement requires arbitration in accordance with the AAA Construction Industry Rules, then issues regarding the agreement's scope and validity are for the arbitrator to decide.

In *Dow Roofing Systems, LLC v. Great Commission Baptist Church*, No. 02-16-00395-CV, 2017 WL 3298264 (Tex. App.—Fort Worth Aug. 3, 2017, pet. denied) (mem. op.), the Fort Worth Court of Appeals considered whether the scope of the arbitration agreement and the defense of unconscionability were issues for the arbitrator to decide.

This dispute arose from the construction of a building for Great Commission Baptist Church, and involved two arbitration agreements: one set forth in the Applicator Agreement between the roofing contractor and Dow Roofing Systems, LLC, the manufacturer/supplier of the TPO membrane used to cover the building's roof; and the other set forth in a ten-year Limited Warranty against leaks issued to the Church by Dow Roofing. Both arbitration agreements provided for arbitration "in accordance with" the AAA Construction Industry Arbitration Rules.

The Church eventually filed suit against the roofing contractor and Dow Roofing, and the roofing contractor cross-claimed against Dow Roofing for contribution and indemnity. Dow Roofing then moved to compel arbitration of the Church's and the roofing contractor's claims based upon the arbitration agreements in the Limited Warranty and the Applicator Agreement. The Church opposed arbitration on the grounds, among others, that the claims asserted were beyond the scope of the arbitration agreements, and that the arbitration agreements were unconscionable. The trial court ultimately denied the motion to compel arbitration, and Dow Roofing appealed.

The Fort Worth Court of Appeals held that, because the arbitration agreements required arbitration "in accordance with" the AAA Construction Industry Rules, issues regarding the scope and validity of the arbitration agreements were for the arbitrator to decide. Citing *Schlumberger Tech. Corp. v. Baker Hughes Inc.*, 355 S.W.3d 791, 803 (Tex. App.—Houston [1st Dist.] 2011, no pet.) and Rule 1(a) of the Construction Rules, the Fort Worth court reasoned that the language "in accordance with" makes the AAA Construction Industry Rules part of the arbitration agreement; and under Rule 9(a) of the Construction Rules, the arbitrator has "the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement." Further, the arbitration agreements called for arbitration of any controversy or claim arising out of or related to the Applicator Agreement and the Limited Warranty—the agreements did not carve out any category of claims, nor did they include only specific categories of claims that the arbitrator must decide. That language, combined with the relevant language from the AAA Construction Industry Rules assigning arbitrability questions to the arbitrator, evidenced a clear and unmistakable delegation of arbitrability to the arbitrator. Accordingly, the Fort Worth court held that the parties were required to raise their challenge to the arbitration agreements' scope, as well as their defense that the arbitration agreements were unconscionable, in the arbitration itself.

iv. A challenge to the continuing validity of the contract containing the arbitration agreement, as opposed to a condition precedent to formation of the contract, is for the arbitrator to decide.

In *Dow Roofing Systems, LLC v. Great Commission Baptist Church*, No. 02-16-00395-CV, 2017 WL 3298264 (Tex. App.—Fort Worth Aug. 3, 2017, pet. denied) (mem. op.), the Fort Worth Court of Appeals also considered whether a party's challenge to the continuing validity of

the contract containing the arbitration agreement was for the arbitrator, or the trial court, to decide.

As noted above, the Limited Warranty issued to the Church by Dow Roofing contained an arbitration agreement. The Limited Warranty permitted Dow Roofing to declare the Limited Warranty "null and void" if, in its discretion, Dow Roofing determined that one of three specific events had occurred: (1) the Church had alterations or repairs made on the roof without Dow Roofing's authorization; (2) the Church failed to use reasonable care in maintaining the roof; or (3) the Church failed to comply with the Limited Warranty's terms. The Church additionally opposed Dow Roofing's motion to compel arbitration on the ground that, because Dow Roofing previously had declared the Limited Warranty "null and void," the Limited Warranty never came into existence and, thus, neither did the arbitration agreement contained within it.

The Fort Worth Court of Appeals held that the arbitrator was required to decide the consequences of Dow Roofing's decision to declare the Limited Warranty "null and void." Citing *In re Morgan Stanley & Co.*, 293 S.W.3d 182, 185-87 (Tex. 2009), the Fort Worth court explained that a court decides challenges to the requirements for contract formation, while an arbitrator must decide the question of whether a contract that meets the requirements for contract formation is nevertheless enforceable. The Fort Worth court reasoned that an argument relying on the Limited Warranty's termination provision is not a challenge to the contract's formation because the termination provision is not a condition precedent to formation. Rather, the termination provision merely allowed Dow Roofing to cancel the Limited Warranty in certain limited circumstances after the agreement was entered, but did not prevent formation of the agreement in the first place. Because the Church's defense challenged the continuing validity of the Limited Warranty but did not challenge the requirements for formation of a contract, the Fort Worth Court held that the arbitrator must decide what effect, if any, Dow Roofing's decision to declare the Limited Warranty "null and void" had an the Limited Warranty's validity.

4. Compelling arbitration despite pending discovery

i. A trial court has jurisdiction to assess whether an arbitration agreement mandates the stay of a Rule 202 action pending arbitration.

In *In re Amarillo II Enterprises, LLC*, No. 07-17-00005-CV, 2017 WL 491938 (Tex. App.—Amarillo Feb. 3, 2017, orig. proceeding) (mem. op.), the Amarillo Court of Appeals considered whether a trial court has jurisdiction to assess whether an arbitration agreement mandates the stay of a Rule 202 petition to conduct discovery of potential claims pending arbitration.

Dr. Thomas Sames entered into a contract with Amarillo II Enterprises, LLC to act as Amarillo's medical director. The parties' contract contained an arbitration agreement providing that

> [a]ny dispute or controversy arising under, out of or in connection with, or in relation to this Agreement, or any amendment hereof, or the breach hereof shall be determined and settled by arbitration in accordance with the rules of the American Arbitration Association and applying the laws of the State of Texas.

A dispute later arose, leading Dr. Sames to file a petition to conduct discovery of potential claims pursuant to Rule 202 of the Texas Rules of Civil Procedure. Dr. Sames sought discovery from

Amarillo, among other potential parties. His potential claims related to gender discrimination, defamation, breach of contract and tortious interference with contract. Amarillo filed a motion to stay acting upon the Rule 202 petition, asserting it was entitled to that relief due to the parties' arbitration agreement. The trial court granted the Rule 202 petition and denied Amarillo's motion to stay. The trial court's order recited, "[b]ecause the only proceeding before the Court is a rule 202 petition, the Court lacks jurisdiction to grant the Motion to Stay and compel arbitration." Amarillo then sought mandamus relief from the court of appeals.

The Amarillo Court of Appeals held that, if the trial court is precluded from trying the anticipated suit due to the existence of an enforceable arbitration agreement, it may not permit pre-suit discovery on the claims to be raised in that suit and encompassed within the arbitration agreement. Citing *In re Wolfe*, 341 S.W.3d 932 (Tex. 2011) and *In re Depinho*, 505 S.W.3d 621 (Tex. 2016) (per curiam), the Amarillo court reasoned that one cannot get through Rule 202 that which would be denied him in the anticipated action. Nor can Rule 202 be used to obtain discovery pertaining to a potential claim over which the trial court would lack jurisdiction. Thus, following the reasoning of and policy underlying *Wolfe* and *Depinho*, "it would be logical to infer that if the trial court is barred from adjudicating the anticipated suit, it cannot permit pre-suit discovery on claims underlying that suit."

The Amarillo court further reasoned that the AAA rules do not necessarily authorize the same discovery permitted by the Texas Rules of Civil Procedure. So, it may also be true that Dr. Sames sought discovery that would be unavailable to him in arbitration, and attempted the proverbial "end-run" thought improper by the Supreme Court in *Wolfe* and *Depinho*. Irrespective of which reason was applicable (i.e., the trial court cannot litigate the anticipated suit, or the discovery cannot be obtained in the arbitration), the Amarillo court held that the effect of the arbitration agreement had to be addressed by the trial court in deciding whether to stay action on the Rule 202 proceeding. To the extent the trial court had jurisdiction to consider the Rule 202 request, the Amarillo court saw nothing that would deprive the trial court of the authority to assess whether an arbitration agreement mandates the stay of a Rule 202 action pending arbitration. Thus, the trial court erred in concluding that it lacked jurisdiction to stay consideration of the Rule 202 petition, and in concluding that it lacked jurisdiction to compel arbitration.

ii. A trial court abuses its discretion if it defers ruling on a motion to compel arbitration until after the completion of discovery beyond that which is authorized.

In *In re DISH Network, LLC*, 528 S.W.3d 177 (Tex. App.—El Paso 2017, orig. proceeding), the El Paso Court of Appeals considered whether a trial court abused its discretion in deferring a ruling on the defendant's motion to compel arbitration until after the completion of certain discovery.

Yvette Delgado was employed by DISH Network, LLC as a Human Resources Manager. While she was employed by DISH, Delgado assisted DISH's outside counsel, Hagan Noll & Boyle (HNB), in employment-related lawsuits brought against DISH. Following her termination, Delgado sued DISH for discrimination and retaliation. HNB sent a letter to Delgado's counsel regarding the arbitration agreement signed by Delgado when she was hired by DISH. Delgado responded that a conflict of interest may exist between Delgado and HNB which would require HNB to be disqualified. DISH filed a motion to compel arbitration. Delgado, in turn, served DISH with requests for production seeking documents pertaining to the disqualification issue and then filed an objection to the hearing on DISH's motion to compel arbitration, asking the trial

court to continue the hearing and permit discovery on the disqualification issue. The trial court did not issue a ruling on DISH's motion to compel arbitration. Instead, the trial court granted Delgado's objection to hearing the motion to compel arbitration prior to the completion of discovery regarding disqualification of HNB. The trial court subsequently signed an order compelling discovery of documents from DISH, and DISH sought mandamus relief in the court of appeals.

The El Paso Court of Appeals held that the trial court abused its discretion by deferring a ruling on DISH's motion to compel arbitration until after completion of the discovery sought by Delgado. The El Paso court reasoned that, as a general rule, a motion to compel arbitration should be resolved without delay. Further, CPRC §171.086 permits discovery to be taken when it is needed before the arbitration or to permit the arbitration to be conducted in an orderly manner. Thus, a trial court abuses its discretion if it defers ruling on a motion to compel arbitration until after the completion of discovery beyond that which is authorized. Because Delgado failed to offer any evidence that she had an express or implied relationship with HNB, the trial court abused its discretion by granting Delgado's motion to compel discovery on the disqualification issue. Consequently, the trial court also abused its discretion by permitting the challenged discovery rather than deciding DISH's motion to compel arbitration.

B. Judicial Review of Arbitration Awards

1. Improper modification

In *Gordon v. Nickerson*, No. 03-16-00071-CV, 2017 WL 1549150 (Tex. App.—Austin Apr. 27, 2017, no pet.) (mem. op.), the Austin Court of Appeals considered whether a trial court's award of attorney's fees incurred in seeking confirmation of an arbitration award constituted an improper modification of the arbitration award.

A dispute regarding use of a water well led adjoining landowners, the Nickersons and the Gordons, to enter into a mediated settlement agreement (MSA). The MSA provided that binding arbitration would be used to resolve any disputes arising from the MSA. Two such disputes arose, resulting in arbitration proceedings and culminating in an arbitration award. The arbitrator awarded the Nickersons, among other relief, $3,000 in attorney's fees and ordered that amount be offset against the purchase price of certain real property. The trial court signed a final judgment confirming the arbitration award, and also awarding the Nickersons $9,563.48 in attorney's fees for seeking confirmation of the arbitration award. On appeal, the Gordons contended that the trial court improperly modified the arbitration award by awarding attorney's fees to the Nickersons.

The Austin Court of Appeals held that the trial court's award of $9,563.48 in attorney's fees to the Nickersons constituted an improper modification of the arbitration award. Under "well-established" Texas case law, if an arbitration award includes an award of attorney's fees, a trial court may not award additional attorney's fees for enforcing or appealing the confirmation of the award unless the arbitration agreement provides otherwise.[28] The Austin court reasoned that here, the trial court awarded attorney's fees to the Nickersons based upon its finding that they incurred $9,563.48 in reasonable and necessary attorney's fees in their efforts to affirm the arbitration award. Further, the arbitration agreement in the MSA did not "provide otherwise."

[28] 2017 WL 1549150, at *3 & n.8 (citing *Crossmark, Inc. v. Hazar*, 124 S.W.3d 422, 436 (Tex. App.—Dallas 2004, pet. denied); *Cooper v. Bushong*, 10 S.W.3d 20, 26 (Tex. App.—Austin 1999, pet. denied)).

Accordingly, the Austin court held that the trial court erred by awarding such fees in its final judgment.

The Nickersons further argued that the fee award was proper because the Gordons' challenge to the arbitration award was "without justification," pointing to the holding in *Stage Stores, Inc. v. Gunnerson*, 477 S.W.3d 848, 863-64 (Tex. App.—Houston [1st Dist.] 2015, no pet.) that a trial court may award attorney's fees to the party seeking to confirm the arbitration award when its opponent's challenge to the award is "without merit" and its refusal to abide by the award is "without justification." The Austin court disagreed, explaining that the evidence and the pleadings showed, among other things, that the Gordons had good-faith concerns regarding the viability of the MSA. Thus, the Austin court refused to conclude that the Gordons' efforts were "without justification."

Author's Note: In *Methodist Healthcare System, Ltd., LLP v. Friesenhahn*, No. 04-16-00824-CV, 2017 WL 4518284, at *4 (Tex. App.—San Antonio Oct. 11, 2017, pet. filed) (mem. op.), summarized below, the San Antonio Court of Appeals likewise held that the trial court's award of attorney's fees incurred in seeking confirmation of the arbitration award constituted an improper modification of the arbitration award.

2. Grounds for vacatur

i. Arbitrator's sanctions orders were properly set aside on the basis of evident partiality, where the arbitrator failed to disclose that a party's counsel had appeared before her in two prior arbitrations, and amended her disclosures only after the opposing party's counsel learned that information.

In *Builders First Source-South Texas, LP v. Ortiz*, 515 S.W.3d 451 (Tex. App.—Houston [14th Dist.] 2017, pet. denied), the Houston (Fourteenth) Court of Appeals considered whether an arbitrator's sanctions orders were obtained through evident partiality by the arbitrator.

Gerardo Batista Ortiz (Batista) worked for Builders First Source-South Texas, LP at one of its construction sites. An arbitration provision in his employment agreement with Builders First required claims for job-related injuries to be submitted to arbitration before the AAA. Batista was injured while working at the construction site, and subsequently filed claims in arbitration alleging negligence and gross negligence against Builders First.

The AAA appointed Lynne Gomez to serve as arbitrator. Shortly after her appointment, Gomez submitted a sworn disclosure in which she stated that none of the other party representatives, law firms, or parties had appeared before her in past arbitration cases; and that she had conducted a conflicts check. Nearly one year later, the parties conducted a telephone hearing with Gomez. While waiting for Batista's counsel to join the call, Gomez and Jay Wallace, counsel for Builders First, discussed two cases in which Wallace had appeared as counsel for a party before Gomez. Batista's counsel alleged that, when he joined the call, the conversation between Gomez and Wallace was "extremely friendly" and they appeared to joke about Gomez's favorable decisions for Wallace in past arbitrations. At the end of the call, Gomez disclosed to Batista's counsel that Wallace had appeared before her twice in the past. Gomez then submitted a written amended disclosure identifying the cases in which Wallace had appeared before her.

Batista's counsel filed a written objection with the AAA to Gomez's continued involvement as arbitrator, arguing that Gomez was not impartial, citing previous adverse rulings in the arbitration which showed Gomez's bias, and pointing to the conversation during the telephone hearing that led to the amended disclosure. Batista also filed a nonsuit without prejudice of his claims in the AAA arbitration. The AAA then issued a letter stating that it reaffirmed Gomez as the arbitrator. After Batista nonsuited his claims in the arbitration, Builders First and a non-party re-urged their motions for sanctions against Batista related to prior discovery matters. Gomez issued an order finding that Batista engaged in sanctionable conduct and discovery abuse, and awarded monetary sanctions against Batista in excess of $4,500.

Batista then joined Builders First as a defendant in an already-pending lawsuit related to his injuries, and filed a motion asking the trial court to set aside the sanctions orders issued by Gomez on the basis of evident partiality. Batista also sought an order protecting him from arbitrating the matter with the AAA or, alternatively, allowing him to select a neutral arbitrator to be accepted by the court, or prohibiting Gomez from presiding over any arbitration. Builders First, in turn, filed a motion to compel arbitration and dismiss or stay all proceedings in the trial court pending the completion of arbitration. The trial court granted Batista's motion, set aside all orders and decisions issued in the AAA arbitration before Gomez, and decreed that all orders and decisions issued in the arbitration were obtained by Gomez's "fraudulent nondisclosure and partiality" toward Wallace and Builders First. The trial court additionally appointed a new arbitrator to preside over the arbitration. Builders First appealed.

The Houston (Fourteenth) Court of Appeals held the trial court properly set aside the arbitrator's sanctions orders on the basis of evident partiality. Justice Christopher authored the majority opinion, joined by Justice Brown. The majority first considered whether the trial court had jurisdiction to review the arbitrator's sanctions orders. As noted, Batista voluntarily nonsuited his claims in the arbitration. Thus, the only claims for affirmative relief that remained pending at the time of the nonsuit were the sanctions motions filed by Builders First and the non-party. Once those sanctions motions were adjudicated, no further issues remained before the arbitrator. As a result, the sanctions orders were final and were subject to review by the trial court for evident partiality.

The majority next considered whether the trial court properly found that the sanctions orders should be set aside and a new arbitrator appointed because of evident partiality. Under the FAA, parties may apply to an appropriate court to vacate an arbitration award based on grounds of evident partiality, which may be shown by an arbitrator's failure to "disclose facts which might, to an objective observer, create a reasonable impression of the arbitrator's partiality." An arbitrator need not disclose trivial relationships or connections, but the nondisclosure itself—rather than actual partiality or bias—establishes the evident partiality ground. In *Alim v. KBR (Kellogg, Brown & Root)-Halliburton*, 331 S.W.3d 178, 182 (Tex. App.—Dallas 2011, no pet.), the Dallas court held that a AAA arbitrator's failure to disclose that a party representative had appeared before him in a past arbitration—and the failure to amend or correct his disclosure to reflect that information—constituted evident partiality and constituted grounds for vacating the arbitration award under the FAA. Likewise, the majority reasoned, the fact that counsel for Builders First had appeared before Gomez in two prior arbitrations was not a trivial matter and should have been disclosed. According to the majority, "[t]he failure to disclose the information might, to an objective observer, create a reasonable impression of partiality."

The majority further considered the effect of Gomez's amended disclosures, holding that the amended disclosures did not prevent Batista from establishing evident partiality for two reasons. *First*, the amended disclosures came almost a year into the arbitration, well after the

time that Batista could have struck Gomez as an arbitrator based upon the prior appearances by counsel. *Second*, the evidence presented a fact issue with regard to whether Gomez amended her disclosures because she did not remember the prior appearances by Builders First's counsel, or only because the prior appearances became known to Batista during the phone call. Given the conflicting evidence in the record, the majority held that the evidence supported a finding of evident partiality.

Finally, the majority considered whether the trial court erred in appointing an arbitrator. When a court vacates an award based on evident partiality, both the FAA and the TAA allow the trial court to order a rehearing before a new arbitrator. However, because the parties' arbitration agreement states that they will conduct the arbitration under the AAA, the parties must go through the AAA appointment process for selection of a new arbitrator. Therefore, the majority held that the trial court's appointment of an arbitrator must be set aside, and the parties must return to the AAA for the appointment of a new arbitrator (not Gomez).

Author's Note: Justice Jamison authored a concurring opinion to "highlight gaps in the record that mandate the seemingly harsh conclusion that Batista's rights were prejudiced by the arbitrator's evident partiality based on her failure to initially disclose prior cases she had arbitrated for Builders First's counsel…." Justice Jamison pointed out, among other things, that "the AAA rules fail to address several key matters that sometime appear in arbitration rules and would have assisted [the Houston court's] analysis," including that the AAA rules state no procedures or criteria for the disqualification hearing, selection of the decision makers, or the determination of whether the arbitrator should be disqualified or reaffirmed.

ii. Evident partiality is not shown by an arbitrator's failure to disclose information of which he is completely unaware.

In *Forest Oil Corp. v. El Rucio Land & Cattle Co.*, 518 S.W.3d 422 (Tex. 2017), the Texas Supreme Court considered whether an arbitration award should be vacated based upon the evident partiality of one arbitrator, or because the arbitration panel exceeded its powers.

Forest Oil Corporation produced natural gas on the McAllen Ranch, controlled by James McAllen. McAllen sued Forest Oil for underpayment of royalties, but the parties ultimately resolved their disputes with a Settlement Agreement and Surface Agreement, both of which contained an arbitration agreement. Notably, the arbitration agreement gave the arbitration panel "the authority to award punitive damages where allowed by Texas substantive law." McAllen later sued Forest Oil for environmental contamination and improper disposal of hazardous materials on the Ranch, and McAllen was compelled to arbitrate its claims. Arbitration was before a panel of three arbitrators. Forest Oil chose B. Daryl Bristow, McAllen chose Donato Ramos, and a district judge chose Clayton Hoover as the third arbitrator.

A divided panel issued an award in favor of McAllen, awarding McAllen both actual and exemplary damages, and issuing declarations regarding Forest Oil's continuing obligations under the parties' Agreements. Forest Oil filed a motion to vacate the arbitration award on several grounds, including evident partiality in regard to arbitrator Ramos, and that the arbitration panel exceeded its powers in awarding exemplary damages that were not allowed by Texas substantive law. In regard to evident partiality, Forest Oil offered evidence that McAllen had previously objected to using Ramos as a mediator in another case, apparently to avoid any conflict with Ramos serving as an arbitrator in this case, and neither McAllen nor Ramos had disclosed that information to Forest Oil. The trial court denied Forest Oil's motion to vacate the arbitration award, and the court of appeals affirmed.

The Texas Supreme Court held that the arbitration award was not required to be vacated on the basis of evident partiality or because the arbitration panel had exceeded its powers. The Supreme Court first addressed the issue of evident partiality, explaining that evident partiality is established by the nondisclosure of facts which might, to an objective observer, create a reasonable impression of the arbitrator's partiality, regardless of whether the nondisclosed information necessarily shows partiality or bias. However, "an arbitrator's impartiality cannot be affected by something of which he is completely unaware." The Supreme Court ultimately found no evidence to support Forest Oil's complaint of evident partiality, reasoning:

> It is difficult to see how Ramos could be partial *to* McAllen for objecting to his serving as a mediator in a case in which McAllen was a party. One would think, if anything, the objection would have made Ramos biased against McAllen. But in any event, there is no direct evidence that Ramos knew of the possible mediation, much less that McAllen had objected to avoid any conflict with Ramos' serving as an arbitrator in this case. Even if the fact that Ramos' staff was contacted about his serving as a mediator is circumstantial evidence that Ramos knew of the mediation, we must defer to the trial court's contrary finding if supported by the evidence. The trial court judged the witnesses' credibility and weight of their testimony, ultimately concluding that Ramos "should not be disqualified for failure to disclose a trivial, non-prejudicial, not consummated invitation to act as mediator." The trial court's implied finding that Ramos was unaware of the mediation is supported by the evidence.

Thus, the trial court properly denied Forest Oil's motion to vacate the arbitration award on the basis of evident partiality.

The Supreme Court next addressed Forest Oil's complaint that the arbitration panel had exceeded its powers under the Settlement Agreement by awarding damages not permitted by Texas law and issuing declarations that imposed its own notion of economic justice, all in manifest disregard of the law. But the Supreme Court disagreed, explaining that in determining whether an arbitrator has exceeded his authority, the proper inquiry is *not* whether the arbitrator decided an issue correctly, but rather, whether he had the authority to decide the issue at all. Here, the Settlement Agreement called for arbitration of McAllen's claims, including that Forest Oil breached the Surface Agreement's remediation requirements. Further, the Settlement Agreement gave the arbitrators "the authority to award punitive damages where allowed by Texas substantive law". Although Forest Oil argued that the arbitration panel's award of damages exceeded Texas law (and, therefore, the arbitrators exceeded their authority), the Settlement Agreement also provided that all "disputes relating to his Agreement or disputes over the scope of this arbitration clause will be resolved by arbitration." According to the Supreme Court, "[u]nder this provision, determining what damages Texas law allows is as much within the arbitrators' broad authority as determining the amount to be awarded." Moreover, the arbitration panel's declarations clarified Forest Oil's remediation obligations under the parties' Agreements. The Supreme Court concluded that "[a]ll these issues are within the bounds of the parties' agreements, and the panel was authorized to decide them." Thus, the trial court properly denied Forest Oil's motion to vacate the arbitration award on the ground that the arbitration panel had exceeded its powers.

iii. Arbitrators did not exceed their powers by finding that neither side was the "prevailing party" for the purposes of contractual attorney's fees provision.

In *Pasadera Builders, LP v. Hughes*, No. 04-17-00021-CV, 2017 WL 6345218 (Tex. App.—San Antonio Dec. 13, 2017, no pet. h.) (mem. op.), the San Antonio Court of Appeals considered whether an arbitration panel exceeded its powers by finding that neither side was the "prevailing party" entitled to recover attorney's fees, expenses, and costs under the parties' construction contract.

Todd Hughes contracted with Pasadera Builders, LP to construct a custom-built home. The parties' construction contract contained an arbitration agreement, as well as the following provision regarding the recovery of attorney's fees:

> "The prevailing party in any action to enforce the terms of this Agreement shall be entitled to receive from the non-prevailing party all reasonable attorney's fees and all expenses and court or arbitration costs."

After construction was complete, the home experienced water-intrusion issues, and Hughes ultimately filed suit against Pasadera. The trial court ordered the parties to submit all of their claims to arbitration based upon the parties' arbitration agreement.

The arbitration panel issued an award finding that Pasadera breached its express limited warranty, and that Pasadera's offer and supplemental offer of settlement made under RCLA were reasonable. Because Hughes rejected the offer, the arbitration panel further concluded that Hughes could not recover an amount in excess of the fair market value of Pasadera's last offer of settlement and could recover only the reasonable and necessary costs and attorney's fees Hughes incurred before the offer was rejected. Further, in regard to the attorney's fees provision in the construction contract, the arbitration panel found:

> In *Fitzgerald v. Schroder Ventures II, LLC*, 345 S.W.3d 624, 628-29 (Tex. App.—San Antonio 2011, no writ), the Fourth Court of Appeals concluded that…a defendant that obtained a judgment in its favor (take-nothing) is the prevailing party and is therefore entitled to attorney's fees. In this case, [Pasadera] did not obtain a take-nothing award. [Pasadera] could have drafted "prevailing party" in a way that could have provided it prevailing party status but did not do so. Accordingly, the panel concludes that [Pasadera] was not a "prevailing party."
>
> However, since the panel has found that [Hughes] rejected a reasonable offer, he is not a prevailing party either and is only entitled to recover those reasonable and necessary attorney's fees and necessary costs incurred before the offer was rejected. *See* TEX. PROP. CODE §27.004(e)(2).

Hughes then filed a motion to confirm the arbitration award, while Pasadera filed a motion to vacate the portion of the arbitration award finding that neither party was a "prevailing party." The trial court granted Hughes's motion to confirm and denied Pasadera's motion to vacate. On appeal, Pasadera asserted that the arbitration panel exceeded its powers by failing to determine that Pasadera was the "prevailing party" and by failing to award Pasadera its attorney's fees, expenses, and costs. Citing *Townes Telecomm., Inc. v. Travis, Wolff & Co., L.L.P.*, 291

S.W.3d 490 (Tex. App.—Dallas 2009, pet. denied), Pasadera argued that the arbitration panel was required to determine that one of the parties was a "prevailing party."

The San Antonio Court of Appeals held that, based upon the language in the parties' construction contract, the arbitration panel did not exceed its powers by finding that neither side was a "prevailing party." Pursuant to CPRC §171.088(a)(3)(A), on an application of a party, a trial court shall vacate an arbitration award if the arbitrators "exceeded their powers." Citing *DiAthegen, LLC v. Phyton Biotech, Inc.*, No. 04-14-00267-CV, 2015 WL 5037645, at *4 (Tex. App.—San Antonio Aug. 26, 2015, pet. denied) (mem. op), the San Antonio court explained that an arbitrator exceeds his powers if he acts contrary to express contractual provisions, such as when the arbitration award ignores a clear contractual limitation on the arbitrator's authority. However, it is not enough to show that the arbitrator committed an error, or even a serious error. Rather, it is only when an arbitrator strays from interpretation and application of the agreement and "effectively dispenses his own brand of industrial justice" that his decision may be unenforceable. Thus, Texas courts uniformly acknowledge that a mistake of fact or law by an arbitrator is not a proper ground for vacating an arbitration award.

The San Antonio court reasoned that, unlike the arbitration agreement in *Townes*[29], the parties' construction contract did not contain any language specifically foreclosing the arbitration panel from determining that neither side was a "prevailing party." Because the arbitration panel was not specifically foreclosed from making that finding, the San Antonio court concluded that the arbitration panel did not act in direct contravention of the agreement or exceed its powers. Accordingly, the trial court did not err in denying Pasadera's motion to vacate.

iv. Arbitration panel exceeded its powers by arbitrating a dispute that had been settled by the parties.

In *Higginson v. Martin*, No. 07-15-00343-CV, 2017 WL 603626 (Tex. App.—Amarillo Feb. 14, 2017, pet. filed) (mem. op.), the Amarillo Court of Appeals considered whether the arbitrators exceeded their powers by refusing to accept the parties' settlement agreement that would have resolved their disputes.

Shareholders of a closely-held corporation entered into a Shareholders' Agreement which contained the following arbitration agreement:

> 12.5 Mediation and Arbitration. If a claim, demand, disagreement, controversy, or dispute (collectively, "Dispute") arises in connection with this Agreement or the breach thereof and if the Dispute cannot be settled through direct discussions, the parties agree to endeavor first to settle the Dispute in an amicable manner by mediation.... The mediation will be completed within thirty days of receipt of written demand for mediation. Thereafter, any unresolved controversy or claim

[29] In *Townes*, the arbitration agreement provided:

> All reasonable costs of both parties, as determined by the arbitrators, including but not limited to (1) the costs, including reasonable attorneys' fees, of the arbitration; (2) the fees and expenses of the AAA and the arbitrators; and (3) the costs, including reasonable attorney's fees, necessary to confirm the award in court shall be borne entirely by the non-prevailing party (to be designated by the arbitration panel in the award) and may not be allocated between the parties by the arbitration panel.

291 S.W.3d at 492-93.

> relating to this Agreement or breach thereof will be settled by binding arbitration initiated by written notice by either party to the other of the intent to arbitrate. The arbitration will be held in Lubbock, Lubbock County, Texas, United States of America, and administered by the American Arbitration Association, in accordance with its Commercial Arbitration Rules, and judgment on the award rendered may be entered in any court having jurisdiction....

A dispute later arose, leading one shareholder to file suit against the others. The trial court ultimately granted defendants' motion to compel arbitration. During the arbitration, in response to a request from the arbitration panel, defendants' counsel sent an e-mail transmitting to the panel a proposed "Arbitration Award" which purported to be a settlement of all disputes at issue in the arbitration proceeding. The "Arbitration Award" was not signed by the parties, but it was signed by their counsel, "approved as to form only." Despite the joint representation of counsel that the dispute had been settled, the arbitration panel refused to accept or sign the "Arbitration Award" because it was not willing to approve the form of the award as presented. As a result, the parties proceeded with arbitration.

The arbitration panel ultimately issued an award in favor of defendants, who then filed their petition to confirm and enforce the arbitration award. The plaintiff filed a motion to vacate the arbitration award on the ground that the arbitration panel exceeded its powers. The trial court denied defendants' petition to confirm, granted plaintiff's motion to vacate, vacated the arbitration award, and scheduled the dispute for trial. On appeal, the defendants argued that the arbitration panel exceeded its powers by refusing to accept the parties' settlement agreement that would have resolved their disputes.

The Amarillo Court of Appeals held that the arbitration panel exceeded its powers by arbitrating a dispute that had been settled by the parties. Both the TAA and the FAA authorize courts to vacate an arbitration award whenever arbitrators exceed their powers. An arbitrator's power and authority depends on the provisions under which the arbitrator was appointed; thus, arbitrators exceed that authority when they disregard the contract and decide matters not properly before them. In that regard, the appropriate inquiry is not whether the arbitrator decided an issue correctly, but instead whether the arbitrator had authority to decide the issue at all. Citing *Gulf Oil Corp. v. Guidry*, 160 Tex. 139, 327 S.W.2d 406, 408 (1959), the Amarillo court explained that an arbitrator's award in excess of its jurisdiction is void.

The Amarillo court reasoned that the issue before the trial court was whether there was an existing dispute to be arbitrated, not the propriety of the ultimate decision of the arbitration panel. Paragraph 12.5 of the Shareholders' Agreement specifically provides for arbitration "if the Dispute (defined as 'a claim, demand, disagreement, controversy, or dispute') *cannot be settled*…." Settlement, therefore, deprives the arbitrator of any authority to act and the trial court was within its authority to determine whether or not a settlement existed prior to the proceedings before the arbitration panel. Having found that the parties had settled their dispute, the trial court did not abuse its discretion in finding that the jurisdiction of the arbitration panel ended. Because the arbitration panel lacked the jurisdictional prerequisite of a matter in controversy, the Amarillo court held that the trial court did not err in denying defendants' motion to confirm the arbitration award or in granting plaintiff's motion to vacate the award.

v. A mere mistake of law is insufficient to vacate an arbitration award on the basis of "undue means."

In *IOC Co., LLC v. City of Edinburg*, No. 13-16-00117-CV, 2017 WL 3084293 (Tex. App.—Corpus Christi July 20, 2017, pet. denied) (mem. op.), the Corpus Christ Court of Appeals considered whether the trial court erred in vacating an arbitration award because it was "obtained by…undue means," as provided in CPRC §171.088(a)(1).

The City of Edinburg entered into two contracts with IOC Company, LLC to perform engineering and architectural construction for paving and drainage improvements to Canton Road and Sugar Road. Each contract contained an arbitration agreement. Disputes later arose between IOC and the City related to the Canton Road and Sugar Road Projects, and both matters were consolidated and arbitrated by the same arbitrator. IOC sought damages for owner-caused delay (specifically, damages in the form of additional labor costs, equipment costs, material-escalation costs, extended-field costs, and mark-up costs), while the City countered that the damages sought by IOC were not available under Section 271.153 of the Texas Local Government Code. The arbitrator found that the City materially breached both contracts without excuse and was liable to IOC for damages, that IOC did not materially breach either contract, and that Section 271.153 of the Local Government Code was not a bar to IOC's recovery.

The City filed a petition and application to vacate the arbitration award. IOC answered, moved to deny the City's application to vacate, and filed its own petition and motion to confirm the arbitration award. The trial court granted the City's motion to vacate and denied IOC's motion to confirm, and IOC appealed. On appeal, the City argued that the arbitration award should be vacated under CPRC §171.088(a)(1) because it was "obtained by…undue means." According to the City, the arbitrator (1) flagrantly disregarded well-established statutes that limit the award against local governments; and (2) disregarded unambiguous contractual provisions, including provisions regarding requests for additional compensation, change orders, and differing site conditions.

The Corpus Christi Court of Appeals held that the City failed to meet its burden to establish that IOC obtained the arbitration award based upon "undue means"—that is, conduct amounting to immoral, illegal, or bad-faith conduct. Pursuant to CPRC §171.088(a)(1), on an application of a party, a trial court shall vacate an arbitration award if "the award was obtained by corruption, fraud, or other undue means." Texas courts have defined behavior amounting to "undue means" as that which is "immoral, illegal, or bad-faith conduct."[30] However, a mere mistake of law is insufficient to vacate an arbitration award on the basis of "undue means." The Corpus Christi court reasoned that, even if the arbitrator made minor errors or misapplied Section 271.153 of the Local Government Code to the facts of this case, as the City argued, "such a mistake of law is not enough to amount to undue means." Accordingly, the City failed to meet its burden to vacate the arbitration award under CPRC §171.088(a)(1)'s "undue means" provision.

[30] 2017 WL 3084293, at *4 (citing *Las Palmas Med. Ctr. v. Moore*, 349 S.W.3d 57, 69 (Tex. App.—El Paso 2010, pet. denied); *LeFoumba v. Legend Classic Homes, Ltd.*, No. 14-08-00243-CV, 2009 WL 3109875 (Tex. App.—Houston [14th Dist.] 2009, no pet.) (mem. op.); *In re Arbitration Between Trans. Chem., Ltd. & China Nat'l Machinery Import & Export Corp.*, 978 F. Supp. 266, 304 (S.D. Tex. 1997)).

vi. Incarceration in federal prison may not be sufficient cause for postponement of an arbitration hearing.

In *Howerton v. Wood*, No. 02-15-00327-CV, 2017 WL 710631 (Tex. App.—Fort Worth Feb. 23, 2017, no pet.) (mem. op.), the Fort Worth Court of Appeals considered whether the arbitrator's refusal to postpone the hearing due to a party's incarceration in federal prison constituted sufficient grounds to vacate the arbitration award.

The Woods bought a home in Mansfield, Texas and hired Ty Howerton to be the general contractor for extensive renovations to the home. The parties' general contract contained an arbitration agreement. Suffice it to say that the renovation went "horribly wrong" and had major problems from the beginning. The Woods later discovered that Howerton had pleaded guilty two years earlier to conspiracy to commit wire fraud. Howerton was sentenced to 60 months in federal prison and ordered to pay nearly $8 million in restitution.

Shortly before Howerton was sentenced, the Woods filed suit against Howerton and other defendants for breach of contract, breach of warranty, fraud, DTPA violations, violations of the Construction Trust Fund Act, breach of fiduciary duty, knowing participation in a breach of fiduciary duty, negligence, and violations of the Theft Liability Act. The defendants filed a motion to compel arbitration, which was granted. The arbitrator held a five-day hearing over the course of two months, and ultimately entered an award in favor of the Woods. Although he was incarcerated in federal prison during the arbitration proceedings, Howerton was represented by counsel at the arbitration hearing and testified by telephone the final day of the hearing.

The Woods filed an application for the trial court to confirm the arbitration award, and Howerton filed a motion to vacate the award. The trial court denied Howerton's motion to vacate and granted the Woods' motion to confirm the arbitration award. On appeal, Howerton contended that he was not allowed to fully participate in the arbitration hearing because he was in federal prison and was denied a postponement after showing sufficient cause. Thus, according to Howerton, the trial court erred in refusing to vacate the arbitration award.

The Fort Worth Court of Appeals held that, while "unusual," the circumstances of this case did not show sufficient cause such that the arbitration award must be vacated. Under both the FAA and TAA, an arbitration award is subject to vacatur if the arbitrator refuses to postpone the hearing even though sufficient cause for the postponement was shown. Courts may look to grounds a trial court would find sufficient to support a motion for continuance in determining sufficient cause for a postponement. Pursuant to Texas Rule of Civil Procedure 251, a trial court may grant a continuance only upon "sufficient cause supported by affidavit, or by consent of the parties, or by operation of law." Thus, because Howerton's postponement requests were not verified or supported by affidavit, the Fort Worth court reasoned it was entitled to presume that the arbitrator did not abuse his discretion by denying his requests. Further, Howerton's lawyer vigorously questioned witnesses at the arbitration hearing, introduced evidence, and "ably represented" Howerton's interests even though the lawyer was not being paid and Howerton was uncooperative. Contrary to Howerton's assertion, he was not "deprived of his right to be heard and present a meaningful defense." Citing *Laws v. Morgan Stanley Dean Witter*, 452 F.3d 398, 399 (5th Cir. 2006), the Fort Worth court explained, "[t]o constitute misconduct requiring vacation of an award, an error in the arbitrator's determination must be one...which so affects the rights of a party that it may be said that he was deprived of a fair hearing." The Fort Worth court concluded that Howerton's rights were not so affected that he was deprived of a fair hearing and, therefore, the trial court did not err in denying Howerton's motion to vacate the arbitration award.

vii. Manifest disregard of the law is not a ground for vacatur of an arbitration award under the FAA.

In *Prescription Health Network, LLC v. Adams*, No. 02-15-00279-CV, 2017 WL 1416875 (Tex. App.—Fort Worth Apr. 20, 2017, pet. denied) (mem. op.), the Fort Worth Court of Appeals considered whether the doctrine of manifest disregard exists as a ground for vacatur of an arbitration award under the FAA.

The Adams Plaintiffs filed a lawsuit asserting a host of tort claims against the PHN Defendants arising from the parties' Franchise Agreement. The PHN Defendants moved to compel arbitration based upon the arbitration agreement in the Franchise Agreement, which provided for arbitration governed by the FAA. The trial court granted the motion to compel arbitration and stayed the litigation pending the completion of arbitration. The arbitration panel ultimately entered a "reasoned award" and later a supplemental award in favor of the Adams Plaintiffs, awarding them damages, attorney's fees, and costs. The PHN Defendants filed a motion to modify or vacate the arbitration award, asserting that the arbitration panel acted with "manifest disregard of the law." This was so, according to the PHN Defendants, because the arbitration award stated that the Adams Plaintiffs' tort claims would be governed by Texas law, yet when reviewing the Adams Plaintiffs' DTPA claims, the panel applied Florida law under the Florida Deceptive and Unfair Trade Practices Act rather than Texas law under the DTPA. The trial court granted the Adams Plaintiffs' motion to confirm the award and denied the PHN Defendants' motion to modify or vacate the award, and the PHN Defendants appealed.

The Fort Worth Court of Appeals held that manifest disregard of the law is not a ground for vacatur of an arbitration award under the FAA. The Fort Worth court first discussed the origins of the "manifest disregard" doctrine, explaining that use of "manifest disregard" as a basis for vacating or modifying arbitration awards had its genesis in *Wilko v. Swan*, 346 U.S. 427, 436-37, 440 (1953), *overruled on other grounds by Rodriguez de Quijas v. Shearson/Am. Exp., Inc.*, 490 U.S. 477 (1989), where the United States Supreme Court found that "the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation." Later, in *Hall Street Assocs., L.L.C., v. Mattel, Inc.*, 552 U.S. 576, 585 (2008), the Supreme Court recognized that its language in *Wilko* was vague and then held that under the FAA, an arbitrator's decision may be vacated only under one of the four statutory grounds set out in 9 U.S.C. §10. The Fort Worth court additionally noted that in *Citigroup Global Markets, Inc. v. Bacon*, 562 F.3d 349, 358 (5th Cir. 2009), the Fifth Circuit held that in light of *Hall Street*, "[t]o the extent that our previous precedent holds that nonstatutory grounds may support the vacatur of an arbitration award, it is hereby overruled."

Citing a footnote in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 671 n.3 (2010), the PHN Defendants nevertheless argued that the doctrine "manifest disregard" was not dead. There, the Supreme Court stated in dicta that it was not deciding whether "manifest disregard" survived its decision in *Hall Street* as an independent ground for review or a ground for vacatur set forth in the FAA. But the Fort Worth court rejected the PHN Defendants' argument, reasoning that at least one federal district court has examined the same footnote and found that the "Fifth Circuit has not responded to *Stolt-Nielsen* and therefore [*Citigroup*'s] refusal to recognize 'manifest disregard' as a separate ground for vacatur remains the rule in [the Fifth] Circuit."[31] The Fort Worth court agreed and concluded that the Fifth Circuit's holding in *Citigroup* is persuasive and that the Supreme Court in *Hall Street* made clear that Sections 10 and

[31] 2017 WL 1416875, at *5 (quoting *Shaw Constructors, Inc. v. HPD, LLC*, 749 F. Supp. 2d 474, 479 (E.D. La. 2010)).

11 contain the exclusive and explicit grounds for vacating or modifying an arbitration award under the FAA.

The Fort Worth court additionally observed that the Fifth Circuit has at least twice recognized that *Citigroup* removes manifest disregard as a potential independent nonstatutory ground for vacatur under the FAA[32]; that the Fort Worth court itself has impliedly recognized that manifest disregard does not exist as a ground for vacatur under the FAA[33]; and that several other intermediate appellate courts have held either that "manifest disregard" does not exist as a ground for vacating an FAA arbitration award or that the four grounds explicitly listed in Section 10(a) are the only grounds for vacating an FAA arbitration award.[34] Thus, the Fort Worth court held that the trial court properly denied the PHN Defendants' motion to modify or vacate to the extent it was premised upon manifest disregard of the law.

3. Contracting for expanded review

i. Arbitration agreement did not provide for expanded judicial review of exemplary damages award.

In *Forest Oil Corp. v. El Rucio Land & Cattle Co.*, 518 S.W.3d 422 (Tex. 2017), the Texas Supreme Court also considered whether parties contracted for expanded judicial review of an arbitration award, as permitted by *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84 (Tex. 2011).

Forest Oil Corporation produced natural gas on the McAllen Ranch, controlled by James McAllen. McAllen sued Forest Oil for underpayment of royalties, but the parties ultimately resolved their disputes with a Settlement Agreement and Surface Agreement, both of which contained an arbitration agreement. Notably, the arbitration agreement gave the arbitration panel "the authority to award punitive damages where allowed by Texas substantive law." The arbitration agreement additionally provided that the panel was required to "apply the Texas Rules of Civil Procedure" and its decisions were subject to the parties' right to apply for relief in the district court, where the court shall apply an "abuse of discretion standard and render such orders as may be necessary."

McAllen later sued Forest Oil for environmental contamination and improper disposal of hazardous materials on the Ranch, and McAllen was compelled to arbitrate its claims. The arbitration panel issued an award in favor of McAllen, awarding McAllen both actual and exemplary damages. Forest Oil filed a motion to vacate the arbitration award on several grounds, including that the arbitration panel exceeded its powers in awarding exemplary damages that were not allowed by Texas substantive law. The trial court denied Forest Oil's motion to vacate the arbitration award, and the court of appeals affirmed. Before the Texas Supreme Court, Forest

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[32] *Id*. (citing *OMG, L.P. v. Heritage Auctions, Inc.*, 612 Fed. Appx. 207, 209-10 (5th Cir. 2015), *cert. denied*, 136 S. Ct. 503 (2015); *McVay v. Halliburton Energy Servs., Inc.*, 608 Fed. Appx. 222, 225 (5th Cir. 2015)).

[33] *Id*. at *6 (citing *Gilbert v. Rain & Hail Ins.*, No. 02-16-00277-CV, 2017 WL 710702, at *2 (Tex. App.—Fort Worth, Feb. 23, 2017, pet. denied) (mem. op.)).

[34] *Id*. (citing *Casa Del Mar Ass'n, Inc. v. Williams & Thomas, L.P.*, 476 S.W.3d 96, 100-01 (Tex. App.—Houston [14th Dist.] 2015, no pet.); *Venture Cotton Coop. v. Neudorf*, No. 14-13-00808-CV, 2014 WL 4557765, at *3 (Tex. App.—Houston [14th Dist.] Sept. 16, 2014, no pet.) (mem. op.); *IQ Holdings, Inc. v. Villa D'Este Condo. Owner's Assoc., Inc.*, 509 S.W.3d 367, 376 (Tex. App.—Houston [1st Dist.] 2014, no pet.); *Good Times Stores, Inc. v. Macias*, 355 S.W.3d 240, 244 (Tex. App.—El Paso 2011, pet. denied), *cert. denied*, 132 S. Ct. 2398 (2012); *Ancor Holdings, LLC v. Peterson, Goldman & Villani, Inc.*, 294 S.W.3d 818, 828-29 (Tex. App.–Dallas 2009, no pet.)).

Oil contended that by authorizing the arbitration panel "to award punitive damages where allowed by Texas substantive law," the parties agreed to expanded judicial review of the exemplary damages award.

The Texas Supreme Court held that the arbitration agreement did not provide for expanded judicial review of the exemplary damages award. The Supreme Court explained that the TAA generally restricts judicial review of arbitration awards, but parties can, by "clear agreement," contract for expanded judicial review. Here, however, such a clear agreement was lacking, as evidenced by the disparate treatment of discovery matters in the same paragraph. As noted, the arbitration agreement provided that the arbitration panel was required to "apply the Texas Rules of Civil Procedure" and its decisions were subject to the parties' right to apply for relief to the district court, where the court shall apply an "abuse of discretion standard and render such orders as may be necessary." But no such direction was provided in connection with exemplary damages. Accordingly, the Supreme Court concluded, "[i]n the absence of a clear agreement to limit the panel's authority and expand the scope of judicial review, this Court may not exercise expanded judicial review of exemplary damages."

ii. Arbitration agreement did not provide for expanded judicial review of arbitration award.

In *Methodist Healthcare System, Ltd., LLP v. Friesenhahn*, No. 04-16-00824-CV, 2017 WL 4518284 (Tex. App.—San Antonio Oct. 11, 2017, pet. filed) (mem. op.), the San Antonio Court of Appeals considered whether the parties contracted for expanded judicial review of the arbitration award.

Nancy Friesenhahn was terminated by Methodist Healthcare System for sending a reference letter on behalf of a former employee who was also a friend. Friesenhahn claimed she was fired because of her gender and age, and submitted her claim to arbitration. The arbitrator issued an award in favor of Friesenhahn, awarding her damages and attorney's fees. Friesenhahn filed a motion to confirm the arbitration award, and Methodist filed a motion to vacate the award. The trial court ultimately entered judgment confirming the arbitration award, and Methodist appealed. On appeal, Methodist quoted language from various provisions of the arbitration agreement to argue that the agreement provided for expanded judicial review of the arbitration award, as follows:

Title of section	Language quoted
"How does arbitration work?"	"[T]he arbitrator will apply the same laws and will be able to grant the same relief as would a judge or jury."
"What remedies are available in arbitration?"	"The arbitrator has the same power, authority, and limitations to award any remedy to which either party would have been entitled had the dispute been taken to a government agency or to a court."
"What authority does the arbitrator have?"	"The arbitrator will have all the powers a judge would have in dealing with any question or dispute that may arise up through the arbitrator rendering a decision. The arbitrator's power is limited to rights which would be protected in

> court. The arbitrator must apply the same statutory law and follow the same case precedent that would have to be applied and followed by the state or federal court judge who would otherwise have jurisdiction of the dispute. The arbitrator will apply the burden of proof required by applicable federal, state or local law. Like a judge, the arbitrator will have no power to change the Employer's policies and procedures (including this one), to change the law applicable to the facts of the dispute, or to substitute his/her business judgment for that of the Employer. The arbitrator must enforce, and not deviate in any way from, the Procedures herein. The arbitrator will not award relief greater than what the employee would otherwise be entitled to in a court of law."

The San Antonio Court of Appeals held that the arbitration agreement did not clearly expand judicial review of an arbitration award to encompass reversible error under standards applicable in a conventional appeal from a final judgment rendered after trial. The San Antonio court reasoned that the arbitration agreement in *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84 (Tex. 2011), which the Texas Supreme Court construed to provide for expanded judicial review, stated that the arbitrator "does not have authority (i) to render a decision which contains a reversible error of state or federal law, or (ii) to apply a cause of action or remedy not expressly provided for under existing state or federal law." The Supreme Court held that the parties expanded the scope of judicial review because they agreed an arbitrator did "not have authority to reach a decision based on reversible error." The reference to "reversible error" was a clear reference to the type of review undertaken in reviewing judicial decisions. The Supreme Court again addressed the issue of expanded judicial review in *Forest Oil Corp. v. El Rucio Land & Cattle Co.*, 518 S.W.3d 422 (Tex. 2017), summarized immediately above, where the Supreme Court held that "[i]n the absence of a clear agreement to limit the [arbitration] panel's authority and expand the scope of judicial review, this Court may not exercise expanded judicial review…."

The San Antonio court reasoned that, in contrast to the arbitration agreement in *Nafta Traders*, the above-quoted provisions of the arbitration agreement merely explain the authority the arbitrator does have. Because the arbitration agreement did not contain any language referencing judicial review or a standard applicable in a conventional judicial review like the reference to "reversible error" in *Nafta Traders*, the San Antonio court held that the arbitration agreement was not a "clear agreement to limit the [arbitrator's] authority ***and*** expand the scope of judicial review."

Author's Note: In *Pasadera Builders, LP v. Hughes*, No. 04-17-00021-CV, 2017 WL 6345218, at *2 n.2 (Tex. App.—San Antonio Dec. 13, 2017, no pet. h.) (mem. op.), summarized above, the San Antonio Court of Appeals likewise held that the following language in the parties' construction contract did not provide for expanded judicial review of the arbitration award:

> "The parties agree that in the event of an arbitration proceeding pursuant hereto, the parties shall file a joint motion to request that the arbitrator strictly observe all

applicable state and federal laws, including, but not limited to, applicable statutes of limitation."

4. Res Judicata

In *Premium Plastics Supply, Inc. v. Howell*, — S.W.3d — , 2017 WL 4288074 (Tex. App.—Houston [1st Dist.] 2017, no pet.), the Houston (First) Court of Appeals considered whether a party's counterclaims, which were raised but voluntarily dismissed in the arbitration, were barred by res judicata.

Premium Plastics Supply, Inc. signed a two-year lease for commercial space owned by Thomas and Laura Howell. The parties' lease contained the following arbitration agreement:

> **ARBITRATION.** Any controversy or claim related to this contract, including the construction or application of this contract, will be settled by binding arbitration under the rules of the American Arbitration Association, and any judgment granted by the arbitrator(s) may be enforced in any court of proper jurisdiction.

Premium Plastics continued to occupy the premises after the lease ended, but failed to pay the rent due under the lease's holdover clause. Thus, the Howells sent a notice of default seeking payment. When Premium Plastics failed to pay, the Howells initiated arbitration and then changed the locks on the leased space. In response, Premium Plastics asserted counterclaims in the arbitration for improper lockout, unauthorized access, and breach of contract. However, Premium Plastics dismissed the counterclaims before the arbitration hearing to pursue them in a trial court.

The arbitrator ultimately awarded the Howells $33,500 in unpaid rent, and the Howells filed suit in Harris County seeking a declaratory judgment confirming the arbitration award. The Howells subsequently filed a motion for summary judgment to confirm the award. Premium Plastics then amended their answer to reassert the identical counterclaims they had previously raised and withdrawn in the arbitration proceedings. The trial court granted the Howells' motion for summary judgment and confirmed the arbitration award. The Howells then moved for summary judgment on Premium Plastics' counterclaims, asserting that they were barred by res judicata. The trial court granted the Howells' second motion for summary judgment, and Premium Plastics appealed. On appeal, Premium Plastics asserted that the issue of res judicata must be decided by the arbitrator and not by the trial court.

The Houston (First) Court of Appeals held that the Howells met their burden to conclusively prove the elements of their res judicata defense and, therefore, the trial court properly granted summary judgment on Premium Plastics' counterclaims. Res judicata, or claims preclusion, prevents the relitigation of a claim or cause of action that has been finally adjudicated, as well as related matters that, with the use of diligence, should have been litigated in the prior suit. Pursuant to Texas Rule of Civil Procedure 97(a), a counterclaim is required to be litigated in an initial arbitration or suit when "it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction." To establish their right to judgment as a matter of law on their affirmative defense of res judicata, the Howells had to establish (1) a prior final judgment on the merits by a court of competent jurisdiction; (2) identity of parties or those in privity with them; and (3) a subsequent action based on the same claims as were or could have

been raised in the first action. Because the second element was undisputed, the Houston court considered only the first and third elements.

Citing *Tanox, Inc. v. Akin, Gump, Strauss, Hauer & Feld*, 105 S.W.3d 244, 270 (Tex. App.—Houston [14th Dist.] 2003, pet. denied), the Houston court explained that an arbitration award is treated as a prior final judgment and has preclusive effect for purposes of res judicata. Because their summary judgment evidence included a copy of the arbitration award, the Howells therefore proved the existence of a prior final judgment on the merits.

Likewise, the Howells' summary judgment evidence demonstrated both that Premium Plastics' counterclaims were raised in the arbitration before being voluntarily dismissed, and that those counterclaims could and should have been raised in the arbitration. The counterclaims asserted in the trial court were identical to those raised in the arbitration. Further, Premium Plastics' counterclaims all arose out of their landlord-tenant relationship with the Howells; that relationship was created by the lease, which contains the arbitration agreement. Accordingly, the Houston court held that Premium Plastics' counterclaims were subject to the arbitration agreement, and that the Howells conclusively proved the elements of their res judicata defense.

Finally, the Houston court considered, and rejected, Premium Plastics' argument that the issue of res judicata could only be decided by the arbitrator. Unlike *W. Dow Hamm III Corp. v. Millennium Income Fund, LLC*, 237 S.W.3d 745 (Tex. App.—Houston [1st Dist.] 2007, no pet.), upon which Premium Plastics relied for its argument, the question to be decided was not whether Premium Plastics' counterclaims cannot be arbitrated; rather, the question was whether Premium Plastics' counterclaims can be relitigated and were not compulsory counterclaims. According to the Houston court, *Tanox* demonstrates that, under these circumstances, the trial court has jurisdiction to determine the issue of res judicata. Accordingly, Premium Plastics failed to raise a fact issue regarding whether the trial court could determine that their counterclaims were barred by res judicata.

C. Non-Signatory Arbitration

1. Nonsignatory plaintiff not required to arbitrate his claim against signatory defendant.

In *Albertson's Holdings, LLC v. Kay*, 514 S.W.3d 878 (Tex. App.—Tyler 2017, no pet.), the Tyler Court of Appeals also considered whether a nonsignatory plaintiff was required to arbitrate his claim for loss of consortium against a signatory defendant.

Ruth Kay was employed by Albertson's Holdings, LLC. She signed "Albertson's LLC Texas Workplace Injury Benefit Plan," which included an arbitration agreement making arbitration mandatory for certain injury-related claims, and also containing the following provisions:

> These provisions [mandating arbitration of certain injury-related disputes] also apply to any claims that may be brought by an Associate's spouse, children, parents, beneficiaries, Representatives, executors, administrators, guardians, heirs or assigns (including, but not limited to, any survival or wrongful-death claims). This binding arbitration will be the sole and exclusive remedy for resolving any such claim or dispute for any arbitral claims….

> (e) **Binding Effect**: This provision for resolving claims by arbitration is equally binding upon, and applies to any such claims that may be brought by, or which are derivative of, an Employer and each Associate and his/her spouse, children, parents, beneficiaries, Representatives, executors, administrators, guardians, heirs or assigns (including, but not limited to, any survival or wrongful death claim).

Ruth was injured while in the course of her employment, and she and her husband, Frank, filed suit against Albertson's for negligence. Ruth sought damages for her injuries, while Frank sought damages for loss of consortium. Albertson's filed a motion to compel arbitration, which the trial court denied. On appeal, Albertson's argued that Frank was required to arbitrate his claim because Ruth signed the Plan containing the arbitration agreement as Frank's agent; because Frank is a third-party beneficiary under the Plan; and because Frank's loss-of-consortium claim is derivative of Ruth's claims.

The Tyler Court of Appeals held that Albertson's failed to establish any theory applicable to bind Frank, as a nonsignatory, to Albertson's arbitration agreement with Ruth. Under Texas law, arbitration agreements may bind nonsignatories under any of six theories: (1) incorporation by reference, (2) assumption, (3) agency, (4) alter ego, (5) equitable estoppel, and (6) third-party beneficiary. Albertson's first argued that Frank was bound by the arbitration agreement because Ruth signed as his agent. The Tyler court disagreed, explaining that the marital relationship does not, in itself, make one spouse the agent of the other spouse. Further, there is no presumption that one spouse is the agent of the other. Because Albertson's failed to offer proof of an agency relationship, the Tyler court concluded that Frank could not be bound by the arbitration agreement on the basis of agency.

Albertson's next argued that the arbitration agreement was binding on Frank because he is a third-party beneficiary under the Plan. According to Albertson's, Frank is the beneficiary of death benefits and, as the employee's eligible spouse, would be paid death benefits resulting from a covered injury to Ruth. Again, the Tyler court disagreed. Although the Texas Supreme Court has held that nonsignatory wrongful-death beneficiaries must arbitrate wrongful-death claims against an employer where the decedent signed an arbitration agreement[35], the Tyler court held that this this rationale was inapplicable because Frank did not bring a wrongful-death cause of action against Albertson's.

Finally, Albertson's argued that the arbitration agreement is binding on Frank due to the derivative nature of his claim, which stemmed entirely from Ruth's injuries. The Tyler court again disagreed, explaining that Frank's loss-of-consortium claim is derivative in the sense that he will be required to prove Albertson's was liable for Ruth's injuries in order to recover damages. But loss-of-consortium claims are not entirely derivative; instead, they are separate and independent claims distinct from the underlying action. Therefore, Frank does not entirely stand in Ruth's legal shoes, and is not bound by her arbitration agreement with Albertson's. Accordingly, the trial court did not err in determining that Frank was not required to arbitrate his loss-of-consortium claim against Albertson's.

[35] 514 S.W.3d at 884 (citing *In re Labatt Food Serv., L.P.*, 279 S.W.3d 640, 644 (Tex. 2009)).

2. Signatory plaintiffs required to arbitrate their claims against nonsignatory defendants.

In *Dargahi v. Handa*, No. 03-17-00386-CV, 2017 WL 5247517 (Tex. App.—Austin Nov. 8, 2017, no pet.) (mem. op.), the Austin Court of Appeals considered whether signatory plaintiffs were required to arbitrate their claims against nonsignatory defendants.

The Handas contracted with Yekk Construction Services, LLC d/b/a Lakeway Custom Homes and Renovation to construct a home. The parties' construction contract contained the following arbitration agreement:

> If a dispute arises between Lakeway Custom Homes and Renovation and [the Handas], which cannot be resolved in good faith through informal discussions, the parties agree to submit the dispute to mediation before resorting to any litigation other than a suit to seek injunctive relief. If mediation is required, the parties shall jointly agree upon a mediator acceptable to both parties. If a dispute cannot be resolved through mediation, both parties agree to submit the dispute to binding arbitration supervised by the American Arbitration Association (AAA)....

A dispute later arose, leading the Handas to sue Yekk and two brothers, Pejman and Kamran Dargahi, for breach of contract, breach of fiduciary duty, fraud, unjust enrichment, money had and received, theft, negligence, and DTPA violations. The Handas alleged, among other things, that Pejman, who signed the construction contract on behalf of Yekk, represented that he and Kamran were "partners" in Yekk. All three defendants filed a motion to compel arbitration, which the trial court denied. On appeal, the Handas argued that Pejman and Kamran were not parties to the arbitration agreement and, therefore, had no right to compel arbitration.

The Austin Court of Appeals held that, to the extent the Handas' disputes with Yekk are subject to arbitration, so are their disputes with Pejman and Kamran. As exemplified by *In re Vesta Insurance Group, Inc.*, 192 S.W.3d 759, 762 (Tex. 2006) (per curiam) and *SEB, Inc. v. Campbell*, No. 03-10-00375-CV, 2011 WL 749292, at *4 (Tex. App.—Austin Mar. 2, 2011, no pet.) (mem. op.), Texas courts recognize that when a principal is bound by the terms of a valid arbitration agreement, its agents, employees, and representatives are also covered by the agreement, even if those agents did not sign the agreement. Thus, under Texas law, the scope of an arbitration agreement may be extended to claims against agents of the principal bound by the agreement when all the agents' allegedly wrongful acts relate to their behavior as agents of the principal, and those acts were within the scope of the claims covered by the arbitration provisions for which the principal would be liable. The Austin court reasoned that, because Pejman signed the construction contract on Yekk's behalf, the construction contract itself established that Pejman was acting as a representative of Yekk. Thus, under the rule outlined in *In re Vesta* and *SEB*, the Handas' disputes against Pejman must be arbitrated, to the extent that their disputes against Yekk must be.

The Austin court reached the same conclusion in regard to Kamran. Based upon the Handas' own pleadings (which alleged, among other things, that Kamran negligently constructed the home and misapplied trust funds), there could be no reasonable contention that the Handas engaged in interactions with Kamran and allegedly suffered thereby *except* in his capacity as a representative of Yekk. Further, principles of equitable estoppel barred the Handas from denying that they were required to arbitrate their claims against Kamran (as well as Pejman). The Austin court reasoned that the Handas' claims against Kamran sought to derive a direct benefit from the construction contract. Thus, by filing their lawsuit, which in substance is based upon the

construction contract, the Handas subjected themselves to the construction contract's terms, including the arbitration agreement. Accordingly, the Austin court held that the Handas' disputes against Kamran must be arbitrated, to the extent that their disputes against Yekk must be.

D. Waiver of Right to Arbitration

1. A party does not waive its right to arbitration by waiting nine months to move to compel arbitration; seeking arbitration only after the plaintiff moves for summary judgment on liability issues; entering into a Rule 11 agreement concerning the plaintiff's motion to compel discovery; and issuing a third-party subpoena seeking the production of documents.

In *Dargahi v. Handa*, No. 03-17-00386-CV, 2017 WL 5247517 (Tex. App.—Austin Nov. 8, 2017, no pet.) (mem. op.), the Austin Court of Appeals also considered whether the defendants waived their right to arbitration by waiting nine months to file their motion to compel arbitration; seeking arbitration only after the plaintiffs moved for summary judgment on liability issues; entering into a Rule 11 agreement concerning the plaintiffs' motion to compel discovery; and issuing a subpoena to a third party seeking the production of loan records and other documents.

The Handas contracted with Yekk Construction Services, LLC d/b/a Lakeway Custom Homes and Renovation to construct a home. The parties' construction contract contained an arbitration agreement. A dispute later arose, leading the Handas to sue Yekk and two brothers, Pejman and Kamran Dargahi, for breach of contract, breach of fiduciary duty, fraud, unjust enrichment, money had and received, theft, negligence, and DTPA violations. All three defendants filed a motion to compel arbitration, which the trial court denied. On appeal, the Handas argued that the defendants substantially invoked the judicial process, and thereby waived their right to arbitration, because:

- there was an unexplained nine-month delay between the filing of the lawsuit and the filing of defendants' motion to compel arbitration;
- the Handas filed a motion to compel discovery, and the parties subsequently entered into a Rule 11 agreement concerning that motion;
- the defendants filed their motion to compel arbitration six days after the Handas filed a motion for partial summary judgment on liability; and
- six days before they filed their motion to compel arbitration, the defendants issued a subpoena to the Handas' lender seeking the production of loan records and other documents related to the project.

The Austin Court of Appeals held that the totality of circumstances did not evince an intention on the part of the defendants to waive their right to enforce the arbitration agreement. Waiver is decided on a case-by-case basis by assessing the totality of the circumstances. Key factors include: (a) whether the movant was plaintiff or defendant, (b) how long the movant delayed before seeking arbitration, (c) whether the movant knew of the arbitration clause all along, (d) how much pretrial activity related to the merits rather than arbitrability or jurisdiction, (e) how much time and expense has been incurred in litigation, (f) whether the movant sought or opposed arbitration earlier in the case, (g) whether the movant filed affirmative claims or dispositive motions, (h) what discovery would be unavailable in arbitration, (i) whether activity in court would be duplicated in arbitration, (j) when the case was to be tried, and (k) how much discovery has been conducted and who initiated it. The Austin court reasoned that the factors

weighing in favor of waiver—the unexplained nine-month delay, the defendants' issuance of the subpoena to the Handas' lender, the Handas' filing of a motion for partial summary judgment and the timing of the defendants' motion to compel arbitration shortly thereafter, and the Handas' conducting minimal discovery—did not constitute substantial invocation of the judicial process *by the defendants*. Other than the subpoena to the Handas' lender, the rest of the "fairly minimal" discovery was conducted by *the Handas*, who benefitted from their own invocation of the judicial process.

The Austin court additionally held that the Handas failed to prove that they suffered prejudice merely by attaching evidence of their legal expenses; the record showed that the pre-trial costs incurred by the Handas were "largely self-inflicted," as the defendants did not seek discovery from them or file dispositive motions or other pleadings requiring responses. Further, the Handas did not present other evidence of prejudice. Accordingly, the Austin court held that the defendants did not waive their right to arbitrate their disputes with the Handas.

2. A party does not waive its right to arbitration by filing compulsory counterclaims; including in its counterclaims requests for disclosure; settling lien claims asserted by co-defendants; agreeing to a scheduling order setting a trial date; and waiting 22 months to file its motion to compel arbitration.

In *Legoland Discovery Centre (Dallas), LLC v. Superior Builders, LLC*, 531 S.W.3d 218 (Tex. App.—Fort Worth 2017, no pet.), the Fort Worth Court of Appeals considered whether a defendant waived its right to arbitration by filing compulsory counterclaims; including in its counterclaims requests for disclosure; settling lien claims asserted by its co-defendants; agreeing to a scheduling order setting a trial date; and waiting 22 months to file its motion to compel arbitration.

Legoland Discovery Centre (Dallas), LLC hired Superior Builders, LLC to be the general contractor for construction of a water-feature addition to Legoland's entertainment center. The general contract contained an arbitration agreement. Legoland later began receiving nonpayment notices from several of Superior's subcontractors and suppliers, who then filed lien affidavits seeking payment. Legoland stopped paying Superior, notified Superior of its default, and then terminated the general contract after Superior failed to cure the default. Superior filed suit against Legoland, asserting claims for breach of contract, violation of the Prompt Pay Act, quantum meruit, and promissory estoppel, and also sought foreclosure of its mechanic's lien. Legoland answered and filed counterclaims for breach of contract, negligence, and breach of express warranty, and included in its counterclaims a request for disclosure. Superior amended its petition to add as defendants most of the subcontractors identified in Legoland's counterclaims. Two of those subcontractors, in turn, filed counterclaims against Superior and cross-claims against Legoland. The parties entered into an agreed scheduling order setting a trial date. Legoland subsequently conducted discovery with several of the defendant subcontractors and ultimately settled the subcontractors' cross-claims. Once the subcontractors' cross-claims were resolved, Legoland filed a motion to compel arbitration; at that point, 22 months had elapsed since Superior filed suit against Legoland. Thus, Superior opposed arbitration on the ground that Legoland had waived its right to arbitration. The trial court denied Legoland's motion to compel arbitration, concluding that Legoland had waived its right to arbitration by substantially invoking the judicial process to Superior's detriment.

The Fort Worth Court of Appeals held that the totality of the circumstances did not support waiver of the right to arbitration by Legoland. The Fort Worth court reasoned that

Legoland was the defendant, not the plaintiff; Legoland sought only routine disclosures under Rule 194 from Superior, which Superior also requested from Legoland and which would be available and useful during arbitration; only "basic," minimal discovery had occurred even though the discovery deadline had passed; and Legoland did not ask for pretrial, summary disposition of Superior's claims. Further, although Legoland asserted counterclaims seeking affirmative relief against Superior, those counterclaims were compulsory. In addition, even though Legoland did not seek to compel arbitration until 22 months after Superior filed suit, Superior added the subcontractors as defendants four months after filing suit, and Legoland first sought to settle the subcontractors' lien claims before moving to compel arbitration. The subcontractors were not subject to the arbitration agreement and could not be compelled to arbitrate their claims, and Legoland sought arbitration within days of settling with the last subcontractor. Finally, under these facts, Legoland's agreement to entry of a scheduling order setting a trial date did not equate to a waiver of the right to compel arbitration. Accordingly, Superior failed to establish that Legoland substantially invoked the judicial process, and there was no need to address the second factor regarding waiver—prejudice to Superior. Thus, the Fort Worth court held that Superior failed to carry its heavy burden to show that Legoland waived its right to arbitration.

3. A party does not waive his right to arbitration by seeking and obtaining injunctive relief, filing counterclaims, and waiting nearly three months before filing his motion to compel arbitration.

In *Fisher v. Carlile*, No. 01-16-00615-CV, 2017 WL 2774486 (Tex. App.—Houston [1st Dist.] June 27, 2017, no pet.) (mem. op.), the Houston (First) Court of Appeals considered whether a defendant waived his right to arbitration by seeking and obtaining a temporary injunction, filing counterclaims, and waiting nearly three months to file his motion to compel arbitration.

Jeff Fisher invested in real property in the Houston area through a number of LLCs. Fisher and Heather Carlile subsequently created Blavesco Limited to manage some of the properties controlled through the LLCs. Fisher and Carlile executed a Shareholder's Agreement containing an arbitration agreement. A dispute later arose, leading Carlile to file suit against Fisher in Harris County for breach of contract and a variety of tort claims. Carlile also sought a temporary restraining order and temporary injunction to prevent Fisher from unlawfully interfering with Blavesco's business operations, and obtained a temporary restraining order to that effect. Carlile then filed a motion for expedited discovery, which was granted, and deposed Fisher using documents he had produced. Fisher, in turn, answered and asserted counterclaims against Carlile for breach of contract and numerous tort claims. Fisher also sought a temporary restraining order and temporary injunction prohibiting Carlile from taking any actions with regard to Blavesco outside the normal course of business or incurring any additional debt on behalf of Blavesco. The trial court granted Fisher's application for a temporary restraining order and later held a two-day temporary injunction hearing. Fisher then filed an emergency motion for temporary injunction and sanctions against Carlile after learning she had removed $50,000 from Blavesco's account prior to the hearing. The trial court then signed a temporary injunction order against all parties, and appointed a custodian for Blavesco. Meanwhile, most of the LLCs filed suit against Carlile in Montgomery County; Fisher was not a party to the lawsuit, although he is the controlling managing member of the LLCs.

Fisher filed a motion to compel arbitration in the Harris County suit; at that point, nearly three months had elapsed since Carlile filed her original petition. Carlile opposed arbitration on the ground that Fisher had waived his right to arbitration. The trial court denied Fisher's motion

to compel arbitration, and he appealed. On appeal, Carlile contended that Fisher substantially invoked the judicial process because he: (1) waited three months to file his motion to compel arbitration; (2) only moved to compel arbitration after he received an adverse ruling in the temporary injunction proceedings; (3) sought and obtained a temporary injunction against Carlile; (4) filed counterclaims seeking affirmative relief; (5) engaged in "extensive pretrial activity," such as applying for and obtaining a temporary injunction against Carlile, and participating in the temporary injunction hearing; and (6) filed a related lawsuit against Carlile in Montgomery County.

The Houston (First) Court of Appeals held that, considering the totality of the circumstances, Fisher did not substantially invoke the judicial process and, thus, did not waive his right to arbitration. The Houston court reasoned that Fisher's nearly three-month delay in moving to compel arbitration did not weigh heavily against arbitration. As evidenced by *RSL Funding, LLC v. Pippins*, 499 S.W.3d 423, 433 (Tex. 2016) and *In re Fleetwood Homes of Texas, L.P.*, 257 S.W.3d 692, 693-94 (Tex. 2008), the Texas Supreme Court has found no waiver in cases involving delays of as much as eight months to two years. Further, Fisher's efforts to obtain the temporary injunction against Carlile were not inconsistent with Fisher's right to arbitrate because the relief sought was primarily *defensive* in nature and aimed at preservation of the status quo: he sought injunctive relief to prevent Carlile from destroying evidence, hiding or misappropriating Blavesco's assets, and making disparaging remarks about Fisher and the LLCs to various third parties. Unlike other cases holding that seeking and obtaining temporary injunctive relief prior to requesting arbitration favors a finding of waiver[36], Fisher did not seek injunctive relief based upon the merits of the case, or to secure an advantage with regard to any subsequent claims or in a subsequent legal proceeding.

The Houston court further reasoned that, although Fisher did not move to compel arbitration until after the temporary injunction was entered against him, that factor alone was not dispositive in the waiver analysis because no single factor is dispositive. Likewise, Fisher did not substantially invoke the judicial process by filing counterclaims. Fisher raised various affirmative defenses in his answer, and most of Fisher's counterclaims were largely defensive in nature and were based upon the same general allegations as his affirmative defenses (i.e., that Blavesco's losses were attributable to Carlile's fraudulent conduct, her mismanagement of Blavesco, and her usurpation of the company's assets and business opportunities). In addition, the only discovery that Fisher propounded was a form request for disclosure included in his answer. Carlile, on the other hand, sought and received a motion for expedited discovery, allowing her to depose Fisher prior to the temporary injunction hearing and question him based upon documents Fisher produced pursuant to the order. Thus, the discovery in this case was initiated by Carlile, not Fisher.

Finally, the Houston court rejected Carlile's argument that Fisher invoked the judicial process by causing some of the LLCs to file suit in Montgomery County. The Houston court reasoned that the LLCs, not Fisher, were the plaintiffs in the Montgomery County lawsuit. Although he is the controlling managing member of the LLCs, Fisher, individually, was not a party to the suit. Furthermore, none of the plaintiff LLCs in the Montgomery County lawsuit were parties to the arbitration agreement and, thus, were not bound to arbitrate their claims. Under these facts, the Houston court explained, "the activities of the parties that are not signatories to the arbitration agreement do not compromise the rights of those parties who are part of that agreement." Accordingly, Carlile failed to meet her burden to demonstrate that Fisher

[36] 2017 WL 2774486, at *4 (citing *Haddock v. Quinn*, 287 S.W.3d 158, 180 (Tex. App.—Fort Worth 2009, pet. denied); *Adams v. StaxxRing, Inc.*, 344 S.W.3d 641, 649-50 (Tex. App.—Dallas 2011, pet. denied)).

substantially invoked the judicial process prior to filing his motion to compel arbitration, and there was no need to consider whether Carlile met her burden of proof with regard to the prejudice element of the waiver analysis.

E. Jurisdiction to Review Interlocutory Orders

In *Galaxy Builders, Ltd. v. Globus Management Group, LLC*, No. 05-17-00831-CV, 2017 WL 4349096 (Tex. App.—Dallas Oct. 2, 2017, no pet.) (mem. op.), the Dallas Court of Appeals considered whether it had jurisdiction to review an order denying an application to enforce a subpoena issued by the arbitrator.

During the arbitration between Galaxy Builders, Ltd. and Globus Management Group, LLC, the arbitrator issued a subpoena against Globus. Galaxy, in turn, filed in the trial court an application to enforce the subpoena pursuant to CPRC §171.086(b)(2), which allows a party, during arbitration, to apply for a court order requiring an adverse party to comply with an order made by the arbitrator. The trial court denied Galaxy's application; however, the trial court's order recited that it was "final," even though it was not actually final for appellate purposes. Thus, Galaxy appealed "as a precaution" and then filed a motion to determine jurisdiction over the appeal.

The Dallas Court of Appeals held that it lacked jurisdiction over Galaxy's appeal. The appealability of orders entered under the TAA is governed by CPRC §171.098. Citing *East Texas Salt Water Disposal Co. v. Werline*, 307 S.W.3d 267, 277 (Tex. 2010) (Jefferson, J., dissenting), the Dallas court explained that CPRC §171.098, which lists the orders from which an appeal may be taken, is "intended to remove doubts as to what orders are appealable and to limit appeals prior to judgment to those instances where the element of finality is present." An order denying an application to enforce a subpoena does not have any "element of finality" and is not included among the appealable orders listed in CPRC §171.098. Accordingly, the Dallas court held that the complained-of order was not appealable, and dismissed Galaxy's appeal.

IV. BOND CLAIMS

In *Star Operations, Inc. v. Dig Tech, Inc.*, No. 03-15-00423-CV, 2017 WL 3263352 (Tex. App.—Austin July 27, 2017, pet. filed) (mem. op.), the Austin Court of Appeals also considered whether the Miller Act or the McGregor Act applied to a lower-tier subcontractor's payment-bond claim, and whether the subcontractor substantially complied with the McGregor Act's notice requirements and, therefore, properly perfected its claim.

Central Texas Highway Constructors, LLC was hired as the design-build contractor for the construction of SH 130 toll-road Segments 5 and 6 southeast of Austin. The project received some amount of federal funding. Central Texas hired Star Operations, Inc. as a subcontractor to build infrastructure for the illumination, signal, intelligent-transportation, and toll-collection systems for the project. Central Texas also separately hired Dig Tech, Inc. as a subcontractor to relocate and adjust electric-distribution facilities. Star later entered into an oral subcontract with Dig Tech to perform hole-boring work for the installation of electrical conduit on Star's portion of the project. When Star failed to pay Dig Tech for the work it performed, Dig Tech filed suit against Star and its surety, Great American Insurance Company, asserting claims for breach of contract and quantum meruit. Following a jury trial, the trial court entered judgment in favor of Dig Tech, awarding it damages and attorney's fees for Star's breach of the oral subcontract. The trial court also ordered in the judgment that Dig Tech substantially complied with the notice provisions of the McGregor Act to perfect its payment-bond claim and, therefore, Great

American was obligated under the terms of the payment bond to make the payments to Dig Tech that Star was obligated to make.

On appeal, Star and Great American contended that (1) the Miller Act, not the McGregor Act, should apply to the project because it was a federally funded "public work" project and, therefore, federal courts have exclusive subject-matter jurisdiction over Dig Tech's payment-bond claim; and (2) alternatively, if the McGregor Act applies, the evidence at trial showed that Dig Tech failed to comply with the McGregor Act's notice requirements and, thus, failed to perfect its payment-bond claim.

The Austin Court of Appeals held that the payment bond was not issued on a project governed by the Miller Act and, therefore, the McGregor Act applied to Dig Tech's payment-bond claim. The Austin court drew guidance from *Operating Engineers Health & Welfare Trust Fund v. JWJ Contracting Co.*, 135 F.3d 671, 675-76 (9th Cir. 1998), where the Ninth Circuit explained:

> Although there is no clear test for designating a project a "public work of the United States," courts often look to the following as indicia: whether the United States is a contracting party, an obligee to the bond, an initiator or ultimate operator of the project; whether the work is done on property belonging to the United States; or whether the bonds are issued under the Miller Act.

The Austin court reasoned that, here, the indicia identified by the Ninth Circuit in *JWJ Contracting* were all absent. The United States or an agency of the United States or a person acting as the agent of the United States did not contract for the work at issue. The payment bond was issued on the subcontract between Star, as subcontractor, and Central Texas, as prime contractor; and Star did not contend that either party was acting as an agent of the United States. In addition, the United States government was not an initiator or ultimate operator of the project, and the work was not done on property belonging to the United States. Further, the Miller Act specifically requires that the payment bond be furnished to the United States government, but the subcontract between Central Texas and Star required that the payment bond be furnished to *Central Texas*, and there was no evidence showing that the payment bond was furnished to the United States, rather than Central Texas, or that the United States was also an obligee on the bond. In addition, the form of the payment bond itself provided that suit may be brought in state court or federal court where the project is situated, providing another indication that the parties did not intend for the payment bond to be construed as a Miller Act bond, because federal courts have exclusive subject-matter jurisdiction over Miller Act claims. Accordingly, the Austin court concluded that the Miller Act did not deprive the trial court of subject-matter jurisdiction over Dig Tech's payment-bond claim.

The Austin court additionally held that Dig Tech's provision of actual notice to Central Texas, Star, and Great American constituted substantial compliance with the McGregor Act's notice requirements and, therefore, Dig Tech properly perfected its payment-bond claim. Star and Great American contended that Dig Tech failed to comply with the McGregor Act's notice requirements in two respects: (1) Dig Tech never provided a sworn statement of account to Great American, and (2) Dig Tech failed to provide notice to the "prime contractor" of its claim. The Austin court disagreed, reasoning that the McGregor Act was not intended to set up "technical tricks, traps, and stumbling blocks to the filing of legitimate notices of claims," but "to provide a simple and direct method of giving notice and perfecting claims." The Austin court further observed that the McGregor Act is remedial in nature and "should be liberally construed to achieve its purposes." Consequently, while courts typically find that parties must strictly comply

with notification deadlines, only substantial compliance is required for other notice provisions. Here, although Dig Tech did not provide a sworn statement of account to Great American, Dig Tech did provide true and accurate information about the amount of its claim to Great American, in the form of invoices and a description of the work it performed, which were attached to a letter sent by Dig Tech's counsel to Great American. According to the Austin court, the "evident purpose" of the McGregor Act's sworn-statement requirement "is to provide the surety with true and accurate information about the amount of the claim, so that the surety may prepare to defend against the claim"; and the Austin court found that Dig Tech's deviation from the sworn-statement requirement had not "seriously hindered the legislature's purpose" because Great American had actual notice of true and accurate information about the amount of Dig Tech's claim. Thus, the Austin court held that actual notice to the surety constitutes substantial compliance with the McGregor Act's notice requirements.

Similarly, the Austin court held that Dig Tech's provision of actual notice to both Star, the principal and obligor on the bond, and Great American, the surety, constituted substantial compliance with the McGregor Act's requirement that the claimant notify the "prime contractor" and surety. Here, SH 130 Concession Company, the developer for the highway-construction project, was the "prime contractor" as that term is defined in the McGregor Act. But Dig Tech never provided notice of its payment-bond claim to SH 130 Concession. Instead, Dig Tech provided notice to Central Texas, Star, and Great American, which the Austin court reasoned "comports with the overarching purpose of the McGregor Act" because Star, as principal, and Great American, as surety on the bond, both had actual notice of true and accurate information about the amount of the claim before suit was filed against them. Based upon the "specific facts" involved, the Austin court held that "this actual notice to the parties who were liable on the bond constitutes substantial compliance." The Austin court further reasoned that releasing Great American from its liability on the bond because SH 130 Concession—who was not a party to the bond and who had no potential liability related to the bond—did not receive notice (and did not complain of its lack of notice) of the bond claim "would be contrary to the purpose of the statutory scheme and create an absurd result." Accordingly, the trial court did not err by ruling that Dig Tech properly perfected its payment-bond claim.

Author's Note: In a footnote, the Austin court explained that, although no party had raised the issue, it was "questionable whether the McGregor Act should apply to the contractually required bond at issue in this case." According to the Austin court, the only payment bond required under the McGregor Act is one that a governmental entity requires a prime contractor to execute to the governmental entity before beginning the work. Here, in contrast, the payment bond was issued by a lower-tier subcontractor to a subcontractor pursuant to the terms of their subcontract. Regardless, the Austin court explained that the result would be the same even if it were to hold that the McGregor Act did not apply because the payment bond itself did not contain any notice requirements.

V. LIEN CLAIMS

A. Fraudulent-lien claims

In *Lyon v. Building Galveston, Inc.*, No. 01-15-00664-CV, 2017 WL 4545831 (Tex. App.—Houston [1st Dist.] Oct. 12, 2017, no pet. h.) (mem. op. on reh'g), the Houston (First) Court of Appeals also considered whether legally sufficient evidence supported the jury's finding that a subcontractor violated the fraudulent-lien statute, CPRC §12.002(a), because its lien exceeded the maximum amount allowed for a subcontractor's lien under Section 53.024 of the Texas Property Code.

Building Galveston, Inc. (BGI) entered into a subcontract agreement with Lyon Construction Services whereby Lyon agreed to serve as BGI's subcontractor on a remodeling project. BGI subsequently terminated Lyon, claiming Lyon's work was defective and that Lyon had failed to correct the defects. Lyon sent a letter to BGI demanding payment of an additional $35,697 for work it performed under the subcontract. Lyon also sent the property owners notice of unpaid labor and materials in accordance with Section 53.056 of the Texas Property Code, and later executed a lien affidavit claiming a lien on the property for $35,697.

Lyon subsequently filed suit against the property owners to foreclose on its lien. BGI intervened in the suit, asserting its own claims against Lyon for breach of contract, negligent misrepresentation, and fraud, among other claims, as well as a claim under CPRC §12.002 for filing a fraudulent lien, as defined by Section 53.024 of the Texas Property Code. The owners ultimately settled with Lyon, and the parties' remaining claims were tried to a jury. The jury found that Lyon had made, presented, or used a fraudulent lien or claim against real property, and found that $31,930.75 would fairly and reasonably compensate BGI for its resulting damages. The liability question for BGI's fraudulent-lien claim was as follows:

> Did [Lyon] make, present or use a document or other record with knowledge that the document or other record was a fraudulent lien or claim against real property or an interest in real property with the intent to defraud and with the intent that the document be given the legal effect of evidencing a valid lien or claim against real property or an interest in real property with the intent to cause [BGI] to suffer financial injury?

The jury was instructed that:

> A lien or claim is fraudulent if the person who files it has actual knowledge that the lien or claim was not valid at the time it was filed.
>
> A lien is invalid if the amount of a lien claimed by a subcontractor exceeds:
>
> (1) An amount equal to the proportion of the total subcontract price that the sum of the labor performed, materials furnished, materials specially fabricated, reasonable overhead costs incurred, and proportionate profit margin bears to the total subcontract price; minus
>
> (2) the sum of previous payments received by the claimant on the subcontract.

The trial court ultimately entered judgment in favor of BGI, and Lyon appealed.

On appeal, Lyon argued there was legally insufficient evidence to support the jury's finding that Lyon made, presented, or used a fraudulent lien or claim. According to Lyon, the jury had to implicitly make several other affirmative findings, including that the amount of Lyon's claimed lien exceeded the maximum amount allowed for a subcontractor's lien under Section 53.024 of the Texas Property Code. Thus, Lyon contended there was legally insufficient evidence to support the jury's implicit finding that his $35,697 lien was invalid because there was no evidence applying the statutory formula to the facts of this case, and thereby identifying the amount of Section 53.024's statutory cap.

The Houston (First) Court of Appeals held that the evidence was legally insufficient to support the jury's finding that Lyon's lien was invalid, pursuant to Section 53.024 of the Texas Property Code, and that Lyon had filed a fraudulent lien. The Houston court reasoned that Section 53.024 of the Property Code expressly limits the amount of a subcontractor's lien, based upon the statutory formula quoted verbatim in the jury charge. Although it was undisputed that Lyon did not calculate its lien based upon the statutory formula set forth in Section 53.024, the Houston court held that "[t]he plain language of the statute does not require subcontractors to calculate their lien using a specific method." Thus, the fact that Lyon used a different method to calculate its lien did not mean that Lyon's lien was per se invalid.

After reviewing the record, the Houston court was unable to find any evidence establishing two components of Section 53.024's formula—Lyon's proportionate profit margin and the reasonable overhead costs Lyon incurred on the project. Therefore, the jury did not have the evidence necessary to determine whether the proportionate value of Lyon's labor performed, materials furnished, reasonable overhead costs incurred, and proportionate profit margin to the total subcontract price, less previous payments received under the subcontract, totaled less than Lyon's claimed lien of $35,697. Accordingly, the Houston court held that there was no evidence to support the jury's finding that Lyon made, presented, or used a fraudulent lien or claim, as the jury had been instructed. Thus, the Houston court rendered judgment in Lyon's favor with respect to BGI's fraudulent-lien claim.

B. A motion to remove an invalid lien under Section 53.160 of the Texas Property Code operates, in effect, as a motion for partial summary judgment; and an order granting such a motion may constitute a final and appealable judgment.

In *In re M&O Homebuilders, Inc.*, 516 S.W.3d 101 (Tex. App.—Houston [1st Dist.] 2017, orig. proceeding [mand. filed]), the Houston (First) Court of Appeals considered whether a trial court's order granting a motion to remove an invalid lien under Section 53.160 of the Texas Property Code was a final and appealable judgment.

Paul Elizondo contracted with M&O Homebuilders, Inc. to construct a home. A payment dispute arose, leading Elizondo to file suit against M&O for negligence, breach of contract, breach of warranty, and fraud, among other claims. Elizondo also filed a lis pendens and, later, a lien on property owned by M&O, claiming that a structure on the property was likely built using misapplied construction funds from the construction of Elizondo's home. M&O filed a summary motion to remove an invalid lien under Section 53.160 of the Texas Property Code. The trial court signed an order granting M&O's motion, but the order also contained a Mother Hubbard clause and finality language reciting,

> "This judgment is final, disposes of all claims and all parties, and is appealable. All relief not granted herein is denied."

More than 30 days later, Elizondo asked the trial court to correct the order by removing the finality language that had admittedly been included by mistake. The trial agreed it had no intention of entering a final judgment in the case and signed an amended order deleting the Mother Hubbard clause and the finality language. M&O then sought mandamus relief in the court of appeals, asserting that the amended order was signed outside the trial court's plenary power and was therefore void.

A divided panel of the Houston (First) Court of Appeals held that the original order granting M&O's motion to remove an invalid lien was a final and appealable judgment. Justice Brown authored the majority opinion, joined by Justice Jennings. The majority explained that, in *Lehmann v. Har-Con Corp.*, 39 S.W.3d 191, 192-93 (Tex. 2001), the Texas Supreme Court held that a judgment is final for the purposes of appeal if it "actually disposes of all claims and parties then before the court, regardless of its language, or it states with unmistakable clarity that it is a final judgment as to all claims and all parties." The Supreme Court in *Lehmann* additionally gave an example of clear and unequivocal language that would leave no doubt that the trial court entered a final judgment: "This judgment finally disposes of all parties and all claims and is appealable." The majority reasoned that this language was indistinguishable from the language in the trial court's original order. Accordingly, because the trial court's original order contained this clear finality language, the majority held it was a final and appealable judgment.

The majority next considered, and rejected, Elizondo's argument that the *Lehmann* finality rule was inapplicable because M&O's motion sought only to remove a lien and did not seek a judgment adjudicating a claim. Citing *Daughters of Charity Health Services v. Linnstaedter*, 226 S.W.3d 409, 411 (Tex. 2007), the majority reasoned that "a lien *is* a claim allowed by statute for parties to secure payment." Thus, the majority held that a summary motion that seeks a declaration that a lien is invalid—as M&O's motion did—seeks a summary adjudication of that claim and operates, in effect, as a motion for partial summary judgment. The majority further observed that, in *Blevins v. Andrews*, No. 01-08-00598-CV, 2010 WL 1611382 (Tex. App.—Houston [1st Dist.] Apr. 22, 2010, no pet.) (mem. op.), the Houston (First) Court of Appeals had addressed an appeal from a summary-judgment order resolving a lien and did not hold that the judgment was not final because a lien is not a claim to be adjudicated. Similarly, in *Ready Cable, Inc. v. RJP S. Comfort Homes, Inc.*, 295 S.W.3d 763 (Tex. App.—Austin 2009, no pet.), the Austin Court of Appeals addressed a summary judgment resolving a lien without holding that a lien is not a claim. Therefore, the majority held that the trial court's original order granting M&O's motion to remove an invalid lien was final, even if it granted more relief than was sought or intended. Accordingly, the trial court's amended order was signed outside the trial court's plenary power and was therefore void.

Justice Keyes authored a dissenting opinion, explaining that a summary motion to remove an invalid lien pursuant to Section 53.160 of the Texas Property Code is fundamentally different from a motion for summary judgment, a motion for default judgment, or any of the cases cited by M&O in which Mother Hubbard clauses have been used to create a final judgment, all of which involved parties seeking final disposition of an aspect of their case. Justice Keyes would have held that the finality language mistakenly included in the trial court's original order granting M&O's motion to remove an invalid lien did not convert that particular interlocutory order into a final judgment, and that the trial court properly amended the order to remove the Mother Hubbard clause and finality language.

VI. CONSTRUCTION LABOR

A. Liability of Property Owner

In *Torres v. Mansell*, 518 S.W.3d 481 (Tex. App.—Amarillo 2017, pet. filed), the Amarillo Court of Appeals considered whether CPRC Chapter 95 applied to a subcontractor's claims, and whether the owner exercised sufficient control over the manner in which the subcontractor performed his work, making the owner liable under Chapter 95 for the subcontractor's injuries.

Mueller Supply Co. contracted with A&S Construction to build a sales office. A&S, in turn, hired Chino as a subcontractor to lay a cement parking lot surrounding the sales office. Hilario Torres worked for Chino and was attempting to level freshly poured concrete one night when the metal handle of the bull float he was using touched an electrical line, causing him to be electrocuted. The electrical line was over or adjacent to that portion of the parking lot being completed. Apparently, the float's handle was approximately 16' in length, and it contacted the live wire as Torres pulled the float across the cement's surface. Torres suffered extensive injury and filed suit against Mueller, asserting claims for premises liability, active negligence, negligence per se, and gross negligence.

Mueller filed a motion for summary judgment, invoking CPRC Chapter 95 and arguing that Chapter 95 applied to Torres' claims. Mueller additionally argued that it retained no control over the work performed by Torres or his employer, Chino. The trial court granted Mueller's motion for summary judgment, and Torres appealed. On appeal, Torres argued that CPRC Chapter 95 did not apply to his claims because the improvement being completed—the parking lot—did not cause his injury; and, even if Chapter 95 did apply, Mueller exercised sufficient control over the manner in which Torres performed his work.

The Amarillo Court of Appeals held that CPRC Chapter 95 applied to Torres' claims. Drawing guidance from the Texas Supreme Court's decision in *Ineos USA, L.L.C. v. Elmgren*, 505 S.W.3d 555 (Tex. 2016), reported in last year's case law update, the Amarillo court explained:

> We read *Ineos* as directing us to determine what the "improvement" is by looking at it as a whole, not in potentially divisible parcels. What constitutes the improvement is not limited to the specific mechanism (e.g., gas valve) causing the injury. Rather, the interrelationship of the mechanism with its physical (e.g., within a "single processing system") and geographic (e.g., "within a single plant on Ineos' property") environments are factors that define the improvement's breadth.

The Amarillo court reasoned that, here, it was clear that Mueller was constructing an edifice from which to operate its business and part of that edifice consisted of a cement parking lot. Equally undisputed was that Torres' employer was hired to help complete or install the parking lot and Torres was injured when the tool used to perform that task touched an electrical line. Furthermore, the electrical line hung over or near to that part of the lot he was surfacing with the float. Moreover, in pleading his premises-liability claim, Torres necessarily conceded that the overhead power line was a condition of the work area. That work area also happened to be the improvement (i.e., parking lot) on which he worked. The line's presence had to be factored into the manner in which he performed his work at that spot; indeed, he experienced the result of not factoring it into the equation. "Under those circumstances," the Amarillo court explained, "we cannot but conceive the power line as an aspect of the improvement's state of being or as a condition of the improvement. That being said, we view his injuries as arising from a condition of the improvement on which he worked. Chapter 95 applies here."

The Amarillo court additionally held that Mueller did not exercise or retain sufficient control over the manner in which the work was performed, such that Mueller could not be liable under Chapter 95 for Torres's injury. The Amarillo court reasoned that Mueller retained no contractual right to control the details of performance by any subcontractors, or even the general contractor, A&S. Nor was there any evidence that Mueller actually did control the details or methods of the subcontractors' work to such an extent that the subcontractors could not perform

the work as they chose. Without the requisite evidence of control, the first hurdle found in CPRC §95.003(1) was not cleared, and it was unnecessary to assess whether Mueller had actual knowledge of the danger or condition and failed to adequately warn of it, as required by CPRC §95.003(2). Accordingly, the Amarillo court affirmed the trial court's summary judgment.

B. Liability of General Contractor

In *United Scaffolding, Inc. v. Levine*, — S.W.3d — , 2017 WL 2839842 (Tex. 2017), the Texas Supreme Court considered whether an injured worker's claim against his employer's scaffolding contractor sounded in premises liability or in negligent activity.

Valero Energy Corporation contracted with United Scaffolding, Inc. (USI) to build scaffolds at Valero's Port Arthur refinery. James Levine, a Valero employee, was injured when he slipped on a piece of plywood that had not been nailed down, causing him to fall up to his arms through a hole in the scaffold. Levine alleged he suffered a neck injury as a result of the fall and filed suit against USI, claiming that USI improperly constructed the scaffold and failed to remedy or warn of the dangerous condition on the scaffold, causing Levine's injury. The case ultimately was tried to a jury twice. In both trials, the trial court submitted a general-negligence question to the jury, and USI neither offered a premises-liability question nor objected to the general-negligence question. The jury in the second trial found USI negligent, allocated 100% of the responsibility to USI, and awarded Levine nearly $2 million in damages. In its motion for JNOV, USI argued for the first time that the trial court improperly submitted a general-negligence question to the jury, when Levine's claim sounded in premises liability. The trial court denied USI's motion and entered judgment in Levine's favor. The court of appeals affirmed, holding that the relevant inquiry for determining the proper characterization of Levine's claim hinged on whether USI controlled the premises, which the appellate court held it did not.

A divided Texas Supreme Court held that Levine's claim sounded in premises liability, not negligent activity, and therefore the general-negligence findings could not support Levine's recovery. Justice Green authored the majority opinion, joined by Chief Justice Hecht and Justices Johnson, Willett, Guzman, and Brown. The majority reasoned that a general contractor in control of the premises may be liable for two types of negligence in failing to keep the premises safe: that arising from an activity on the premises, and that arising from a premises defect. As the Supreme Court explained in *Occidental Chemical Corp. v. Jenkins*, 478 S.W.3d 640, 644 (Tex. 2016), reported in the 2016 case law update, when the plaintiff's injury is the result of a contemporaneous, negligent activity on the property, ordinary negligence principles apply. In contrast, when the injury is the result of the property's condition rather than an activity, premises-liability principles apply. Generally, a plaintiff need only submit a general-negligence question in support of its claim under a negligent-activity theory. For a premises liability defendant to be liable for a plaintiff's injury, however, a plaintiff must prove that: (1) the defendant had actual or constructive knowledge of some condition on the premises; (2) the condition posed an unreasonable risk of harm to the plaintiff; (3) the defendant did not exercise reasonable care to reduce or to eliminate the risk; and (4) the defendant's failure to use such care proximately caused the plaintiff's personal injuries. Consequently, when submitting a premises liability cause of action to a jury, a simple negligence question, unaccompanied by the foregoing elements as instructions or definitions, cannot support a recovery in a premises-defect case.

Examining the source of Levine's injury, his pleadings and allegations, and the evidence presented at trial, the majority concluded that Levine's claim was properly characterized as one for premises liability. Levine's allegations and the evidence at trial established that the nature of Levine's claim relied upon USI's having retained the right to control the relevant part of the

premises—the scaffold on which Levine alleged he was injured—such that USI had a responsibility to warn of or remedy a dangerous condition. According to the majority, the relevant inquiry for determining what, if any, duties USI owed to Levine was USI's control over the scaffold itself. The question was *not* whether Valero also had control, or even whether Valero had more control; rather, the duty question must focus on USI's right to control the scaffold and subsequent responsibility to warn about or remedy a dangerous condition on the scaffold. According to the majority, the evidence at trial established that USI maintained the right to control the scaffolds until they were dismantled.

The majority additionally held that Levine waived his premises-liability claim by failing to request a premises-liability question or instruction and by failing to secure findings on the premises-liability elements. Because the case was submitted to the jury under only a general-negligence theory of recovery, without the elements of premises liability as instructions or definitions, the verdict could not support Levine's recovery. Moreover, USI was under no duty to object to the jury charge because a defendant has no obligation to object when, as in this case, the wrong theory of recovery is submitted to the jury, and the correct theory is omitted entirely. Further, USI preserved error on the submission argument by raising it in USI's motion for JNOV. Accordingly, the majority reversed the court of appeals' judgment and rendered a take-nothing judgment in USI's favor.

Justice Boyd authored a dissenting opinion, joined by Justices Lehrmann and Devine. According to the dissent, the majority misstated the standard of review, the pleadings, and the evidence in its analysis. The dissenting justices reasoned that at least some evidence established that USI did *not* have control of the scaffold at the time of Levine's accident and, therefore, they were unable to say that submission of the ordinary-negligence question was erroneous.

Author's Note: On January 26, 2018, the Texas Supreme Court issued a corrected opinion. A Westlaw citation to the corrected opinion was unavailable at the time this paper was submitted to the publisher.

C. Workers' Compensation

In *In re Accident Fund General Insurance Co.*, — S.W.3d — , 2017 WL 6391427 (Tex. 2017) (per curiam), the Texas Supreme Court considered whether the Division of Workers' Compensation has exclusive jurisdiction over statutory and tort claims alleging that the "bona fide offer of employment" process set forth in Section 129.6 of the Texas Administrative Code was misused to fabricate grounds for firing a covered employee.

Ricky Sayaz suffered a serious injury in the course and scope of his employment with Coil Tubing Solutions, LLC, a workers' compensation subscriber. Coil Tubing notified its carrier, Accident Fund General Insurance Co., of Sayaz's injury, and Accident Fund accepted coverage and paid income and medical benefits to Sayaz. While Sayaz was recuperating, Coil Tubing sent him two offers for modified-duty work labeled "Bona Fide Offer of Employment"; the second letter provided a beginning date of either three days after the letter's issuance or immediately after acceptance, and an expiration date 11 days after the letter's issuance. Sayaz neither explicitly accepted nor rejected either offer; instead, his wife e-mailed Coil Tubing with concerns about his ability to work. When Sayaz did not accept the offers or return to his former job, and Coil Tubing terminated his employment.

Sayaz did not seek resolution through the workers' compensation administrative process. Instead, he filed suit against Coil Tubing and Accident Fund, characterizing the job offers as

"bogus" because they were extended during times that Sayaz was not permitted to work and that the short response deadline given was "arbitrary." He claimed Coil Tubing terminated him for failing to accept the job offers as pretext for workers' compensation retaliation and that Accident Fund and the insurance adjuster "aided and abetted" Coil Tubing in orchestrating a pretext for terminating him by directing Coil Tubing on how to create a pretext for the wrongful termination, and encouraging Coil Tubing to proceed on arranging a pretext for terminating him based upon those job offers. Accident Fund filed a plea to the jurisdiction, asserting that the Division of Workers' Compensation had exclusive jurisdiction over Sayaz's claims for retaliation, conspiracy, and tortious interference against Accident Fund. The trial court denied Accident Fund's plea to the jurisdiction, and the court of appeals summarily denied Accident Fund's petition for mandamus relief.

The Texas Supreme Court held that the Division of Workers' Compensation had exclusive jurisdiction over Sayaz's retaliation, conspiracy, and tortious-interference claims against Accident Fund. The Supreme Court reasoned that not all statutory and common-law claims against a carrier run counter to the Workers' Compensation Act, but at the same time, neither a claim's label nor the relief requested is determinative of the jurisdictional inquiry. Rather, the substance of the claim controls whether the Texas Workers' Compensation Act provides the exclusive process and remedies and, thus, vests exclusive jurisdiction with the Division. The Supreme Court concluded that Sayaz's claims against Accident Fund—which were all premised upon its participation in the bona-fide-job-offer process and Sayaz's dissatisfaction with those offers—arose out of Accident Fund's investigation, handling, or settling of a claim for workers' compensation benefits and, as a result, "the current Act with its definitions, detailed procedures, and dispute resolution process demonstrate[s] legislative intent for there to be no alternative remedies." Whether the offers were "bona fide" was the threshold factual determination for each of Sayaz's claims against Accident Fund, which meant the trial court was being tasked with making a determination about a matter committed to the Division's exclusive jurisdiction. Because the Division has exclusive jurisdiction over Sayaz's claims against Accident Fund and Sayaz did not exhaust administrative remedies through the workers' compensation system before filing suit, the Supreme Court held that allowing those claims to proceed in the trial court would disrupt the orderly process of government. Thus, the trial court lacked subject-matter jurisdiction over Sayaz's retaliation, conspiracy, and tortious-interference claims against Accident Fund, and mandamus relief was appropriate.

Case Law Update

Gregory M. Cokinos
Cokinos | Young
1221 Lamar Street, 16th Floor
Houston, Texas 77010
(713) 535-5500

Construction Law Foundation of Texas, 31st Annual Construction Law Conference

Bartush-Schnitzius Foods Co. v. Cimco Refrigeration, Inc.

- Bartush contracted with Cimco to install a new refrigeration system at Bartush's food-production facilities.
  - After installation, the refrigeration system failed.
  - The parties were unable to agree on a plan to repair the system.
  - Bartush withheld further payment to Cimco and hired a third-party to install an additional unit to the system.
- Cimco sued Bartush to recover balance owed on the K. Bartush counterclaimed for the cost to hire a third-party to install additional unit.
- Issue: whether an owner's and a contractor's competing claims for breach of K were viable despite the fact that both parties breached the K.
- Holding:
  - Cimco's breach—by providing a defective refrigeration system—was not material as a matter of law.
  - Bartush's subsequent breach (failure to pay) did not discharge Cimco's prior breach, as a material breach excuses only *future* performance, but not *past* performance.
  - Although Bartush remained liable for its subsequent failure to comply, Bartush's claim for damages resulting from Cimco's prior breach remained viable.

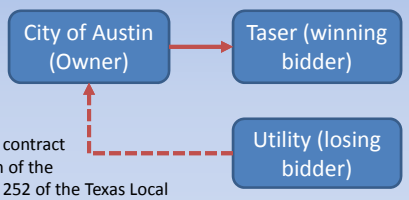
Levco Construction, Inc. v. Whole Foods Market Rocky Mountain/Southwest L.P.

- Whole Foods refused to release the retainage or make payment on the final change order to CCI.
  - Whole Foods claimed that CCI breached the K by allowing liens to be filed on the property.
  - CCI claimed that Whole Foods breached the K by withholding the final payment and retainage.
- Houston Court of Appeals held:
  - Whole Foods breached the K and was obligated to make final payment to CCI.
  - Even if CCI committed the **first** breach of the K, such a breach by CCI would not excuse Whole Foods from subsequent performance after continuing to accept CCI's performance.
  - Whole Foods treated the K as continuing after CCI's alleged breach by paying CCI's progress payment applications, requiring CCI to continue its work on the project, and acknowledging final completion of the project.
  - Whole Foods is deprived of any excuse for subsequently terminating its own performance of its obligation to make final payment to CCI.

City of New Braunfels v. Carowest Land, Ltd.

- City of New Braunfels undertook two projects that involved construction of a drainage channel through land owned by Carowest:
  - (1) South Tributary Regional Flood Control Project; and
  - (2) North Tributary Regional Flood Control Project.
- Via the competitive sealed bid procurement method, Yantis was awarded South Tributary Project.
- Dispute arose → Carowest filed suit against City and Yantis (the GC)
  - In the ensuing lawsuit, the City and Yantis entered into Rule 11 Agreement whereby the City would agree to award Yantis the North Tributary Project in exchange for Yanti's release of its delay claims against the City.
  - Carowest amended its pleadings to assert declarations that the construction contract for the North Tributary Project was void and in violation of the (1) Texas Open Meetings Act, (2) Chapter 551 of the Texas Government Code, and (3) § 252.043 of the Texas Local Government Code.
  - Issue: whether a City is immune from suit on claims for declaratory relief?
- Austin Court of Appeals held:
  - Although both provisions provide an express statutory waiver of immunity, **neither** §551.142(a) nor §252.061 waives immunity from suit for declaratory relief.

City of Austin v. Utility Associates, Inc.



- City of Austin awarded $12.2MM contract to Taser International for outfit of body-worn cameras for Austin PD.
  - Utility filed suit against the City claiming that the contract award to Taser was void due to the City's violation of the competitive-bidding requirements under Chapter 252 of the Texas Local Government Code.
  - V. Bruce Evans (tax payer) joined in the lawsuit.
- City argued that immunity barred Utility's and Evan's claims for both injunctive and declaratory relief.
- The Austin Court of Appeals held:
  - Utility lacked standing to pursue injunctive relief because Utility was neither a resident taxpayer, nor was the contract at issue "for the construction of public works."
  - Although Evans satisfied the residential taxpayer "standing" requirement, the injunctive relief authorized by §252.061 extends only to barring performance of an improperly procured contract, and makes no mention of a further remedy of re-awarding the contract to another bidder.

Levinson Alcoser Associates, L.P. v. El Pistolon II, Ltd.

- The Texas Supreme Court considered whether the "knowledge" requirement set forth in CPRC §150.002(a)(3) may be satisfied solely from the expert's licensure or active engagement in the practice.
- El Pistolon attached to its lawsuit, an affidavit that only included the following information:
  - "I am a professional architect who is registered to practice in the State of Texas, license number 11655. I have been a registered architect in Texas since 1980, and have an active architecture practice in the State of Texas today."
- The Texas Supreme Court held that the affidavit failed to demonstrate "knowledge":
  - "Knowledge" requirement is not synonymous with the expert's licensure or active engagement in the practice; rather, it requires some additional explication or evidence reflecting the expert's familiarity or experience with the practice area at issue in the litigation.
  - Nothing in the record reflected that the expert was knowledgeable in the specific practice area at issue in the litigation: "the design of shopping centers or other similar commercial construction."

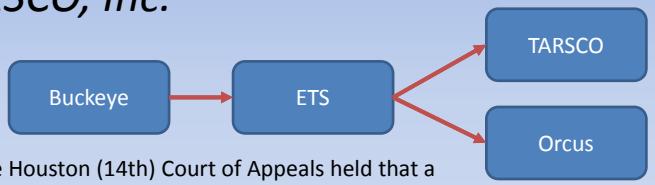
Melden & Hunt, Inc. v. East Rio Hondo Water Supply Corp.

- The Texas Supreme Court considered 2 issues:
  - (1) whether CPRC §150.002(a)(3)'s "knowledge" requirement requires the expert to establish his/her knowledge through testimony that would be competent or admissible as evidence; and
  - (2) whether CPRC §150.002(b)'s "factual-basis" requirement requires the certificate of merit to address the elements of each cause of action asserted by the plaintiff.
- The Affidavit at issue only provided the following:
  - (1) B.S. in civil engineering from Texas A&M; (2) registered P.E. in Texas and eight other states; (3) President and principal of LNV Engineering; (4) has 23 years' of experience in "master planning, detailed design and construction management"; (5) has experience designing and analyzing water-treatment plants like East Rio's; (6) is familiar with the standard of care an engineer of ordinary knowledge and skill should employ when designing such a project.
- Texas Supreme Court held that . . .
  - Chapter 150 did not impose the same level of scrutiny as that imposed on the admissibility of expert-opinion testimony for summary-judgment or trial purposes.
  - The expert's averments about his education and experience, including the "Design and analysis of water treatment plans . . ." were factual statements supporting the conclusion that the expert was "knowledgeable."
  - §150.002(b)'s "factual-basis" requirement does not require a COM to address the elements of each cause of action.

Pedernal Energy, LLC v. Bruington Engineering, Ltd.

- Pedernal filed suit against Bruington (who was hired as the project engineer in connection with the fracturing operations on a gas well) without a COM.
  - Bruington moved for dismissal of the claims against it with prejudice.
  - Before the trial court heard Bruington's motion to dismiss, Pedernal non-suited its claims without prejudice.
  - Pedernal later amended its petition (with a COM) to reassert the same claims against Bruington.
  - Bruington again moved for dismissal of the claims against it with prejudice.
  - Trial court denied the Bruington's motion to dismiss with prejudice.
- Trial court's decision to dismiss with prejudice (or without) should consider "various factors . . . given the facts and circumstances of the particular case."
  - The Texas Supreme Court considered whether the circumstances presented to the trial court at the time of the dismissal demonstrated that (1) Pedernal's claims were meritless, or otherwise, required dismissal with prejudice; or (2) the trial court's action in dismissing without prejudice violated any guiding rules or principles so that its actions were arbitrary and unreasonable and an abuse of discretion.
  - The Texas Supreme Court found no abuse of discretion in the trial court's dismissal of Pedernal's claims **without** prejudice.

Engineering & Terminal Services, L.P. v. TARSCO, Inc.



- The Houston (14th) Court of Appeals held that a COM requirement does not apply to a third-party petition filed by an original plaintiff seeking contribution from a third-party defendant.
- ETS sues Buckeye
  - ➡ Buckeye counterclaims against ETS (alleging ETS's engineering designs were defective)
    - ➡ ETS (as 3rd-party plaintiff) files 3rd-party petition against TARSCO & Orcus.
- ETS's 3rd-party petition did not attach a COM.
- Houston (14th) Court of Appeals held that ETS was not the "plaintiff" who initiated an action for damages arising out of the provision for professional services.

Macina, Bose, Copeland & Associates v. Yanez

- Procedural background:
  - Lopez and Mejia were both seriously injured during construction of an apartment complex.
  - Lopez's wife filed suit against several engineering defendants and two architectural defendants involved in the construction.
  - Mejia later intervened in the suit as plaintiff, bringing claims nearly identical to the claims asserted by Lopez's wife (but without a COM).
- Engineering and architectural defendants filed a Motion to Dismiss against Mejia's claims (for lack of COM).
- Mejia argued that a COM was not required because he was not a "plaintiff" within the meaning of CPRC §150.002.
- The Dallas Court of Appeals disagreed with Mejia's argument:
  - Mejia's claim was an independent suit for damages that he chose to bring under the same cause number as Lopez's wife's suit by intervening in her suit. Had Mejia filed his suit under a new cause as a separate lawsuit, there is no question that he would have been "the plaintiff" and required to file a COM.

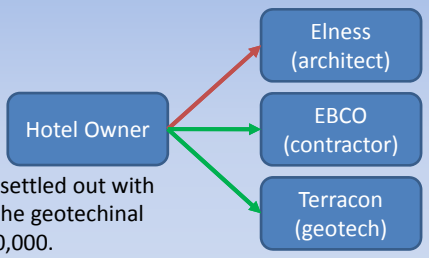
In re Coppola

- The Coppolas sold property to Nancy Adams and Adams Investment Properties, LLC ("Adams"), with the intent that Adams would use the property as a veterinary clinic and pet-boarding facility.
  - As part of the due diligence, Adams hired two transactional attorneys to provide legal advice on the sale.
- At closing, the Coppolas provided Adams with a survey showing that the property had a 15ft ROW. Adams subsequently learned that local ordinances required a 25ft ROW → Adams filed suit against the Coppolas for fraud, DTPA, etc.
- 76 days before the third trial setting, the Coppolas filed a Motion for Leave to designate the transactional attorneys as responsible third parties.
  - Trial court denied Coppolas's Motion for Leave → Court of Appeals denied mandamus relief.
- The Texas Supreme Court held . . .
  - Mandamus relief is available for the erroneous denial of a motion for leave to designate a RTP.
  - In allowing a case to proceed to trial despite the erroneous denial of a RTP "would skew the proceedings, potentially affect the outcome of the litigation, and compromise the presentation of [the relator's] defense in ways unlikely to be apparent in the appellate record."

Star Operations, Inc. v. Dig Tech, Inc.

- Dig Tech filed suit against Star as a result of Star's failure to pay Dig Tech for the installation of an electrical conduit work on SH 130 toll-road.
- The trial court entered judgment in favor of Dig Tech.
- Star appealed arguing that Dig Tech failed to comply with the requirements under CPRC §18.091.
  - Star argued that Dig Tech failed to present evidence of its damages in the form of a net loss after reduction for income-tax payments or unpaid income-tax liability.
- The Austin Court of Appeals disagreed with Star's argument:
  - The language of the statute expressly points the analysis to the type of damages sought to be recovered, rather than the type of liability claims (contract or personal injury) in question.
  - Dig Tech sought recovery of breach-of-contract damages from Star based upon unpaid invoices.
  - Dig Tech did not seek "loss of earnings."

Elness Swenson Graham Architects v. RLJ II-C Austin Air, LP



- Hotel owner filed suit against the architect, general contractor, and the geotechnical engineering firm.
- Prior to the lawsuit, the Hotel Owner settled out with EBCO (the contractor) and Terracon (the geotechinal engineer), in a total amount of $1,170,000.
  - Remaining Defendant = Elness, the architect
- During trial, the jury found that Elness failed to comply with the K and awarded the Hotel Owner $785,000 → Elness asked the trial court to apply the settlement credits ($1,170,000) to the damages awarded.
- The Austin Court of Appeals agreed with Elness that the Hotel Owner is not entitled to recover attorneys' fees because it did not recover any damages after application of the settlement credit, and thus, not a prevailing party under CPRC Ch. 38.

Vast Construction, LLC v. CTC Contractors, LLC

- The Court of Appeals again held that CPRC Chapter 38 does not provide for an award of attorneys' fees against limited liability company.

Dow Roofing Systems, LLC v. Great Commission Baptist Church

- Two arbitration agreements, which both provided for arbitration "in accordance with" the AAA Construction Industry Arbitration Rules.
- The Fort Worth Court of Appeals held that, because the arbitration agreements required arbitration "in accordance with" the AAA Construction Industry Rules, issues regarding the scope and validity of the arbitration agreements were for the arbitrator to decide.
  - The "in accordance with" phrase makes the AAA Construction Industry Rules part of the arbitration agreement; and under Rule 9(a) of the Construction Rules, the arbitrator has "the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement."

Builders First Source-South Texas, LP v. Ortiz

- Ortiz entered into an employment agreement with Builders First that contained an arbitration agreement covering job-related injuries.
- The AAA appointed Lynee Gomez to serve as the arbitrator.
  - In a sworn disclosure, Gomez stated that none of the other party representatives, law firms, or parties had appeared before her in past arbitration cases.
  - Ortiz's counsel subsequently discovered that Builders' counsel had previously appeared before Gomez twice.
  - Gomez then amended its disclosures identifying the cases in which Builders' counsel had appeared before her.
  - Ortiz filed a written objection with the AAA arguing that Gomez was not impartial—specifically citing to previous adverse rulings (including an award for sanctions against Ortiz).
  - Ortiz non-suited his claim without prejudice in the AAA.
- In an already-pending lawsuit related to Ortiz's injuries, Ortiz filed a motion requesting that the sanctions order be set aside on the basis of evident partiality.
- The Houston (14th) Court of Appeals held that the trial court properly set aside the arbitrator's sanctions because of evident partiality.

Pasadera Builders, LP v. Hughes

- Hughes entered into a construction contract with Pasadera whereby Pasadera was to construct a custom-built home.
  - The agreement contained an arbitration clause and also a prevailing party attorneys' fee provisions.
- The arbitration panel concluded:
  - That Pasadera breached its express limited warranty;
  - Pasadera's RCLA offer was reasonable;
  - Hughes's rejection of Pasadera's RCLA settlement offer meant that Hughes was precluded from recovering an amount in excess of the fair market value of Pasadera's last settlement offer.
  - Neither side were the prevailing party.
- Pasadera appealed on grounds that the arbitration panel exceeded its powers by failing to determine that Pasadera was the "prevailing party."
- The San Antonio Court of Appeals held that, based upon the language in the parties' construction contract, the panel did not exceed its powers by finding that neither was a "prevailing party."
  - It is not enough to show that the arbitrator committed an error, or even a serious error.

Star Operations, Inc. v. Dig Tech, Inc.

- On Appeals, the Surety argued:
  - (1) the Miller Act—not the McGregor Act—should apply to the project because it was a federally funded "public work" project, and, thus, federal courts should have exclusive subject-matter jurisdiction;
  - (2) alternatively, if the McGregor Act applies, Dig Tech's evidence failed to comply with the McGregor Act's notice requirements.
- The Austin Court of Appeals held that the McGregor Act applied—*not* the Miller Act:
  - Although there is no clear test for designating a project a "public work of the United States," courts often look to the following as indicia: whether the United States is a contracting party, an oblige to the bond, an initiator or ultimate operator of the project . . . ."
  - Here, the payment bond was issued on the subcontract between Star and the GC, and Star did not contend that either party was acting as an agent of the US.
- The Court also held that Dig Tech's submission of true and accurate invoices and descriptions of the work (which were all attached to Dig Tech's letter to the surety) substantially complied with the McGregor Act's notice requirements.

Lyon v. Building Galveston, Inc.

- BGI entered into a subcontract with Lyon whereby Lyon would provide remodeling services. BGI subsequently terminated Lyon for defective work.
  - Lyon sent to the owners a notice of unpaid work in accordance with Section 53.056 of the Texas Property Code, and later filed a lien on the property for $35,697.
  - Lyon filed suit against the owner to foreclose on the lien; BGI intervened.
- Jury found that Lyon filed a fraudulent lien on the property and awarded damages to BGI.
- On appeal, Lyon argued:
  - That the jury had to implicitly make the finding that Lyon's claimed lien exceeded the maximum amount allowed for a subcontractor's lien under Section 53.024 of the Texas Property Code.
  - There was legally insufficient evidence to support the jury's implicit finding that Lyon's $35,697 lien was invalid because there was no evidence applying the statutory formula to the facts of the case.
- The Houston (1st) Court of Appeals held:
  - The evidence was legally insufficient to support the jury's findings that Lyon's lien was invalid, pursuant to Section 53.024 of the Property Code.
  - "The plan language of the statute does not require subcontractors to calculate their lien using a specific method." The fact that Lyon used a different method does not mean Lyon's lien was per se invalid.

Torres v. Mansell

- Torres was electrocuted while working on the Project and filed suit against Mueller, asserting claims for premises liability, active negligence, negligence per se, and gross negligence.
- Mueller filed a MSJ invoking CPRC Chapter 95.
- The Amarillo Court of Appeals held:
  - Torres conceded that the overhead powerline was a condition of the work area.
  - Mueller did not exercise or retain sufficient control over the manner in which the work was performed.
  - No evidence that Mueller actually did control the details or methods of the subcontractors' work to such an extent that the subcontractors could not perform the work as they chose.

United Scaffolding, Inc. v. Levine

- Valero contracted with USI to build scaffolds at Valero's Port Arthur refinery. Levine (a Valero employee) was injured when he slipped on a piece of plywood that was not nailed down, causing him to fall through a hole in the scaffold.
- Levin filed suit against USI claiming that USI improperly constructed the scaffold and failed to remedy or warn of the dangerous condition.
  - At trial, the jury awarded Levine nearly $2MM in damages.
- A divided Texas Supreme Court held:
  - Levine's claim sounded in premises liability, not negligent activity, and therefore, the general-negligence findings could not support Levine's recovery.
  - A GC in control of the premises may be liable for two types of negligence in failing to keep the premises safe: (1) that arising from an activity on the premises; or (2) that arising from a premise defect.
  - When an injury is the result of the property's condition rather than an activity, premises-liability principles apply.
  - The majority held that Levine waived his premises-liability claim by failing to request a premises-liability question or instruction and by failing to secure findings on the premises-liability elements.

Section 7.

West Coast Casualty's
Construction Defect Seminar
May 16th 17th and 18th, 2018

Grand Ballroom

Thursday May 17th 2018
10:45 AM – 11:45 AM

Course Title:
"Subrogation is not the type of intervention I need.
How a subrogated insurer affects construction defect matters."

Ryan W. Baldino, Esq., Kim Arnal Esq., Paul Nolan Esq. and Al Clarke Esq.

"Subrogation is not the type of intervention I need. How a subrogated insurer affects construction defect matters."

Ryan W. Baldino, Esq., Kim Arnal Esq., Paul Nolan Esq. and Al Clarke Esq.

The following is a list of cases one needs to understand subrogation:

1. Valley Crest Landscape Development, Inc. v. Mission Pools of Escondido, Inc. (2015) 238 Cal.App.4th 468
2. Interstate Fire & Casualty Ins. Co. v. Cleveland Wrecking Co. (2010) 182 Cal.App.4th 23
3. Patent Scaffolding Co. v. William Simpson Construction Co. (1967) 256 Cal.App.2d 506
4. Mid-Century Ins. Co. v. Hutsel (1970) 10 Cal.App.3d 1065
5. Bramalea California, Inc. v. Reliable Interiors, Inc. (2004) 119 Cal.App.4th 468
6. Crawford v. Weather Shield (2008) 44 Cal.4th 541.
7. Hodge v. Kirkpatrick Development, Inc., 130 Cal.App.4th 540 (2005)
8. Allstate Ins. Co. v. Mel Rapton, Inc., 77 Cal.App.4th 901 (2000)

“1”

Filed 6/26/15; pub. order 7/2/15 (see end of opn.)

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

VALLEY CREST LANDSCAPE DEVELOPMENT, INC.,

Cross-complainant and Respondent,

v.

MISSION POOLS OF ESCONDIDO, INC.,

Cross-defendant and Appellant;

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,

Intervener and Respondent.

G049060

(Super. Ct. No. 30-2008-00104227)

O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, Andrew P. Banks, Judge. Affirmed in part, reversed in part, and remanded.

Murchison & Cumming and Edmund G. Farrell III for Cross-defendant and Appellant.

Wood, Smith, Henning & Berman, Kevin D. Smith, Yvette M. Dumas and Nicholas M. Gedo for Cross-complainant and Respondent and for Intervener and Respondent.

* * *

INTRODUCTION

Jeffrey Epp suffered severe injuries after diving into a swimming pool at the St. Regis Resort, Monarch Beach (the St. Regis). Litigation followed, with Epp and his wife (together, the Epps) suing the owner of the St. Regis and the entities involved in the design and construction of the swimming pool. The defendants included Valley Crest Landscape Development, Inc. (Valley Crest), which was the general contractor for exterior improvements at the St. Regis, and Mission Pools of Escondido, Inc. (Mission Pools), the subcontractor that built the swimming pool.

Summary judgment motions and settlements reduced the litigation to a cross-complaint by Valley Crest and its insurer, National Union Fire Insurance Company of Pittsburgh, PA (National Union), against Mission Pools. Valley Crest sought to recover the amount it spent in the litigation based on a claim of express indemnity under the terms of the subcontract with Mission Pools. National Union sought to recover attorney fees and costs it had spent for Valley Crest's defense and settlement of the Epps' claims pursuant to the policy of general liability insurance that National Union had issued to Valley Crest. National Union proceeded on a claim it was equitably subrogated to Valley Crest's claims against Mission Pools.

The trial court conducted a two-part bench trial on the cross-complaint, found in favor of both Valley Crest and National Union on their respective claims, and awarded them the full amount of recovery sought. In this appeal from the judgment, Mission Pools makes three contentions: (1) the cross-complaint was time-barred under Code of Civil Procedure, section 337.1, subdivision (a) (section 337.1(a)) (all code references are to the Code of Civil Procedure); (2) the trial court erred by finding

National Union could recover on its claim for equitable subrogation because, under the element of balancing the equities, National Union should bear the loss; and (3) the trial court erred by denying Mission Pools a jury trial on Valley Crest's claim for express indemnity.

As to the first contention, we conclude section 337.1(a) does not apply to claims for express indemnity, and, therefore, the first amended cross-complaint was timely. As to the second contention, we conclude the trial court did not abuse its discretion by finding that National Union was entitled to recover based on equitable subrogation. The trial court erred, however, by denying Mission Pools a jury trial on Valley Crest's claim for express indemnity. We therefore reverse the judgment on that claim and remand for further proceedings, but in all other respects affirm.

FACTS AND PROCEDURAL HISTORY

I.

Background: The Parties, Contracts, and Construction of the Swimming Pool

The St. Regis is a resort facility located in Dana Point and is owned by CPH Monarch Hotel, LLC (CPH). STO Design Group (STO) designed all of the swimming pools and improvements at the St. Regis. Lifescapes, International (Lifescapes) was a design consultant to the St. Regis and was responsible for its overall "design concept," including the swimming pools. Valley Crest served as general contractor for all exterior improvements at the St. Regis, and, in November 2000, entered into a construction agreement with CPH (the Construction Agreement). Paragraph 12 of the Construction Agreement contained an indemnity provision requiring Valley Crest to defend and indemnify CPH for any claims arising out of Valley Crest's work.

Valley Crest entered into a construction subcontract with Mission Pools (the Subcontract) to build four separate pools and associated plumbing and mechanical

equipment. Although the Subcontract initially required Mission Pools to install signage and decktop depth markers, those requirements later were removed from its scope of work, and Valley Crest installed the markers.

The indemnity provision in the Subcontract stated: "Subcontractor [(Mission Pools)] indemnifies and holds Contractor [(Valley Crest)] harmless from and against any and all claims, demands or actions made by any person or entity, whether valid or not, arising out of the performance by Subcontractor, including, without limitation, its employees, agents, and sub-subcontractors of this subcontract. Subcontractor agrees to reimburse Contractor upon demand for any expenses, including attorney's fees, incurred by Contractor in defending against or dealing with any such claims, demands, or actions. [¶] Subcontractor specifically obligates itself to Contractor in the following respects . . . [¶] . . . [¶] . . . Subcontractor shall protect, hold free and harmless, defend and indemnify Contractor and Owner . . . from all liability, penalties, costs, losses, damages, expenses, causes of action, judgments or other claims resulting from injury to or death sustained by any person . . . , which injury [or] death . . . arises out of Subcontractor's performance of work under this Subcontract. Subcontractor's aforesaid indemnity and hold harmless obligation shall apply to any act or omission, willful misconduct or negligent conduct, whether active or passive, on the part of Subcontractor or its agents, sub-contractors or employees."

Construction of the swimming pool in which Epp was injured was completed in July 2001. The Orange County Health Care Agency, the Environmental Health Department, and CPH approved the pool and determined it could be open for use in August 2001. Valley Crest accepted completion of the pool from Mission Pools. Since November 2001, neither Valley Crest nor Mission Pools has had any involvement with any of the swimming pools at the St. Regis.

In April 2007, National Union issued a policy of commercial general liability insurance (the National Union Policy) with Valley Crest as the named insured.

The National Union Policy provided: "[National Union] 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. We will have the right and duty to defend the insured against any 'suit' seeking those damages."

II.

The Epps' Litigation, Theories of Liability, and Valley Crest's Tender of Defense to Mission Pools

On September 15, 2007, Epp dived into the shallow end of one the swimming pools at the St. Regis. Epp, who was intoxicated at the time, seriously injured his spine and was rendered a quadriplegic.

In March 2008, the Epps filed a complaint against the St. Regis, Starwood Hotels & Resorts Worldwide, Inc., and Starwood Hotels & Resorts Management Company, Inc., for negligence and loss of consortium. The complaint was answered by CPH.[1] The Epps later amended their complaint to add Valley Crest, Mission Pools, STO, and Lifescapes, as defendants.

In May 2008, Valley Crest tendered its defense to Mission Pools and requested that it defend and indemnify Valley Crest pursuant to the indemnity provision of the Subcontract. Mission Pools never responded to the tender. In July 2008, Valley Crest filed a cross-complaint against Mission Pools for express indemnity based on its alleged breach of the indemnity provision of the Subcontract.

The Epps filed a first amended complaint in May 2009. As relevant here, the first amended complaint alleged, "[the] pool facility failed to provide any visible and effective and legible and conspicuous warnings/signage/depth markings on the pool deck and pool vertical walls nor in the pool area itself that complied with reasonable standards

[1] Starwood Hotels & Resorts Worldwide, Inc., and Starwood Hotels & Resorts Management Company, Inc., were sued erroneously. The parties to this appeal stipulated that CPH owned the St. Regis.

of care." Through discovery, the Epps refined their claims, and they identified the following defects as allegedly contributing to their injuries: (1) "[t]he vertical tile depth markers were partially submerged, making them illegible"; (2) "faded deck top depth markers"; (3) "[p]oor contrast on the signs containing 'No Diving' warning"; (4) "[p]oor location of signs"; (5) "[l]ack of fence between pools so users were not directed to entrance near 'No Diving' sign"; (6) "[f]ailure of hotel to enforce its rule directing users to not use pool after alcohol intake"; and (7) use of colored (French gray) plaster for the swimming pool.

Only points (1) and (7) applied specifically to work performed by Mission Pools. The final point, use of colored plaster, was based on a document in the files of Mission Pools entitled, "Plaster Fact Sheet," which listed an advantage of colored plaster as giving the appearance of greater depth. This fact sheet referred to a plaster color as "French Gray" and was signed by a representative of Lifescapes.

French gray plaster was used to coat the bottoms of several large fountains at the St. Regis. The Epps' expert opined that French gray plaster was also used for the swimming pool in which Jeffrey Epp was injured. The expert testified in her deposition that the swimming pool had been surfaced with a white Portland cement that had a grayish tint to it. The grayish tint made the pool appear deeper than it was. Other testimony and evidence established that white plaster was used for the swimming pool.

III.

Summary Judgment Motions and Settlement of the Epps' Claims

STO, Lifescapes, Valley Crest, and Mission Pools brought motions for summary judgment based on the statute of limitations of section 337.1(a). Mission Pools also asserted it did not use French gray plaster to surface the pools and the vertical tile depth markers it installed did not contribute to the Epps' injuries. Mission Pools submitted portions of the deposition transcript of Epp, who testified he "really didn't see"

the depth markers and "didn't stop and stare at [them] to try and see exactly what [they] said."

The trial court granted the motions brought by STO and Lifescapes. The court granted the motion brought by Mission Pools but only as to the Epps' first amended complaint. The trial court denied Valley Crest's motion on the ground Valley Crest had failed to properly object to evidence that French gray plaster was used for the pool. STO, Lifescapes, and Mission Pools had properly objected to the evidence, and their objections were sustained, leading to summary adjudication in their favor on the issue of use of French gray plaster. Nevertheless, the court denied Mission Pools's motion for summary judgment as against Valley Crest's cross-complaint. The court stated: "Since Valley Crest's Motion was denied, this also must be denied."

The Epps settled their claims with all defendants. The Epps settled with CPH for $4.5 million, with Lifescapes for $15,000, and with STO for a waiver of costs. In March 2012, the Epps' claims against Valley Crest and Mission Pools, and CPH's express indemnity claim against Valley Crest, were resolved by an agreement pursuant to which Valley Crest and Mission Pools together paid $250,000 to the Epps and CPH. Valley Crest's contribution to this settlement was $10,000 to each of the Epps and $30,000 to CPH for a total of $50,000. Mission Pools's contribution to this settlement was $65,000 to each of the Epps and $70,000 to CPH for a total of $200,000.

IV.

Valley Crest's Cross-complaint and National Union's Subrogation Claim

In July 2012, National Union intervened in, and was added as a cross-complainant to, Valley Crest's cross-complaint against Mission Pools. The first amended cross-complaint of Valley Crest and National Union (the first amended cross-complaint) asserted a cause of action for express indemnity by Valley Crest, a cause of action for equitable subrogation by National Union, a cause of action for

declaratory relief by both Valley Crest and National Union, and a cause of action for contribution by both Valley Crest and National Union.

The first amended cross-complaint alleged Valley Crest was obligated under the Construction Agreement to defend and indemnify CPH in the action brought by the Epps and that Valley Crest incurred $202,096.61 in attorney fees and costs defending CPH in that action. The first amended cross-complaint also alleged that pursuant to the indemnity provision in the Subcontract, Valley Crest had incurred $419,064.93 in attorney fees and costs that Valley Crest spent defending itself in the action brought by the Epps and had spent $50,000 in settling that action. Pursuant to the terms of the National Union Policy, Valley Crest paid the first $250,000 in losses as a self-insured retention. In total, the first amended cross-complaint sought to recover $671,161.54 from Mission Pools.

V.

Trial, Findings, and Judgment

Trial on the first amended cross-complaint was undertaken in two phases. In the first phase, National Union's claim for equitable subrogation was tried. In that claim, National Union sought to recover (1) attorney fees and settlement costs it had paid in the defense of Valley Crest pursuant to the National Union Policy and (2) the fees incurred by CPH in its defense pursuant to the additional insured endorsement. In a tentative decision, the trial court found that, by failing to accept the tender of defense when first made, Mission Pools had forfeited its right to seek allocation of the claimed attorney fees and settlement costs between the claims related to the work of Mission Pools and unrelated claims. The court awarded National Union the full amount it paid in the defense of Valley Crest, the full amount National Union paid in defense of CPH, and the full amount National Union paid in settlement, for a total recovery of $421,161.54.

In the second phase, Valley Crest's claim for express indemnity under the terms of the Subcontract was tried. The express indemnity claim initially was set for a

jury trial. Before empanelling the jury, the trial court decided the express indemnity claim was, in effect, for specific performance of the indemnity provision (rather than for damages) and, therefore, was an action in equity for which there was no right to a jury trial. After receiving additional evidence, the trial court found that under the terms of the indemnity provision of the Subcontract, Valley Crest was entitled to recover the entire $250,000 self-insured retention.

The trial court issued a statement of decision making these findings:

1. Pursuant to "express indemnity principles," Valley Crest is entitled to recover out-of-pocket attorney fees and costs incurred in its defense of the Epps' complaint.

2. Pursuant to equitable subrogation principles, National Union is entitled to recover attorney fees and costs above Valley Crest's self-insured retention, which National Union paid for Valley Crest's defense of the Epps' complaint.

3. No apportionment would be made between attorney fees and costs related and unrelated to Mission Pools's work.

4. National Union is entitled to recover $202,096.91 in attorney fees and costs it paid in connection with its defense of CPH.

5. National Union is entitled to recover the $50,000 amount it paid toward settlement.

6. There would be no apportionment of the $50,000 paid in settlement between amounts related and amounts unrelated to Mission Pools's work.

7. The amount of attorney fees and costs incurred in Valley Crest's defense was reasonable.

8. The statute of limitations of section 337.1 did not bar Valley Crest's claims or National Union's claims.

Judgment was entered against Mission Pools and in favor of Valley Crest for $282,496 and in favor of National Union for $494,002.37. Mission Pools timely appealed from the judgment.

DISCUSSION

I.

Statute of Limitations

Mission Pools contends Valley Crest's claim for express indemnity is time-barred under section 337.1(a), which states: "(a) Except as otherwise provided in this section, no action shall be brought to recover damages from any person performing or furnishing the design, specifications, surveying, planning, supervision or observation of construction or construction of an improvement to real property more than four years after the substantial completion of such improvement for any of the following: [¶] (1) Any patent deficiency in the design, specifications, surveying, planning, supervision or observation of construction or construction of an improvement to, or survey of, real property; [¶] (2) Injury to property, real or personal, arising out of any such patent deficiency; or [¶] (3) Injury to the person or for wrongful death arising out of any such patent deficiency."

Section 337.1(a) is inapplicable. Valley Crest sought recovery from Mission Pools based on the indemnity provision in the Subcontract.[2] Thus, Valley Crest brought an action on a contract, not an action to recover damages on any of the grounds

[2] "The obligation of indemnity, which we have defined as 'the obligation resting on one party to make good a loss or damage another has incurred' [citations] may arise under the law of this state from either of two general sources. First, it may arise by virtue of express contractual language establishing a duty in one party to save another harmless upon the occurrence of specified circumstances. Second, it may find its source in equitable considerations brought into play either by contractual language not specifically dealing with indemnification or by the equities of the particular case. [Citations.]" (*E. L. White, Inc. v. City of Huntington Beach* (1978) 21 Cal.3d 497, 506-507.)

listed in section 337.1(a). When, as here, the parties have expressly contracted with respect to the duty to indemnify, the extent of that duty is determined from the contract. (*Rossmoor Sanitation, Inc. v. Pylon, Inc.* (1975) 13 Cal.3d 622, 633.)

An action for indemnity—express or implied—is not included within section 337.1(a)'s definition of the word "action." In contrast, section 337.15, which sets forth a 10-year statute of limitations for latent deficiencies, expressly defines the word "'action'" to include "an action for indemnity." (§ 337.15, subd. (c).) Subdivision (c) of section 337.15 reads: "As used in this section, 'action' includes an action for indemnity brought against a person arising out of that person's performance or furnishing of services or materials referred to in this section, except that a cross-complaint for indemnity may be filed pursuant to subdivision (b) of Section 428.10 in an action which has been brought within the time period set forth in subdivision (a) of this section." This covers both contractual (express) and implied indemnity. (*FNB Mortgage Corp. v. Pacific General Group* (1999) 76 Cal.App.4th 1116, 1127.) Section 337.1 does not include the same or a similar provision. "When terms are used in some statutes but not in other related statutes, we should not imply the terms into the statute from which they were excluded." (*Crouse v. Brobeck, Phleger & Harrison* (1998) 67 Cal.App.4th 1509, 1542, citing *Pasadena Police Officers Assn. v. City of Pasadena* (1990) 51 Cal.3d 564, 576.)

Section 337.1 was enacted in 1967. (See 13B West's Ann. Code Civ. Proc. (2006 ed.) amend. history foll. § 337.1, p. 354.) Section 337.15 was enacted in 1971. (*FNB Mortgage Corp. v. Pacific General Group*, *supra*, 76 Cal.App.4th at p. 1126.) If the Legislature believed the word "action" was broad enough to include an action for indemnity, then it would have had no need to expressly define "action" to include indemnity in section 337.15, subdivision (c).

Mission Pools relies on *Wagner v. State of California* (1978) 86 Cal.App.3d 922 (*Wagner*) to support its argument that section 337.1(a) applies to express indemnity

claims. In *Wagner, supra*, 86 Cal.App.3d at page 928, the Court of Appeal concluded, with respect to equitable indemnity: "The argument that the limitations period of section 337.1 is inapplicable because defendant seeks indemnity is unacceptable. Since the limitations period set forth in section 337.1 would preclude any action other than one excepted by that section, it follows that an action for indemnity based on the same events should also be precluded."

We decline to follow *Wagner* for several reasons. First, *Wagner* did not consider section 337.15, which, unlike section 337.1, defines the word "action" to include an action for indemnity. Second, *Wagner* dealt with equitable indemnity, and, here, we deal with a claim for express indemnity. Because the claim for express indemnity was based on a written contract, it was subject to the statute of limitations of section 337, subdivision 1. Third, *Wagner* is contrary to the principle that "[a] tort defendant retains the right to seek equitable indemnity from another tortfeasor even if the plaintiff's action against the cross-defendant is barred by the statute of limitations." (*Valley Circle Estates v. VTN Consolidated, Inc.* (1983) 33 Cal.3d 604, 611.) For that reason, the court that issued *Wagner* declined to extend it beyond section 337.1. (*Mangini v. Aerojet-General Corp.* (1991) 230 Cal.App.3d 1125, 1154-1155.) Finally, in *Crouse v. Brobeck, Phleger & Harrison, supra*, 67 Cal.App.4th at page 1542, the Court of Appeal criticized *Wagner* on the ground "[it] reached its conclusion without citing, accommodating or distinguishing the existing Supreme Court authority holding that claims for implied indemnity do not accrue until the indemnitee has suffered actual loss through payment."

We therefore conclude the statute of limitations of section 337.1 is inapplicable to Valley Crest's claim for express indemnity and National Union's claim for equitable subrogation, which arose out of the indemnity claim. Valley Crest was, in effect, suing Mission Pools for breach of contract for its alleged failure to fulfill its obligations under the Subcontract. The statute of limitations for breach of a written contract is four years. (§ 337, subd. 1.) A cause of action for breach of an express

indemnity agreement (contractual indemnity) accrues when the indemnitor sustains the loss by paying the money sought to be indemnified from the indemnitee. (*Fidelity & Deposit Co. v. Whitson* (1960) 187 Cal.App.2d 751, 758; see *Valley Circle Estates v. VTN Consolidated, Inc.*, *supra*, 33 Cal.3d at p. 611 ["'The indemnity action, unlike the plaintiff's claim, does not accrue for statute of limitations purposes when the original accident occurs, but instead accrues at the time the tort defendant pays a judgment or settlement as to which he is entitled to indemnity.'"].)

Under those accrual rules, Valley Crest's cause of action for express indemnity accrued at the earliest in May 2008, when Valley Crest tendered its defense to Mission Pools. Valley Crest filed its cross-complaint just two months later, and therefore the express indemnity claim was timely. (§ 337, subd. 1.)

II.

Balancing the Equities

A. *Introduction*

The trial court found that National Union was entitled to recover on its claim against Mission Pools for equitable subrogation. "In the insurance context, subrogation takes the form of an insurer's right to be put in the position of the insured for a loss that the insurer has both insured and paid. [Citations.] When an insurance company pays out a claim on a property insurance policy, the insurance company is subrogated to the rights of its insured against any wrongdoer who is liable to the insured for the insured's damages." (*State Farm General Ins. Co. v. Wells Fargo Bank, N.A.* (2006) 143 Cal.App.4th 1098, 1106 (*State Farm*).)

Here, National Union is the insurer, Valley Crest is the insured, and Mission Pools is the defendant/indemnitor. National Union provided Valley Crest a defense and paid to settle with the Epps based on Valley Crest's claim under the National Union Policy. The trial court found that National Union stood in the place of Valley

Crest to the extent of those payments and therefore could recover from Mission Pools under the express indemnity provision of the Subcontract. Mission Pools argues National Union was not entitled to be equitably subrogated because its equitable position was, on balance, inferior to that of Mission Pools.

B. *Standard of Review*

Equitable subrogation is, as the name suggests, based on equity. (*State Farm, supra*, 143 Cal.App.4th at p. 1106.) After a trial court has exercised its equitable powers, the appellate court reviews the judgment under the abuse of discretion standard. (*City of Barstow v. Mojave Water Agency* (2000) 23 Cal.4th 1224, 1256.)

"'The appropriate test for abuse of discretion is whether the trial court exceeded the bounds of reason. When two or more inferences can reasonably be deduced from the facts, the reviewing court has no authority to substitute its decision for that of the trial court.' [Citation.] [¶] 'The abuse of discretion standard . . . measures whether, given the established evidence, the act of the lower tribunal falls within the permissible range of options set by the legal criteria.'" (*Bank of America, N.A. v. Superior Court* (2013) 212 Cal.App.4th 1076, 1089.) The scope of the trial court's discretion is limited by law governing the subject of the action taken. (*Ibid.*) An action that transgresses the bounds of the applicable legal principles is outside the scope of the trial court's discretion and, therefore, is deemed an abuse of discretion. (*Ibid.*)

In applying the abuse of discretion standard, we determine whether the trial court's factual findings are supported by substantial evidence and independently review its legal conclusions. (*County of San Diego v. Gorham* (2010) 186 Cal.App.4th 1215, 1230.)

As this appeal follows a bench trial, we also apply the doctrine of implied findings. The trial court found that National Union was entitled to recover under equitable subrogation principles, but made no specific findings on balancing or weighing

the equities. No objections were made to the statement of decision, and no party brought omissions or ambiguities in it to the trial court's attention, so we will infer the trial court made findings favorable to the prevailing party on all issues necessary to support the judgment. (*Fladeboe v. American Isuzu Motors Inc.* (2007) 150 Cal.App.4th 42, 59-60.)

C. *Elements of Equitable Subrogation*

"Generally, an insurer on paying a loss is subrogated in a corresponding amount to the insured's right of action against any person responsible for the loss. [Citation.] California law is in accord that insurance companies may be subrogated to the rights of their insureds. [Citation.]" (*Rossmoor Sanitation, Inc. v. Pylon, Inc.*, *supra*, 13 Cal.3d at pp. 633-634.) "[A] general liability insurer that has paid a claim to a third party on behalf of its insured may have an equitable right of subrogation against (1) other parties who contributed to the harm suffered by the third party (joint tortfeasors) under an equitable indemnity theory, and (2) other parties who are legally liable to the insured for the harm suffered by the third party (such as by an indemnification agreement) under a contractual indemnity theory." (*Interstate Fire & Casualty Ins. Co. v. Cleveland Wrecking Co.* (2010) 182 Cal.App.4th 23, 32 (*Interstate Fire*).) This case falls under the second category: National Union's subrogation claim was based on allegations that Mission Pools was legally liable to Valley Crest under the terms of the indemnity provision of the Subcontract.

Case law has identified eight elements of an insurer's cause of action for equitable subrogation.[3] The only element in issue here is No. 7—balancing the equities;

[3] The eight elements are: "'[1] the insured suffered a loss for which the defendant is liable, either as the wrongdoer whose act or omission caused the loss or because the defendant is legally responsible to the insured for the loss caused by the wrongdoer; [2] the claimed loss was one for which the insurer was *not* primarily liable; [3] the insurer has compensated the insured in whole or in part for the same loss for which the defendant is primarily liable; [4] the insurer has paid the claim of its insured to protect its own interest and not as a volunteer; [5] the insured has an existing, assignable cause of action

that is, "justice requires that the loss be entirely shifted from the insurer to the defendant, whose equitable position is inferior to that of the insurer." (*Interstate Fire, supra*, 182 Cal.App.4th at pp. 33-34.) "[T]he aim of equitable subrogation is to shift a loss for which the insurer has compensated its insured to one who caused the loss, or who is legally responsible for the loss caused by another and whose equitable position is inferior to the insurer's. [Citations.]" (*State Farm, supra*, 143 Cal.App.4th at p. 1112.)

D. *Balancing the Equities: The* Interstate Fire *Opinion*

Though easily stated in general terms, the element of balancing the equities lacks specificity in details. "'[T]here is no facile formula for determining superiority of equities, for there is no formula by which to determine the existence or nonexistence of an equity except to the extent that certain familiar fact combinations have been repeatedly adjudged to create an equity in the surety or the third party. . . . '" (*State Farm, supra*, 143 Cal.App.4th at p. 1112.)

Nonetheless, *Interstate Fire, supra*, 182 Cal.App.4th 23, provides a valuable guideline for how to balance the equities in an equitable subrogation claim by an insurer based on the insured's express indemnity claim against the defendant—i.e., the situation presented here. In *Interstate Fire*, Webcor Construction, Inc. (Webcor), was the general contractor for a construction project. (*Id.* at p. 28.) Cleveland Wrecking Company (Cleveland) and Delta Steel Erectors (Delta) were subcontractors on the project. (*Ibid.*) Cleveland and Delta entered into similar subcontracts with Webcor,

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against the defendant which the insured could have asserted for its own benefit had it not been compensated for its loss by the insurer; [6] the insurer has suffered damages caused by the act or omission upon which the liability of the defendant depends; [7] justice requires that the loss be entirely shifted from the insurer to the defendant, whose equitable position is inferior to that of the insurer; and [8] the insurer's damages are in a liquidated sum, generally the amount paid to the insured.'" (*Interstate Fire, supra*, 182 Cal.App.4th at pp. 33-34, quoting *Fireman's Fund Ins. Co. v. Maryland Casualty Co.* (1998) 65 Cal.App.4th 1279, 1292.)

which had express indemnity provisions. (*Ibid.*) Cleveland agreed to indemnify Webcor from "'claims, demands, causes of action, damages, costs, expenses, actual attorney's fees, losses or liability, in law or in equity, of every kind and nature whatsoever ("Claims") arising out of or in connection with Subcontractor's operations to be performed under this Agreement for, but not limited to . . . Personal injury . . . caused or alleged to be caused in whole or in part by any negligent act or omission of Subcontractor [Cleveland].'" (*Ibid.*) Cleveland was required to, at its "'own cost, expense and risk, defend all Claims . . .' by third parties, pay any judgment, and reimburse Webcor and certain others for legal expenses they incurred." (*Ibid.*) Both Cleveland and Delta had agreed to procure liability insurance with Webcor as an additional insured, but only Delta complied. (*Id.* at pp. 28-29.)

While working on the project, a Delta employee (Thelbert Allen Frisby) suffered serious injuries caused, at least in part, by Cleveland. (*Interstate Fire, supra*, 182 Cal.App.4th at p. 29.) Frisby sued Cleveland for negligence and sued Webcor for negligence, premises liability, and negligent provision of unsafe equipment. (*Ibid.*) Webcor tendered its defense and indemnification to Cleveland pursuant to the express indemnity terms of its subcontract. Cleveland rejected the tender. (*Ibid.*) Webcor also tendered its defense and indemnification to Delta, which accepted the tender. (*Ibid.*) Webcor filed a cross-complaint against Cleveland for express indemnification, equitable indemnification, and breach of contract. (*Ibid.*) Webcor dismissed the cross-complaint and the parties expressly reserved the insurer's right to bring a subrogation claim in a separate action. (*Id.* at pp. 29-30.)

Webcor and Frisby entered into a settlement agreement by which Webcor would pay him $575,000. (*Interstate Fire, supra*, 182 Cal.App.4th at p. 30.) The trial court approved the agreement as a good faith settlement. (*Ibid.*) The insurer funded the full amount of the settlement payment and paid over $152,000 in attorney fees and costs to defend Webcor against Frisby's claims. (*Ibid.*) Cleveland also entered into a

settlement agreement with Frisby, which the trial court approved as a good faith settlement. (*Ibid.*)

The insurer filed a complaint for subrogation against Cleveland. (*Interstate Fire, supra*, 182 Cal.App.4th at p. 30.) The complaint alleged that Cleveland breached its contract with Webcor by failing to defend and indemnify Webcor. (*Ibid.*) Cleveland demurred to the subrogation complaint on the ground the insurer was not in a superior position because there were no allegations that Cleveland's breach of contract had caused the loss. (*Ibid.*) After the trial court sustained the demurrer with leave to amend, the insurer filed an amended complaint adding allegations that Cleveland's negligence was a proximate cause of Frisby's injuries and that Cleveland had violated its subcontract by failing to obtain insurance covering Webcor. (*Ibid.*) The insurer sought judgment for all amounts it had spent to defend against and settle the claims against Webcor in the action brought by Frisby. (*Ibid.*) The insurer contended it was subrogated to Webcor's claims against Cleveland for breach of its express indemnity obligation. (*Ibid.*)

Cleveland demurred to the amended complaint, again arguing the insurer did not have superior equities and Webcor did not incur damages by Cleveland's alleged breach of the indemnification provision of the subcontract. (*Interstate Fire, supra,* 182 Cal.App.4th at p. 31.) The trial court sustained the demurrer without leave to amend on the grounds the determination of good faith settlement cut off Webcor's ability to sue Cleveland for indemnity and the insurer's equitable position was not superior to Cleveland's because Webcor had sustained no damages resulting from Cleveland's breach of the indemnity provision. (*Ibid*.)

The Court of Appeal reversed. (*Interstate Fire, supra,* 182 Cal.App.4th at p. 28.) On the issue of balancing the equities, the court concluded, "it can reasonably be inferred that [the insurer]'s equitable position is superior to that of Cleveland." (*Id.* at p. 37.) The court reached its conclusion based on several factors.

The first factor was that Cleveland was alleged to have caused the loss in addition to its alleged liability for the loss under a contractual indemnity provision, and "Cleveland's alleged negligence toward Frisby is relevant to the respective equities of [the insurer] and Cleveland." (*Interstate Fire*, *supra*, 182 Cal.App.4th at p. 39.) "[T]he first amended complaint alleges that Cleveland's negligence caused Frisby's lawsuit, and precipitated the lawsuit against Webcor and Cleveland, which made it necessary for Webcor to incur the costs of defense and settlement. Since it is not alleged that [the insurer] (or even Webcor) was at fault, the allegations of the first amended complaint give rise to the inference that Cleveland should cover Webcor's defense and settlement costs." (*Id.* at pp. 40-41.)

The second factor was the nature of the insurer's and Cleveland's agreements to indemnify Webcor. (*Interstate Fire*, *supra*, 182 Cal.App.4th at p. 42.) "While Cleveland agreed to indemnify Webcor in the subcontractor agreement pertaining to the project from which the underlying injury arose, [the insurer] was a third party insurer uninvolved in the project." (*Ibid.*) Cleveland and the insurer did not agree to indemnify the same loss. (*Id.* at p. 44.) Cleveland agreed to indemnify and hold harmless Webcor from all claims, including personal injury claims, arising out of Cleveland's work on the construction project. (*Ibid.*) By contrast, the insurer provided coverage to Webcor for amounts it became legally obligated to pay as damages because of bodily injury to which the insurance applied, without limitation to liability arising out of Cleveland's work on the construction project. (*Ibid.*)

Put another way, the equities tipped in favor of the insurer because Cleveland agreed to indemnify Webcor specifically against the loss incurred. "An entity which, like Cleveland, agrees to indemnify *the other party to the underlying transaction* has a liability of greater primacy than an independent insurer that insures against loss. [Citations.] The parties directly involved in the transaction are better able to evaluate and control the risk. Therefore, for purposes of weighing the equities in an equitable

subrogation case, and absent language in the insurance policy or indemnification agreement leading to a contrary conclusion (which the parties here do not contend exists), the Agreement between the parties who were connected to the incident giving rise to the loss (Webcor and Cleveland as workers at Frisby's job site) creates the greater equitable responsibility for indemnification, as compared to that of the general liability insurer . . . ." (*Interstate Fire, supra*, 182 Cal.App.4th at p. 44.)

The Court of Appeal also considered the fact the insurer had accepted premiums, but concluded that factor was not dispositive. (*Interstate Fire*, *supra*, 182 Cal.App.4th at p. 45.) "In our view, the fact that [the insurer] accepted premiums is not particularly significant, since every insurer that pays a loss on behalf of its insured will have accepted premiums for the risk. Furthermore, while [the insurer] was compensated for undertaking the risk of loss, so was *Cleveland*, which accepted consideration for the performance of its obligations under the Webcor-Cleveland subcontract. [Citation.] Finally, while it may be that [the insurer] merely did what it was obligated to do under the insurance policy, that does not change the fact that Cleveland did *not* do what it was allegedly obligated to do under the indemnification provision, after it allegedly caused the loss." (*Ibid.*)

Finally, the Court of Appeal considered public policy: "In our view, it is not a good idea to reward parties who refuse to fulfill their alleged indemnification obligations, particularly under the rubric that they are in as good or better an *equitable* position as the insurer that did fulfill its alleged indemnification obligation. We believe it is more prudent to permit subrogation, so that a party with an alleged contractual indemnification obligation will be encouraged to step up in the underlying case and either fulfill the obligation (and implicitly help settle the case) or resolve any dispute over the application of the indemnification obligation. If permitting subrogation to the insurer in any way results in a windfall (because the insurer that accepted premiums to insure against the loss may now shift the loss to the other indemnitor), it would be better for the

windfall to go to the one that undisputedly fulfilled its contractual obligations, rather than to the one that allegedly breached them." (*Interstate Fire*, *supra*, 182 Cal.App.4th at p. 47.) Cleveland, which allegedly contributed to the loss, did not fulfill its contractual obligations to Webcor, while the insurer, which had nothing to do with the incident leading to the loss, abided by its contractual obligation to pay for it. (*Ibid.*) "The comparison, therefore, is between one party who had nothing to do with causing the loss but abided by its contractual obligation to pay for it, and another party who caused the loss and then shunned its contractual obligation to pay it." (*Ibid.*)

E. *Balancing the Equities Between National Union and Mission Pools*

At least in outline form, this case resembles *Interstate Fire*. National Union was subrogated to Valley Crest's right under the express indemnity provision of the Subcontract, just as the insurer in *Interstate Fire* was subrogated to Webcor's rights under the subcontract with Cleveland. Valley Crest in effect obtained insurance for the loss from two sources: the National Union Policy and the indemnity provision of the Subcontract. Who should bear the loss, Mission Pools or National Union? We turn to the factors addressed in *Interstate Fire*.

1. *Cause of the Loss.* National Union did not cause the loss or have anything to do with causing Epp's injuries. Mission Pools was alleged to have contributed to causing Epp's injuries; however, the factual basis for Mission Pools's liability was slim. Of the seven theories of liability asserted by the Epps, only two concerned work performed by Mission Pools: (1) "[t]he vertical tile depth markers were partially submerged, making them illegible" and (2) use of French gray plaster for the pool surface. In granting Mission Pools's motion for summary judgment, the trial court ruled, "there is no evidence that French gray plaster was actually used as opposed to merely approved." In moving for summary judgment, Mission Pools presented evidence that placement of the vertical tile depth markers was not a cause of Epp's injuries.

The statement of decision is silent on the issue whether Mission Pools contributed in some fashion to Jeffrey Epp's injuries. National Union argues we should invoke the doctrine of implied findings and infer the trial court made a factual finding that Mission Pools contributed to Epp's injuries by placing the swimming pool's depth markers below the water line. Implied findings, like express ones, are reviewed under the substantial evidence standard. (*Fladeboe v. American Isuzu Motors Inc.*, *supra*, 150 Cal.App.4th at p. 60.) Here, the parties stipulated as fact: "[R]egarding Mission Pools' work, plaintiffs alleged that the vertical wall markings that state pool depth are halfway submerged, making them illegible, such that pool patrons are unable to correctly read these depth markings. *These allegations were defeated when the Court granted Mission Pools' motion for summary judgment*." (Italics added.)

2. *Nature of Indemnity Agreements.* Mission Pools agreed to indemnify Valley Crest specifically against the type of loss incurred, while National Union provided general liability insurance. "An entity which, like [Mission Pools], agrees to indemnify *the other party to the underlying transaction* has a liability of greater primacy than an independent insurer that insures against loss." (*Interstate Fire*, *supra*, 182 Cal.App.4th at p. 44.) National Union was a third party insurer that was not involved in the construction project. (See *id.* at p. 42.)

CPH was named as an additional insured under the National Union Policy. National Union's decision to accept CPH's tender of defense was based not only on the National Union Policy, but also on the indemnity provision of the Construction Agreement and the obligation imposed by *Crawford v. Weather Shield Mfg., Inc.* (2008) 44 Cal.4th 541. In *Crawford*, the California Supreme Court held a contractual duty to defend under a construction subcontract is triggered merely by allegations that damage or loss was caused by construction defects arising from the subcontractor's negligence, even if a trier of fact later finds the subcontractor was not negligent. (*Id.* at pp. 547, 568.)

3. *Receipt of Premiums.* National Union's receipt of premiums from Valley Crest is a neutral factor. Indeed, "while [National Union] was compensated for undertaking the risk of loss, so was [Mission Pools], which accepted consideration for the performance of its obligations under the . . . [S]ubcontract." (*Interstate Fire*, *supra*, 182 Cal.App.4th at p. 45.)

4. *Compliance with Contractual Obligations.* So far, the equities line up fairly evenly between National Union and Mission Pools. In our opinion, what tips the balance against Mission Pools, and leads us to conclude the trial court did not abuse its discretion, is that Mission Pools did not comply with its obligations under the Subcontract. Mission Pools did not even respond to Valley Crest's tender of defense. In contrast, National Union did everything it was supposed to do to fulfill its obligations under the terms of the National Union Policy. Mission Pools's contractual duty to defend and indemnify under the Subcontract was triggered by the allegations that Missions Pools's negligence contributed to the damage or loss suffered by the Epps. (*Crawford v. Weather Shield Mfg., Inc.*, *supra*, 44 Cal.4th at pp. 547, 568.) Thus, Mission Pools had an obligation to accept Valley Crest's tender of defense when it was made and to provide Valley Crest a defense at least up to the point at which the trial court granted Mission Pools's motion for summary judgment against the Epps.

In addition, the Subcontract required Mission Pools to obtain and maintain in force a policy of commercial general liability insurance with Valley Crest as an additional insured. In April 2001, Mission Pools obtained a commercial general liability policy issued by The Insurance Corporation of New York (ICNY). In May 2008, Valley Crest made a tender of defense to ICNY under the ICNY policy. ICNY declined the tender on the ground that the policy was cancelled as of April 1, 2004, and an injury caused by an occurrence during the policy period was needed to trigger coverage.

The failure by Mission Pools to maintain the insurance required by the Subcontract did not cause the loss; that is, the damages incurred as a result of Epp's

injuries. (See *Patent Scaffolding Co. v. William Simpson Constr. Co.* (1967) 256 Cal.App.2d 506, 512 (*Patent Scaffolding*) [insurer's loss was not caused by the contractor's failure to obtain insurance or to indemnify].) But Mission Pools's failure to fulfill its obligation to maintain insurance supports a finding that National Union was in the superior equitable position. (*Interstate Fire*, *supra*, 182 Cal.App.4th at p. 47.)

Mission Pools argues that we should consider the fact that Valley Crest's motion for summary judgment was denied only because Valley Crest had failed to object properly to evidence that French gray plaster had been used to surface the pool. Mission Pools properly objected to that evidence and its objections were sustained, leading to summary adjudication in its favor. The trial court denied Mission Pools's motion for summary judgment as against Valley Crest's cross-complaint only because Valley Crest's motion for summary judgment was denied. Mission Pools raises a valid point: why should it pay for Valley Crest's litigation mistakes? Though valid, the point is not persuasive because the problem with objections would not have arisen if Mission Pools had fulfilled its contractual obligation and accepted Valley Crest's tender of defense in the first place.

F. *The* Patent Scaffolding *Opinion*

Finally, we address *Patent Scaffolding*, *supra*, 256 Cal.App.2d 506, on which Mission Pools heavily relies. In *Patent Scaffolding*, a subcontractor was hired by a general contractor to perform certain work on a building. (*Id.* at p. 508.) Their contract required the general contractor to obtain fire insurance on the subcontractor's property at the job site, but the general contractor failed to do so. (*Ibid.*) A fire of unknown origin destroyed some of the subcontractor's property. (*Ibid.*) The subcontractor's fire insurers paid the subcontractor for the loss and sought to subrogate to the subcontractor's rights against the general contractor for its failure to obtain insurance. (*Ibid.*) The trial court permitted subrogation on the ground that the general contractor had agreed not only to

obtain fire insurance but also to indemnify the subcontractor against fire loss (despite the absence of an express indemnification provision in the contract). (*Id.* at pp. 508-509.)

The Court of Appeal reversed, holding that the insurers were not entitled to subrogation because the general contractor did not cause the fire and the insurers were merely paying a loss that they had agreed to insure. (*Patent Scaffolding*, *supra*, 256 Cal.App.2d at p. 512.) The Court of Appeal explained: "The insurers' loss was not caused by [the general contractor]'s failure to get insurance or to indemnify [the subcontractor]. The insurers' loss was caused by the fire, the very risk which each assumed, and [the general contractor]'s failure to perform its contractual duty had nothing to do with the fire." (*Ibid.*) The court held that when "two parties are contractually bound by independent contracts to indemnify the same person for the same loss, the payment by one of them to his indemnitee does not create in him equities superior to the nonpaying indemnitor, justifying subrogation, if the latter did not cause or participate in causing the loss." (*Id.* at p. 514.) The court added that "[i]f subrogation were permitted, the insurers who have accepted premiums to cover the very loss which occurred receive a windfall." (*Id.* at p. 516.)

Mission Pools argues *Patent Scaffolding* is analogous to this case because Mission Pools (the indemnitor) did not cause the loss while the National Union (the insurer) accepted premiums to cover the loss. But, as explained in *Interstate Fire*, *supra*, 182 Cal.App.4th at page 39: "(1) *Patent Scaffolding* did not involve a situation where, as here, the defendant *was* alleged to have caused the loss; (2) even where the defendant has not caused the loss, the equities may support the insurer where, as here, the defendant expressly promised to indemnify (not just to obtain insurance) in a contract related to the project from which the underlying loss occurred; and (3) the insurer's receipt of premiums to cover the type of loss that occurred, although a factor to be considered, does not preclude it from being in an equitably superior position to another party that contractually agreed to indemnify." The same distinctions pertain to this case. Here,

Mission Pools was alleged to have contributed to the loss, and, although ultimately exonerated, failed to fulfill its obligation under the indemnity provision of the Subcontract to accept Valley Crest's tender of defense and its obligation to maintain additional insurance.

Age and subsequent appellate court opinions have not been kind to *Patent Scaffolding*. In *Pylon, Inc. v. Olympic Ins. Co.* (1969) 271 Cal.App.2d 643, 651, decided just two years after *Patent Scaffolding*, the Court of Appeal cautioned that "[t]he holding in the *Patent Scaffolding* case does not constitute a rule applicable to every situation in which an insurer of an indemnitee seeks to hold the contractor-indemnitor on an indemnity contract." The Court of Appeal in *Fireman's Fund Ins. Co. v. Wilshire Film Ventures, Inc.* (1997) 52 Cal.App.4th 553, 557, criticized *Patent Scaffolding* as precluding subrogation in any case in which the defendant/indemnitor's negligence is not the cause of the insured's loss, "a result inconsistent with the rule articulated in *Patent Scaffolding* itself and the cases on which it relies." The Court of Appeal in *Interstate Fire* criticized *Patent Scaffolding* on the ground its holding rewarded the party that refused to fulfill its indemnification obligations. (*Interstate Fire*, *supra*, 182 Cal.App.4th at p. 47.) The better policy, the *Interstate Fire* court explained, is to permit subrogation for an insurer that fulfilled its contractual obligations, even if the result was a windfall for the insurer. (*Ibid.*) To whatever extent *Patent Scaffolding* might be relevant here, we decline to follow it.

III.

Jury Trial on Valley Crest's Express Indemnity Claim

Mission Pools argues the trial court erred by denying it a jury trial on Valley Crest's express indemnity claim. The trial court concluded Mission Pools was not entitled to a jury trial on the express indemnity claim because Valley Crest was seeking the equitable remedy of specific performance. The trial court erred. The effect of our

reversal of this portion of the judgment is a remand for a jury trial on the issue of damages on Valley Crest's claim for express indemnity.

A. *Legal Remedy Sought in the First Amended Cross-complaint*

The form of relief sought in the complaint is a reliable indicator whether the action is legal or equitable. (*Martin v. County of Los Angeles* (1996) 51 Cal.App.4th 688, 694.) "'Actions at law *usually* seek a money judgment for damages, while equitable actions seek some form of specific relief and equity decrees are *usually* in personam.'" (*Id.* at pp. 695-696.)

In the express indemnity claim, Valley Crest alleged Mission Pools breached the terms of the indemnity provision of the Subcontract. As a remedy for breach, Valley Crest did not seek a decree of specific performance of the Subcontract. Instead, Valley Crest sought money damages in the form of "reimbursement" of the amounts of $419,064.93 in attorney fees and costs, $50,000 contributed to the settlement with the Epps, and $202,096.61 in attorney fees and costs paid to CPH. By seeking, in effect, money damages, Valley Crest's express indemnity claim was decidedly legal. No decree of specific performance appears in the judgment, which is a judgment for money damages.

In addition, the first amended cross-complaint did not allege inadequacy of legal remedy, which is necessary for specific performance. (5 Witkin, Cal. Procedure (5th ed. 2008) Pleading, § 803, p. 219.) "The basic rule is that governing equitable relief generally, i.e., specific performance will be granted only when the legal remedy, such as an action for damages, is inadequate." (13 Witkin, Summary of Cal. Law (10th ed. 2005) Equity, § 24, p. 312.) By alleging, down to the penny, the precise amount of money sought to be recovered from Mission Pools, the first amended cross-complaint disclosed the legal remedy of damages was adequate. Because Valley Crest had an adequate legal

remedy, it was not entitled to specific performance. (*Canova v. Trustees of Imperial Irrigation Dist. Employee Pension Plan* (2007) 150 Cal.App.4th 1487, 1497.)

B. *No Waiver or Forfeiture of Jury Trial*

Valley Crest argues that Mission Pools waived any right it might have had to a jury trial by failing to object, or by making an ambiguous objection, when the trial court announced its tentative decision to hold a bench trial on the express indemnity claim. Valley Crest misconstrues the law and the record. Section 631, subdivision (f) lists the six ways by which a party can waive a jury trial.[4] Of these, only No. (3)—oral consent in open court—is arguably relevant. Mission Pools did not consent to a bench trial, and, in any case, such consent does not appear in the minutes.

On April 24, 2013, after the first phase of trial had been completed, the trial court asked counsel to address whether the express indemnity claim should be tried to a jury or to the court. After a lengthy discussion covering 30 pages of the reporter's transcript, the trial court decided to conduct a bench trial. During the course of the discussion, counsel for Mission Pools argued that Valley Crest failed to seek specific performance in its cross-complaint and "whether the fees are reasonable and necessary would be and . . . were of necessity would be a question for the jury." Counsel for Mission Pools argued the relief sought by Valley Crest was "not something that would typically be envisioned under specific performance" and Valley Crest had an adequate

[4] Section 631, subdivision (f) reads: "A party waives trial by jury in any of the following ways: [¶] (1) By failing to appear at the trial. [¶] (2) By written consent filed with the clerk or judge. [¶] (3) By oral consent, in open court, entered in the minutes. [¶] (4) By failing to announce that a jury is required, at the time the cause is first set for trial, if it is set upon notice or stipulation, or within five days after notice of setting if it is set without notice or stipulation. [¶] (5) By failing to timely pay the fee described in subdivision (b), unless another party on the same side of the case has paid that fee. [¶] (6) By failing to deposit with the clerk or judge, at the beginning of the second and each succeeding day's session, the sum provided in subdivision (e)."

remedy at law. On this record, Mission Pools did not consent to waiver of a jury trial; moreover, the court minutes of April 24, 2013 do not include any such consent.

Denial of the right to a jury trial is reversible error per se, and no showing of prejudice is required of a party who lost at trial. (*Martin v. County of Los Angeles*, *supra*, 51 Cal.App.4th at p. 698; see *Villano v. Waterman Convalescent Hospital, Inc.* (2010) 181 Cal.App.4th 1189, 1205.) The judgment as to Valley Crest's express indemnity claim is therefore reversed and the matter remanded for further proceedings.

DISPOSITION

The judgment is reversed and the matter is remanded with respect to Valley Crest's claim for express indemnity. In all other respects, the judgment is affirmed. In the interest of justice, no party shall recover costs on appeal.

FYBEL, J.

WE CONCUR:

ARONSON, ACTING P. J.

IKOLA, J.

Filed 7/2/15

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

VALLEY CREST LANDSCAPE DEVELOPMENT, INC.,

Cross-complainant and Respondent,

v.

MISSION POOLS OF ESCONDIDO, INC.,

Cross-defendant and Appellant;

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,

Intervener and Respondent.

G049060

(Super. Ct. No. 30-2008-00104227)

ORDER CERTIFYING OPINION FOR PUBLICATION

On the court's own motion, the above entitled unpublished opinion, filed June 26, 2015, is certified for publication in the Official Reports. The opinion meets the standards for publication set forth in California Rules of Court, rule 8.1105(c)(2), (3), and (7).

FYBEL, J.

WE CONCUR:

ARONSON, ACTING P. J.

IKOLA, J.

“2”

Filed 2/22/10

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

INTERSTATE FIRE AND CASUALTY INSURANCE COMPANY, Plaintiff and Appellant, v. CLEVELAND WRECKING COMPANY, Defendant and Respondent.	A124920 (San Francisco County Super. Ct. No. 475134)

Interstate Fire and Casualty Insurance Company (Interstate) appeals from a judgment entered after the court sustained, without leave to amend, a demurrer to Interstate's amended complaint against Cleveland Wrecking Company (Cleveland). Interstate contends the court erred because: (1) its subrogation complaint, based on its insured's contractual indemnification claim against Cleveland, was not barred by Cleveland's good faith settlement in the underlying litigation; and (2) Cleveland's equities were not equal to or superior to those of Interstate as a matter of law. We agree with Interstate, and the judgment and the order sustaining the demurrer will be reversed.

I. *FACTS AND PROCEDURAL HISTORY*

We derive the relevant facts from the allegations of the operative pleading, Interstate's first amended complaint.

A. *The Parties and the Underlying* Frisby *Litigation*

Webcor Construction, Inc. (Webcor) was the general contractor for a construction project in San Francisco. Cleveland Wrecking Company (Cleveland) was a subcontractor responsible for certain demolition work. Delta Steel Erectors (Delta) was a subcontractor engaged in the installation of steel stairways.

Cleveland and Delta each entered into similar subcontracts with Webcor, by which they undertook to indemnify Webcor for liability arising out of their work and to procure general liability insurance with Webcor as an additional insured.

In particular, section 15.1.1 of the agreement between Webcor and Cleveland (the Agreement) obligated Cleveland to indemnify "Contractor" (Webcor), to the extent set forth therein, from "claims, demands, causes of action, damages, costs, expenses, actual attorney's fees, losses or liability, in law or in equity, of every kind and nature whatsoever ('Claims') arising out of or in connection with Subcontractor's operations to be performed under this Agreement for, but not limited to . . . Personal injury . . . caused or alleged to be caused in whole or in part by any negligent act or omission of Subcontractor [Cleveland]." Under section 15.1.2, Cleveland was required to, at its "own cost, expense and risk, defend all Claims as defined in Section 15.1.1" by third parties, pay any judgment, and reimburse Webcor and certain others for legal expenses they incurred.

Although both Cleveland and Delta had agreed to procure liability insurance with Webcor as an additional insured, only Delta complied with the obligation. Interstate issued to Delta a written commercial general liability policy in effect from July 1, 2003, to July 1, 2004. Webcor was an additional insured.

1. *Frisby's Injury*

On April 29, 2004, Cleveland's employees were moving debris to an area where it could be loaded onto trucks. They had been warned that Delta's employees were working in areas below them, and that Delta's employees were being showered by debris dislodged by Cleveland's operations. One of Delta's employees, ironworker Thelbert Allen Frisby (Frisby), was working in a stairwell below an opening in the floor on which Cleveland's employees were moving the debris.

To move the debris, Cleveland's Bobcat operator drove a loader bucket into the pile of debris, and then backed up with the load to move it. This repeated process moved the pile of debris closer to the opening and ultimately into a slab grabber, which became

dislodged and fell into the opening where Frisby was working. The slab grabber struck Frisby and caused significant injury.

2. *Frisby's Complaint*

Frisby filed a workers' compensation claim against his employer Delta. In addition, he filed a lawsuit against Webcor and Cleveland in San Francisco Superior Court.

In *Frisby v. Cleveland Wrecking Company et al*., San Francisco Superior Court Case No. CGC-05440636, Frisby sought to recover for personal injuries he sustained in the accident, alleging a cause of action against Cleveland for negligence and causes of action against Webcor for negligence, premises liability, and negligent provision of unsafe equipment. Among other things, Frisby alleged that Cleveland breached its duty to perform work in a safe manner by failing to use reasonable care to prevent damage to Frisby, whom it knew or should have known was working in an area below.

3. *Webcor's Tender*

Webcor tendered its defense and indemnification to Cleveland pursuant to the terms of the Agreement. Cleveland rejected the tender. Webcor also tendered its defense and indemnification to Interstate pursuant to the terms of the Interstate-Delta Policy. Interstate accepted it.

4. *Webcor's Cross-Complaint*

Webcor filed a cross-complaint against Cleveland (and Delta) for express indemnification, equitable indemnification, and breach of contract. Webcor thereafter voluntarily dismissed its equitable indemnity and contribution claims with prejudice, but dismissed its cause of action for express indemnity and breach of contract without prejudice. The parties expressly reserved their rights with respect to an Interstate subrogation claim in a separate action.

5. *Settlement of* Frisby

In July 2007, Webcor and Frisby entered into a settlement by which Webcor would pay Frisby $575,000 and Frisby would dismiss his claims against Webcor. The court approved their agreement as a good faith settlement under Code of Civil Procedure

section 877.6. Interstate funded the $575,000 settlement payment and additionally paid over $152,000 for the attorney fees and costs incurred in defending Webcor against Frisby's claims.

Cleveland also entered into a settlement with Frisby, which the court approved as a good faith settlement as well. (Code Civ. Proc., § 877.6.)

B. *The Subrogation Litigation*

In the matter before us, Interstate filed a complaint for subrogation against Cleveland, alleging that Cleveland had breached its contract with Webcor by failing to defend and indemnify Webcor in *Frisby*.

Cleveland filed a general demurrer, contending that Interstate was not entitled to subrogation as a matter of law, because it was not in a superior equitable position to Cleveland, and because Cleveland's alleged breach of contract had not caused any damage. The court sustained the demurrer with leave to amend, allowing Interstate to allege how Cleveland's tortious conduct gave rise to the loss.

In its first amended complaint, Interstate realleged Cleveland's breach of its agreement to defend and indemnify Webcor. Interstate further alleged that Cleveland's negligence was a proximate cause of Frisby's injuries, and that Cleveland had violated its subcontract by failing to obtain insurance covering Webcor. Interstate sought judgment for all amounts it spent to defend against and settle the claims against Webcor in *Frisby*, alleging it was subrogated to Webcor's claims against Cleveland for breach of its express contractual indemnity obligation. Attached to the first amended complaint were the Webcor-Cleveland subcontract and the Interstate-Delta Policy, provision 8 of which set forth a subrogation clause: "If the insured has rights to recover all or part of any payment we have made under this Coverage Part, those rights are transferred to us. The insured must do nothing after loss to impair them. At our request, the insured will bring 'suit' or transfer those rights to us and help us enforce them."

Cleveland filed a general demurrer, again arguing that Interstate lacked the superior equities required for subrogation and that Webcor did not incur damages by Cleveland's alleged breach of the indemnification provision. Cleveland requested

judicial notice of files and records including the good faith settlement order and dismissal in *Frisby*.

The court sustained Cleveland's demurrer without leave to amend. By written order, the court explained: "The good faith settlement in the *Frisby* case cut off Webcor's ability to sue Cleveland for indemnity or contribution for its alleged negligent conduct. At the same time, Webcor has no claim against Cleveland for Cleveland's breach of its duty to defend Webcor because Webcor has sustained no damages as a consequence of the breach. It is for this reason that Interstate's equitable position is not superior to Cleveland's equitable position. [Citations.]"

A judgment of dismissal was entered, and this appeal followed.

II. *DISCUSSION*

Interstate contends the trial court erred in sustaining the demurrer for two reasons: (1) the good faith settlement between Cleveland and Frisby did not bar Interstate from proceeding against Cleveland on a claim for breach of an express contractual indemnification provision; and (2) the court erred in concluding that Webcor suffered no damages from Cleveland's alleged breach of the Agreement and that Interstate's equitable position was therefore not superior to Cleveland's.

In reviewing an order sustaining a demurrer, we assume the truth of all well-pleaded material facts, as well as those facts that may be implied or inferred from the express allegations. (*Blank v. Kirwan* (1985) 39 Cal.3d 311, 318.) We consider as well any matters that may be judicially noticed. (*Ibid*.) We then determine de novo whether the allegations stated any cause of action as a matter of law. (*Ibid*.) Where, as here, the demurrer is sustained without leave to amend, we determine if necessary whether the plaintiff established a reasonable possibility that the defect in the complaint could be cured by amendment. (*Zelig v. County of Los Angeles* (2002) 27 Cal.4th 1112, 1126.)

After a brief review of the nature of subrogation, we address the parties' contentions.

A. *Subrogation*

Subrogation is the "substitution of another person in place of the creditor or claimant to whose rights he or she succeeds in relation to the debt or claim." (*Fireman's Fund Ins. Co. v. Maryland Casualty Co*. (1998) 65 Cal.App.4th 1279, 1291.) "In the case of insurance, subrogation takes the form of an insurer's right to be put in the position of the insured in order to pursue recovery from third parties legally responsible to the insured for a loss which the insurer has both insured and paid. [Citations.]" (*Id*. at pp. 1291-1292.) "The subrogated insurer is said to ' "stand in the shoes" ' of its insured, because it has no greater rights than the insured and is subject to the same defenses assertable against the insured. Thus, an insurer cannot acquire by subrogation anything to which the insured has no rights, and may claim no rights which the insured does not have." (*Id*. at pp. 1292-1293.)

Usually, a general liability insurer that has paid a claim to a third party on behalf of its insured may have an equitable right of subrogation against (1) other parties who contributed to the harm suffered by the third party (joint tortfeasors) under an equitable indemnification theory, and (2) other parties who are legally liable to the insured for the harm suffered by the third party (such as by an indemnification agreement) under a contractual indemnity theory. As we shall see, a good faith settlement will preclude claims based on an equitable indemnity theory but not claims based on a contractual indemnity theory, yet subrogation may not be obtained even as to contractual indemnity claims unless the insurer is in an equitable position superior to that of the defendant.

B. *Effect of Good Faith Settlement*

A determination that a settlement was made in good faith bars the nonsettling defendants from asserting claims against the settling tortfeasor for equitable comparative contribution and partial or comparative indemnity. (Code Civ. Proc., § 877.6, subd. (c).) Because an insurer stands in the shoes of its insured in a subrogation action, the insurer cannot pursue those types of indemnity claims against the settling tortfeasor. (See *Wilshire Ins. Co. v. Tuff Boy Holding, Inc.* (2001) 86 Cal.App.4th 627, 631-633, 640.)

However, a good faith settlement order does not bar a non-settling tortfeasor from asserting an indemnification claim against the settling defendants based on an express contract. (*Bay Development, Ltd. v. Superior Court* (1990) 50 Cal.3d 1012, 1031-1032 [good faith settlement bars claim for implied contractual indemnity, but not express contractual indemnity]; *Plant Insulation Co. v. Fibreboard Corp.* (1990) 224 Cal.App.3d 781, 790; *C.L. Peck Contractors v. Superior Court* (1984) 159 Cal.App.3d 828, 834 ["We hold that an indemnity claim against a codefendant based on express contract survives a good faith [Code of Civil Procedure] section 877.6 settlement"].) Because an insurer stands in the shoes of its insured, the insurer can pursue a cause of action against the settling tortfeasor for breach of an express contractual indemnification clause.

Interstate's first amended complaint against Cleveland sets forth a claim for express contractual indemnity, based on Cleveland's refusal to defend and indemnify Webcor under the terms of the Agreement. The claim is not barred by the good faith settlement determination.

Cleveland argues that Interstate's claim for express contractual indemnity does not seek damages resulting from Cleveland's alleged contractual breach, but rather seeks to recover tort damages resulting from Cleveland's alleged negligence, a liability precluded by the good faith settlement order under Code of Civil Procedure section 877.6. Cleveland is incorrect. As discussed *post*, Interstate's allegations concerning Cleveland's negligence pertains neither to the legal theory of the indemnity claim nor the amount or nature of the damages alleged, but to the respective equities of the parties. The good faith settlement does not bar Interstate from pursuing its cause of action for express contractual indemnification against Cleveland.[1]

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[1] The trial court did not expressly rule that the good faith settlement barred Interstate from proceeding against Cleveland on a claim for breach of an express indemnification provision. It ruled that the good faith settlement "cut off Webcor'[s] ability to sue Cleveland for indemnity or contribution *for its alleged negligent conduct*." (Italics added.) To the extent the court meant that Interstate's new allegations about Cleveland's tortious conduct did not entitle it to subrogate to any claim for *equitable* indemnification, it was correct. However, the fact that Interstate was clearly purporting

C. *Elements of Subrogation*

"The essential elements of an insurer's cause of action for equitable subrogation are as follows: [1] the insured suffered a loss for which the defendant is liable, either as the wrongdoer whose act or omission caused the loss or because the defendant is legally responsible to the insured for the loss caused by the wrongdoer; [2] the claimed loss was one for which the insurer was *not* primarily liable; [3] the insurer has compensated the insured in whole or in part for the same loss for which the defendant is primarily liable; [4] the insurer has paid the claim of its insured to protect its own interest and not as a volunteer; [5] the insured has an existing, assignable cause of action against the defendant which the insured could have asserted for its own benefit had it not been compensated for its loss by the insurer; [6] the insurer has suffered damages caused by the act or omission upon which the liability of the defendant depends; [7] justice requires that the loss be entirely shifted from the insurer to the defendant, whose equitable position is inferior to that of the insurer; and [8] the insurer's damages are in a liquidated sum, generally the amount paid to the insured." (*Fireman's Fund Ins. Co. v. Maryland Cas. Co., supra,* 65 Cal.App.4th at p. 1292.)

Cleveland contends that all but the fourth and eighth elements are not met, based largely on its specious contention that Webcor suffered no damages from Cleveland's alleged breach of the Agreement. We address each of the disputed elements in turn.

1. The Insured Webcor Suffered a Loss for which Defendant Cleveland is Liable

According to the allegations of the first amended complaint, Webcor suffered a loss in defending against the *Frisby* litigation and incurring the *Frisby* settlement. It is further alleged that Cleveland is legally responsible to Webcor for that loss under the terms of the indemnification provision in the Agreement. These allegations satisfy this first element of a subrogation claim.

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to subrogate to Webcor's right to *contractual* indemnification required the trial court – and now requires this court – to determine whether subrogation is unavailable as a matter of law on other grounds.

Cleveland contends Webcor did not actually suffer any loss, because Interstate paid the costs of defending against and settling Frisby's claims. Because Interstate paid these costs, Cleveland concludes, Interstate cannot subrogate to recover them.

Cleveland's position is untenable. The only reason Webcor had no out-of-pocket expense was because its insurer, now seeking subrogation, made the payment. Under Cleveland's view, no insurer could *ever* state a cause of action for subrogation in order to recover amounts it paid on behalf of its insured, because of the very fact that it had paid amounts on behalf of its insured. Not only is this illogical, it contradicts decades of cases consistently holding that an insurer may be equitably subrogated to its insured's indemnification claims. (See, e.g., *Rossmoor Sanitation, Inc. v. Pylon, Inc*. (1975) 13 Cal.3d 622, 634 (*Rossmoor*) [landowner's insurer was subrogated to the landowner's right of express contractual indemnification against a contractor, where the insurer had paid the judgment for the landowner]; *Truck Ins. Exchange v. County of Los Angeles* (2002) 95 Cal.App.4th 13, 27 (*Truck*) [hospital's insurer, which incurred defense costs on hospital's behalf, was subrogated to hospital's cause of action against county for express contractual indemnity].)[2] Indeed, the insurer's right to subrogation does not even arise *unless* it has paid for its insured's loss. (*Smith v. Parks Manor* (1987) 197 Cal.App.3d 872, 878-879 [where insurer reached a settlement agreement on behalf of its insured to pay the injured parties, the insured at that point had suffered a loss, the insurer was subrogated to the insured's rights upon payment of the settlement, and it was "not necessary for [the insured] actually to pay the settlement sum out-of-pocket, then secure reimbursement, to suffer a loss"].)

Cleveland's argument apparently stems from a faulty reading of *Bramalea California, Inc. v. Reliable Interiors, Inc.* (2004) 119 Cal.App.4th 468 (*Bramalea*) and *Patent Scaffolding Co. v. William Simpson Constr. Co.* (1967) 256 Cal.App.2d 506

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[2] Cleveland contends that *Truck* and *Rossmoor* are inapplicable because they did not involve good faith settlements. However, Cleveland does not explain why this distinction would make any difference. A good faith settlement might bar an equitable indemnity claim, but not an express contractual indemnity claim. Furthermore, even though Webcor incurred its loss by way of a good faith settlement, it still incurred its loss.

(*Patent Scaffolding*). Cleveland cites these cases for the proposition that the collateral source rule (which permits a plaintiff to recover against tortfeasors even though it has been compensated by its insurer) applied only to a plaintiff's tort claims, and not to contract claims like the one asserted by Interstate. The collateral source rule, however, pertains to whether an *insured* may recover on its own behalf. (*Bramalea*, at p. 473 [insured could not recover in contract from third party where loss compensated by insurer].) It has nothing to do with whether the *insurer* can recover in subrogation on its insured's contractual indemnification claim. In fact, after the court in *Patent Scaffolding* discussed, as an unnecessary aside, that the insured could not invoke the collateral source rule, the court returned to the subrogation issue before it: "*Insurers' Equitable Subrogation* [¶] The fact alone that Patent could not recover from Simpson because Patent suffered no loss *does not defeat the insurers' subrogation rights*." (*Patent Scaffolding*, at p. 511, italics added.)[3]

2. *The Loss Was One for which the Insurer Was Not Primarily Liable*

The "loss," for purposes of this analysis, is the amount incurred in defending Webcor and settling Frisby's claims against Webcor. The liability for this amount was arguably on the shoulders of Cleveland (under the Agreement), Delta (under the Webcor-Delta contract), and Interstate (under the Interstate-Delta policy, with Webcor as an additional insured). In its first amended complaint, however, Interstate alleged: "*Cleveland* is *solely* responsible for the costs of defense and settlement of Frisby's claims against Webcor." (Italics added.) Cleveland does not demonstrate that another allegation, or any other matter subject to consideration at the demurrer stage, establishes that Interstate was primarily liable for the loss.

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[3] Another way to look at the situation is this: Interstate's payment to Frisby and payment for Webcor's defense simultaneously satisfied both the first element of a subrogation claim (Webcor's loss) *and* the third element (Interstate's reimbursement of Webcor for the loss). Cleveland's insistence that Webcor suffered no loss because Interstate paid Frisby, and Interstate therefore suffered no loss because it stands in the shoes of its insured, is circular and erroneous.

Cleveland's only argument on this point is that Delta and Cleveland did not bear "more or less primary liability than the other," since both of them had entered into contracts by which they were obligated to defend and indemnify Webcor. Cleveland has not demonstrated why that would make Interstate *primarily* liable. For purposes of Cleveland's demurrer, this element of subrogation was met.

3. *The Insurer Compensated the Insured for the Loss*

Interstate compensated Webcor for the defense and settlement in *Frisby*, by paying Frisby and Webcor's attorneys. Cleveland nonetheless argues that Interstate made those payments because of its obligations under the Interstate-Delta insurance policy, and not because of Cleveland's contractual breach of the indemnification provision or its alleged negligence in causing Frisby's injuries. However, regardless of why Interstate made the payments, it made the payments. Indeed, it can always be said that an insurer has compensated its insured because it had to under its insurance policy. Cleveland provides no authority for its suggestion that subrogation must be denied on this ground.

4. *The Insured Has a Cause of Action Against the Defendant*

This element asks whether Webcor would have an assignable cause of action against Cleveland "had it not been compensated for its loss" by Interstate. (*Fireman's Fund Ins. Co. v. Maryland Cas. Co*., *supra*, 65 Cal.App.4th at p. 1292.) The first amended complaint satisfies this element, alleging that, under the terms of the Webcor-Cleveland contract, Cleveland had a duty to defend and indemnify Webcor, and it breached that duty by failing to do so. Webcor could have pursued a cause of action against Cleveland had Interstate not made the payments, and there is no contention the cause of action is of a type that cannot be assigned.

Cleveland urges that Webcor does not have an existing cause of action against Cleveland because Webcor has already been fully compensated by Interstate. This argument is of course wrong, not only for the reasons stated above, but also because it is directly contradicted by the wording of the subrogation element itself. The element – even as described in Cleveland's own brief – asks whether the insured has a cause of action against the defendant which it could have asserted "had it *not* been compensated

for its loss by the insurer." (Italics added.) (See *Fireman's Fund Inc. Co. v. Maryland Cas. Co*., *supra*, 65 Cal.App.4th at p. 1292.)

5. *The Insurer Suffered Damages Arising from the Defendant's Act or Omission*

Interstate has suffered damages by Cleveland's failure to indemnify Webcor for its costs of defense and settlement payment to Frisby. If Cleveland had made the payments, Interstate would not have had to make them.

Cleveland argues that Interstate has not actually suffered damages, because Interstate was obligated to defend and indemnify Webcor anyway under the terms of the insurance policy. However, this merely reflects Cleveland's view that Interstate should have to pay, while Webcor alleges that Cleveland should pay. The fact that both Interstate and Cleveland were contractually obligated to defend and indemnify Webcor in the *Frisby* litigation gives rise to the question of which of them is in a superior equitable position to the other. We address that issue next.[4]

6. *The Insurer's Superior Equitable Position*

This element asks whether it is fair to shift the entire loss from Interstate to Cleveland, because Interstate's equitable position is superior to Cleveland's. Based on the allegations of the first amended complaint in this case, it can reasonably be inferred that Interstate's equitable position is superior to that of Cleveland.

Cleveland, which had the burden in its demurrer to show that Interstate cannot establish superior equities as a matter of law, relies on a number of cases including *Meyers v. Bank of America etc*. (1938) 11 Cal.2d 92 and *Patent Scaffolding*, *supra*, 256 Cal.App.2d 506. We summarize these two cases as a starting point, and conclude that neither they nor the other cases on which Cleveland relies support Cleveland's arguments.

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[4] At oral argument, Cleveland noted that Interstate's insurance was stated to be primary insurance. The specification of *insurance* as primary with respect to other potential competing insurance policies does not in itself mean that the insurer's obligation to the insured kicks in before or notwithstanding the contractual *indemnification* obligations of a third-party such as Cleveland.

In *Meyers*, an office manager obtained possession of checks payable to Meyers, forged them for his own use, and negotiated them with an individual defendant. The individual defendant in turn deposited them with the defendant bank, which accepted them. (*Meyers*, *supra*, 11 Cal.2d at p. 93.) Meyers was indemnified for his loss under a bond issued by his surety, and the surety pursued the bank in subrogation. (*Id*. at p. 94.) The court ruled that the surety could not recover: "[T]he right to maintain an action of this kind and to a recovery thereunder involves a consideration of, and must necessarily depend upon the respective equities of the parties. Here, the indemnitor [the surety company] has discharged its primary contract liability. It has paid what it contracted to pay, and has retained to its own use the premiums and benefits of such contract. It now seeks to recover from the bank the amount thus paid. It must be conceded that the bank is an innocent third party, and its duty to the employer was based upon an entirely different theory of contract [not disclosed in the opinion], with which the indemnitor was not in privity. *Neither the indemnitor nor the bank was the wrongdoer*, but by independent contract obligation each was liable to the employer. In equity, it cannot be said that the satisfaction by the bonding company of its primary liability should entitle it to recover against the bank upon a totally different liability. The bank, not being a wrongdoer, but in the ordinary course of banking business, paid money upon these checks, the genuineness of which it had no reason to doubt, and from which it received no benefits. The primary cause of the loss was the forgeries committed by the employee, whose integrity was at least impliedly vouched for by his employer to the bank. We cannot say that as between the bank and the paid indemnitor [the surety], the bank should stand the loss." (*Id*. at pp. 102-103, italics added.)

Meyers is not on point. In that case, the bank played no part in the underlying loss, and there is no indication that the bank's alleged contractual liability to Meyers was an express contractual obligation to indemnify Meyers for such a loss. The alleged facts in the matter before us are just the opposite: Cleveland *did* allegedly contribute to the underlying loss (by negligently causing Frisby's injuries), and Cleveland *was* allegedly contractually obligated to indemnify Webcor for the loss.

A little closer to our case, but still plainly distinguishable, is *Patent Scaffolding*. There, a subcontractor (Patent) was hired by a general contractor (Simpson) to perform certain work on a building. (*Patent Scaffolding*, *supra*, 256 Cal.App.2d at p. 508.) Their contract required Simpson to obtain fire insurance on Patent's property at the job site, but Simpson failed to do so. (*Ibid*.) A fire of unknown origin destroyed Patent's property. (*Ibid*.) Patent's own fire insurers paid Patent for the loss, and then sought to subrogate to Patent's rights against Simpson for the latter's failure to obtain the insurance. (*Ibid*.) The trial court permitted subrogation, finding that Simpson had agreed not only to obtain fire insurance but also to indemnify Patent against fire loss (despite the absence of an express indemnification provision in the contract). (*Id*. at pp. 508-509.)

The Court of Appeal reversed, holding that the insurers were not entitled to subrogation because Simpson did not cause the fire and the insurers were merely paying a loss that they had agreed to insure. The court explained: "The insurers' loss was not caused by Simpson's failure to get insurance or to indemnify Patent. The insurers' loss was caused by the fire, the very risk which each assumed, and Simpson's failure to perform its contractual duty had nothing to do with the fire." (*Patent Scaffolding*, *supra*, 256 Cal.App.2d at p. 512.) The court held: when "two parties are contractually bound by independent contracts to indemnify the same person for the same loss, the payment by one of them to his indemnitee does not create in him equities superior to the nonpaying indemnitor, justifying subrogation, if the latter did not cause or participate in causing the loss." (*Id*. at p. 514.)

Under *Patent Scaffolding* and its progeny, Cleveland urges, Interstate is precluded from subrogation. Specifically, Cleveland argues, Interstate's loss was not caused by Cleveland's failure to defend, indemnify, or obtain insurance for Webcor, but by the lawsuit Frisby brought for his injuries at the job site, which was one of the specific risks that Interstate accepted premiums to cover.

Patent Scaffolding supports neither Cleveland's argument nor the trial court's decision in this case, for three reasons: (1) *Patent Scaffolding* did not involve a situation where, as here, the defendant *was* alleged to have caused the loss; (2) even where the

defendant has not caused the loss, the equities may support the insurer where, as here, the defendant expressly promised to indemnify (not just to obtain insurance) in a contract related to the project from which the underlying loss occurred; and (3) the insurer's receipt of premiums to cover the type of loss that occurred, although a factor to be considered, does not preclude it from being in an equitably superior position to another party that contractually agreed to indemnify.

a. *Additional allegations that Cleveland caused the loss*

Unlike the proposed indemnitor in *Patent Scaffolding*, Cleveland is not only alleged to be liable for the loss under a contractual provision, it is also alleged to have *caused* the loss. Cleveland's alleged negligence toward Frisby is relevant to the respective equities of Interstate and Cleveland.

Instructive in this regard is *Pylon, Inc. v. Olympic Ins. Co.* (1969) 271 Cal.App.2d 643 (*Pylon*), decided just two years after *Patent Scaffolding*. The court in *Pylon* stated: "The holding in the *Patent Scaffolding* case does not constitute a rule applicable to every situation in which an insurer of an indemnitee seeks to hold the contractor-indemnitor on an indemnity contract." (*Pylon*, at p. 651.) The *Pylon* court cited our Supreme Court's decision in *Harvey Machine Co. v. Hatzel & Buehler, Inc*. (1960) 54 Cal.2d 445, in which the defendants had agreed in a construction contract to indemnify a landowner for any liability imposed against the landowner, including for injuries to the defendants' employees. One of the defendants' employees was thereafter injured and sued the landowner. The landowner *and its liability insurance carrier* sued the defendants; defendants were held obligated to indemnify the plaintiffs under the *contractual* indemnification provision. The *Pylon* court observed: "The *Harvey Machine Co.* case clearly holds that the insurance carrier of an indemnitee is subrogated to the right of the latter to obtain indemnification for loss paid by the carrier from *an indemnitor whose active negligence, operating concurrently with the negligence of the indemnitee, caused the loss*." (*Pylon, supra*, 271 Cal.App.2d at p. 652, italics added.) *Pylon*, therefore, teaches that an insurer is subrogated to its insured's express contractual indemnity claim

against a party who contributed toward the underlying loss, despite *Patent Scaffolding*. That is the situation alleged here.

Of additional and much more recent guidance is *Truck, supra,* 95 Cal.App.4th 13. There, a county and a hospital (Santa Marta) entered into an agreement by which Santa Marta would provide services for patients referred by the county. The county agreed, among other things, to refer only low-risk patients and further agreed to indemnify Santa Marta for claims or damages. (*Id*. at p. 16.) The county later referred a high-risk patient, Panduro, to Santa Marta, who was injured, as was her baby, during a breech birth. The Panduros sued the county and Santa Marta for her injuries. (*Ibid*.) The county refused to defend Santa Marta, so Santa Marta's insurer (Truck) provided a defense. (*Id*. at p. 17.) The jury found that the county was negligent in causing the Panduros' injuries, but Santa Marta was not. (*Ibid*.) Truck thereafter sued the county in subrogation, based on the county's contractual obligation to indemnify and defend Santa Marta in the medical malpractice action. (*Id*. at p. 18.)

On appeal, the court held that Truck was entitled to equitable subrogation, because the county had caused the underlying loss. "County's negligent referral of a high-risk patient to Santa Marta resulted in injury to the Panduros, precipitated the Panduros' lawsuit against County and Santa Marta, and made it necessary for Santa Marta to incur defense costs. Since Santa Marta was not at fault and County's misconduct was a substantial factor in causing Santa Marta to incur defense costs, we conclude that County is primarily liable and equitably should bear the entire obligation. We therefore conclude that Truck has established a right of subrogation against County subject to any applicable defenses that County may have." (*Truck, supra,* 95 Cal.App.4th at p. 27.)

As applied here, the first amended complaint alleges that Cleveland's negligence caused Frisby's lawsuit, and precipitated the lawsuit against Webcor and Cleveland, which made it necessary for Webcor to incur the costs of defense and settlement. Since it is not alleged that Interstate (or even Webcor) was at fault, the allegations of the first amended complaint give rise to the inference that Cleveland should cover Webcor's defense and settlement costs.

There is, of course, a distinction between the circumstances of *Truck* and the facts of this case. *Truck* was decided after a trial had determined that the insured (Santa Marta) was not negligent and the proposed indemnitor (county) was negligent. By contrast, this case comes after a pair of good faith settlements in which the insured (Webcor) and the proposed indemnitor (Cleveland) each settled in purported relation to their respective degrees of liability. We must ask, therefore, whether the procedural posture of this case compels an analysis or result different from that in *Truck.* In particular, is it appropriate to consider the extent to which Cleveland *tortiously* caused the loss (which would ordinarily be the subject of a claim for equitable indemnity), in determining whether Cleveland may be held liable for the loss under a subrogated claim for *contractual* indemnity, where the parties have already indicated by good faith settlements their proportionate culpability for the underlying injuries to Frisby?

First, it must be emphasized – contrary to Cleveland's protestations – that Interstate's allegations of Cleveland's negligence are not being used to assert an equitable indemnity claim. The only consideration of the extent to which Cleveland caused the underlying loss (i.e. its alleged negligence in causing Frisby's injuries) is to determine whether the equities tip in Interstate's favor, so that Interstate may pursue in subrogation a contractual indemnity claim. In other words, Interstate's indemnity claim is based solely on Cleveland's contractual obligations (the indemnity provision), Cleveland's breach of contract (not providing or paying for a defense or the settlement of Webcor's liability in *Frisby*), and the resulting contractual damages (the costs of defending against and settling Frisby's claims against Webcor).[5]

Second, we see no reason that Cleveland's alleged negligence in causing the loss should be ignored in determining the respective equities of the parties, simply because Interstate is seeking to subrogate to a contractual indemnity claim rather than an equitable

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[5] Nor are the allegations of Cleveland's negligence being used to ascertain the extent of Cleveland's duty of contractual indemnity, which must be determined from the contract rather than reliance on the doctrine of equitable indemnity. (*Rossmoor, supra,* 13 Cal.3d at p. 628.)

indemnity claim. The court in *Truck* considered the county's negligence in permitting the insurer to pursue the county on a contractual indemnification claim. Consideration of Cleveland's alleged causation of the underlying loss is entirely consistent with the fundamental proposition set forth in every relevant case the parties have cited: the party more responsible for the loss, or in a better position to avoid it, should bear the loss.

Third, we recognize that the good faith settlement order in the underlying case determined that the amount Cleveland paid to Frisby to settle the case was sufficiently proportionate to Cleveland's *tort* liability to Frisby. Notwithstanding its good faith settlement, however, Cleveland should have appreciated the risk that this litigation would ensue, because a good faith settlement order does not bar contractual indemnity claims.[6]

In the final analysis, consistent with authorities such as *Patent Scaffolding*, *Pylon*, and *Truck*, Interstate's allegations that Cleveland caused the injuries giving rise to the loss supports the inference that Interstate's equitable position is superior to Cleveland's.

b. *The nature and context of the parties' promises to indemnify*

Aside from Cleveland's alleged cause of the underlying loss, another factor in the comparison of Interstate's and Cleveland's equities relates to the nature and context of their respective agreements to indemnify Webcor. While Cleveland agreed to indemnify Webcor in the subcontractor agreement pertaining to the project from which the underlying injury arose, Interstate was a third-party insurer uninvolved in the project.

In *Fireman's Fund Ins. Co. v. Wilshire Film Ventures, Inc.* (1997) 52 Cal.App.4th 553 (*Wilshire*), Wilshire Film Ventures, Inc. (Wilshire) leased camera equipment from Leonetti Company (Leonetti), under an agreement requiring Wilshire to return the

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[6] Cleveland asserts that the good faith settlement cuts off Cleveland's tort liability and precludes a finding that Cleveland was primarily responsible for Frisby's injuries or that Delta or Webcor was not primarily responsible for them. It cites to an order in *Frisby* simply providing that Webcor's and Cleveland's good faith settlement motions, being unopposed, were granted. Neither the order nor allegations in *Frisby* that Webcor contributed to the injuries demonstrate dispositively that Webcor was the primary cause of harm. On this record, Cleveland's conclusory assertion, unsupported by relevant legal authorities or record citations, does not establish that the good faith settlements preclude Interstate's cause of action as a matter of law.

equipment by a certain date or pay its value. (*Id*. at p. 555 & fn. 1.) Through no fault of Wilshire, burglars broke into a van and stole the equipment while it was on lease to Wilshire. (*Ibid*.) Wilshire refused to pay Leonetti for the equipment. (*Ibid*.) Leonetti submitted a claim to its own insurer (Fireman's Fund), which paid the claim and filed a subrogation action against Wilshire for breach of its contractual obligations. (*Ibid*.) A jury found for Fireman's Fund. (*Ibid*.)

On appeal, Wilshire cited *Patent Scaffolding* and argued that subrogation was inappropriate because Wilshire had not caused the burglary. (*Wilshire, supra,* 52 Cal.App.4th at p. 556.) The Court of Appeal asserted: "Wilshire misses the point." (*Ibid*.) Independent of who caused the burglary, the insurer could pursue its claim against Wilshire.

The court first distinguished *Patent Scaffolding*, because both parties in that case (the insurer and Simpson) had agreed to indemnify the *same* loss, since both agreed to obtain insurance to cover potential fire damage; but Fireman's Fund and Wilshire had *not* agreed to indemnify the same loss, since Fireman's Fund agreed to provide insurance while Wilshire agreed to pay for the equipment if it did not return it. (*Wilshire, supra,* 52 Cal.App.4th at p. 557.)[7]

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[7] The court in *Wilshire* also explained a shortcoming in the *Patent Scaffolding* reasoning: "The problem with *Patent Scaffolding*'s 'causal connection' approach is that it appears to preclude recovery in any case in which the defendant's negligence is not the cause of the insured's loss, a result inconsistent with the rule articulated in *Patent Scaffolding* itself and the cases on which it relies. As noted at the outset, the first element of a subrogation claim is satisfied if the insurer proves that the insured suffered a loss for which the defendant is liable *either* (a) because the defendant is a wrongdoer whose act or omission caused the loss *or* (b) because the defendant is legally responsible to the insured for the loss causes by the wrongdoer." (*Wilshire, supra*, 52 Cal.App.4th at p. 557.)

We find the reasoning of *Patent Scaffolding* puzzling on another ground. The court defended its ruling because "[t]he contest is not between two insurance companies, each of which has received premiums for bearing the loss which ultimately occurred, but between insurers and a general contractor [Simpson] who received no independent consideration for the assumption of the risk." (*Wilshire, supra*, 256 Cal.App.2d at p. 516.) This distinction suggests that the equitable positions of the insurers and Simpson

The court then compared Fireman's Fund's insurance obligation with Wilshire's contractual obligation, and concluded that Wilshire's obligation to pay for the equipment if it was not returned made it primarily liable for the loss, even though it had not caused the loss. (*Wilshire, supra,* 52 Cal.App.4th at p. 558.) The court concluded: "It follows that, on our facts, Fireman's Fund's position is superior to Wilshire's position. Wilshire was obligated to return the equipment or pay for it, not merely to provide insurance coverage. Wilshire did neither, and is therefore in breach of its contractual obligation. Fireman's Fund, on the other hand, fully performed its contractual obligation by paying its insured the benefits due under its contract. As between these parties, therefore, the equities are with Fireman's Fund and it is entitled to recover from Wilshire. [Citation.]" (*Id*. at pp. 558-559.)[8]

Applying *Wilshire* to the matter at hand, Cleveland and Interstate did not agree to indemnify the same loss. Cleveland agreed to indemnify and hold harmless Webcor from all claims "arising out of or in connection with [Cleveland's] operations to be performed under this Agreement," for, but not limited to, personal injury (including bodily injury) to an employee of another subcontractor, "caused or alleged to be caused in whole or in part by any negligent act or omission of Subcontractor." (Agreement, § 15.1.1.) It also agreed to indemnify Webcor for losses or liability Webcor incurred for Cleveland's failure to procure liability insurance with Webcor as an additional insured and other breaches of Cleveland's obligations. (Agreement, §§ 15.1.1(f), 16.) By contrast, the Interstate insurance policy provided coverage to Webcor for amounts Webcor became legally obligated to pay as damages because of bodily injury to which the insurance applied, without limiting it to liability arising out of or in connection with Cleveland's

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were not equal, but favored Simpson. On the same page of its opinion, however, the court indicated a contrary view, declaring that "had Simpson first paid, it *likewise* would be denied equitable subrogation against the insurers." (*Ibid.*, italics added.)

[8] Cleveland argues that *Fireman's Fund Ins. Co. v. Wilshire Film Ventures, Inc*. is inapposite because it did not involve a good faith settlement. *Patent Scaffolding* and other cases on which Cleveland relies did not involve a good faith settlement either. In any event, Cleveland has not shown the distinction to be material, because a good faith settlement does not preclude the express contractual indemnity claim Interstate alleged.

operations to be performed under the Webcor-Cleveland subcontract. (See *Pylon*, *supra*, 271 Cal.App.2d at p. 648 [insurer and indemnitor under contract provision did not indemnify the same risk].)

Furthermore, comparing Interstate's undertaking with Cleveland's undertaking tips the scale of equities in Interstate's favor. An entity which, like Cleveland, agrees to indemnify *the other party to the underlying transaction* has a liability of greater primacy than an independent insurer that insures against loss. (See *Wilshire*, *supra*, 52 Cal.App.4th at pp. 558-559; *Meyer Koulish Co. v. Cannon* (1963) 213 Cal.App.2d 419, 423, 429 (*Meyer Koulish*) [insurer was entitled to equitable subrogation against the party who had agreed to accept the risk of loss for consigned jewelry until its return to the insured].) The parties directly involved in the transaction are better able to evaluate and control the risk. Therefore, for purposes of weighing the equities in an equitable subrogation case, and absent language in the insurance policy or indemnification agreement leading to a contrary conclusion (which the parties here do not contend), the Agreement between the parties who were connected to the incident giving rise to the loss (Webcor and Cleveland as workers at Frisby's job site) creates the greater equitable responsibility for indemnification, as compared to that of the general liability insurer (Interstate).[9]

c. *Interstate's receipt of premiums is not dispositive*

Cleveland insists, based on language found in *Patent Scaffolding*, that Interstate should not be able to obtain indemnification from Cleveland because it accepted premiums to insure the risk of loss. Cleveland is incorrect.

In our view, the fact that Interstate accepted premiums is not particularly significant, since every insurer that pays a loss on behalf of its insured will have accepted

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[9] Our conclusion is also consistent with numerous cases holding that the insurer of a party who contractually agreed to indemnify another party can be held entirely liable for the loss, notwithstanding the provisions of the competing insurance agreements, in order to give effect to the contractual indemnification provision. (See, e.g., *Hartford Casualty Ins. Co. v. Mt. Hawley Ins. Co.* (2004) 123 Cal.App.4th 278, 289-298, and cases cited therein.)

premiums for the risk. Furthermore, while Interstate was compensated for undertaking the risk of loss, so was *Cleveland*, which accepted consideration for the performance of its obligations under the Webcor-Cleveland subcontract. (See *California Food Service Corp. v. Great American Ins. Co*. (1982) 130 Cal.App.3d 892, 900, fn.2.) Finally, while it may be that Interstate merely did what it was obligated to do under the insurance policy, that does not change the fact that Cleveland did *not* do what it was allegedly obligated to do under the indemnification provision, after it allegedly caused the loss.

The extent to which an insurer's receipt of premiums relates to the equities of subrogation was clarified by this appellate district in *State Farm General Ins. Co. v. Wells Fargo Bank, N.A.* (2006) 143 Cal.App.4th 1098 (*State Farm*). There, the premises of State Farm's insureds sustained damage from a fire that had started in an adjacent apartment building. State Farm paid its insureds' claim for the fire loss, and then sued in subrogation the other apartment building's owner and others (respondents). Although respondents had not actually ignited the fire, State Farm contended the fire was caused by respondents' negligent failure to provide for the safe disposal of fireplace ashes. The trial court granted summary judgment in favor of respondents, on the ground that State Farm's claims were barred by the doctrine of superior equities. (*Id*. at p. 1103.)

The appellate court reversed. The court rejected the respondents' contention that the insurer was not entitled to subrogation due to its receipt of premiums. "[T]he fact that an insurer has been compensated for its risk *does not*, in and of itself, swing the balance in favor of a third party. [Citation.] Rather, compensation is a 'fact to be considered, it is no more than that . . . .' [Citations.]" (*State Farm, supra*, 143 Cal.App.4th at pp. 1110-1111, italics added.)

The *State Farm* court then noted that "a significant factor in weighing the equities is whether a defendant's negligent acts were *related* to or contributed to the primary cause of loss," and the issue was "whether respondents were in a better position to avoid the loss than State Farm or its insureds." (*State Farm, supra*, 143 Cal.App.4th at p. 1118.) "While arguably an insurer should in fairness bear the loss where the third party's liability is *solely* contractual [citing *Morse*, *Meyers*, and *Patent Scaffolding* but

noting the split of authority in *Wilshire* and *Meyer Koulish*], such a result seems unfair when the loss has been caused by the third party's tortious conduct." (*State Farm*, at p. 1118 & fn. 12, italics added.) Because State Farm alleged that respondents negligently permitted a fire to occur and to spread to its insureds' property, it could proceed in subrogation against respondents, even though the respondents had not actually started the fire. (*Id*. at p. 1119.)

The court in *State Farm* ruled: "In the case at bench, the contest is between an innocent insurance company (which admittedly received premiums for the very loss that occurred) and alleged tortfeasors (who did not physically start the fire, but whose negligence allegedly permitted the fire to be started and to spread by failing to provide for the safe disposal of fireplace ashes). On this record, we cannot say that respondents are entitled to judgment as a matter of law, based on the doctrine of superior equities. We reverse the trial court's order granting summary judgment on that basis." (*State Farm, supra,* 143 Cal.App.4th at p. 1119.)

As applied in the matter before us, Interstate's acceptance of premiums does not itself preclude subrogation as a matter of law, particularly since the risk it insured was distinct from the risk Cleveland agreed to indemnify, and Cleveland's alleged negligence contributed to the loss. Based on the allegations of the first amended complaint, *State Farm* indicates that Cleveland's demurrer should have been overruled.

d. *Public policy favors equitable subrogation under the facts alleged*

Patent Scaffolding recognized the unfairness of precluding an insurer from subrogating to a claim against a party who had refused to live up to its promise of contractual indemnification. The court acknowledged that its rule led to a result that "appears to reward delay in the payment of just claims because had Simpson first paid, it likewise would be denied equitable subrogation against the insurers," but chalked it up to the fact that justice is not always perfect and the insurer could have sought equitable contribution (to share the loss) rather than the all-or-nothing equitable subrogation. (*Patent Scaffolding*, *supra*, 256 Cal.App.2d at p. 516.) Here, of course, equitable

contribution is no longer available to Interstate because of the determination that Cleveland's settlement was a good faith settlement. Although one could fault Interstate for not tying up that loose end in the *Frisby* litigation, the fault (if any) could also be laid at Cleveland's feet for the same reason. It may also be that the parties found it more prudent to resolve the underlying *Frisby* litigation promptly, without the delay that would be entailed in litigating this indemnification dispute.

In any event, the result we reach in this case avoids the injustice of *Patent Scaffolding*. In our view, it is not a good idea to reward parties who refuse to fulfill their alleged indemnification obligations, particularly under the rubric that they are in as good or better *equitable* position as the insurer that did fulfill its alleged indemnification obligation. We believe it is more prudent to permit subrogation, so that a party with an alleged contractual indemnification obligation will be encouraged to step up in the underlying case and either fulfill the obligation (and implicitly help settle the case) or resolve any dispute over the application of the indemnification obligation. If permitting subrogation to the insurer in any way results in a windfall (because the insurer that accepted premiums to insure against the loss may now shift the loss to the other indemnitor), it would be better for the windfall to go to the one that undisputedly fulfilled its contractual obligations, than to the one that allegedly breached them.

In the matter before us, Interstate issued insurance, accepted Webcor's defense, and made the payment to resolve the claims against Webcor. According to the allegations of the first amended complaint, Interstate did everything it was supposed to do to fulfill its contractual obligations to Webcor. Cleveland, on the other hand, allegedly did not. Although contractually obligated to obtain insurance covering Webcor, it failed to do so. Notwithstanding its alleged contractual obligation to defend and indemnify Webcor, it refused to defend or indemnify. While Interstate had nothing to do with the incident underlying the *Frisby* litigation, Cleveland was allegedly a contributory cause to Frisby's injuries. The comparison, therefore, is between one party who had nothing to do with causing the loss but abided by its contractual obligation to pay for it, and another party who caused the loss and then shunned its contractual obligation to pay it. Based on

the allegations of the first amended complaint, Interstate is in a superior equitable position to Cleveland.

e. *Cleveland's cases are inapposite*

The remaining cases on which Cleveland relies are distinguishable from this case. In *California Food Service Corp. v. Great American Ins. Co., supra,* 130 Cal.App.3d 892, Sandy's operated a restaurant under a lease requiring it to obtain fire insurance on the building. Sandy's insured the building through its insurer (Highlands). Sandy's later agreed to sell the restaurant to CFS, which also obtained fire insurance on the building for the benefit of the building's owners, through Great American. (*Id*. at pp. 895-896.) Before the sale of the restaurant consummated, there was a fire. The owner of the building looked to Sandy's, whose insurer (Highlands) paid the claim. (*Id*. at p. 896.) Highlands sought recovery in subrogation from CFS's insurer, Great American. (*Ibid.*) Viewing the Highlands contract and the CFS contract on equal footing, the court held that Highlands could not obtain equitable subrogation from CFS's insurer, Great American. (*Id*. at pp. 895, 901.) The court nonetheless found that the insurers should split the loss under the doctrine of equitable contribution. (*Id*. at p. 895.)

California Food Service, which followed *Patent Scaffolding*, is distinguishable from this case for the same reason we distinguished *Patent Scaffolding*: in those cases, the insurer did not allege a causal connection between the defendant and the loss; in this case, Interstate made this allegation.

In *Fireman's Fund Ins. Co. v. Morse Signal Devices* (1984) 151 Cal.App.3d 681 (*Morse*), Fireman's Fund insured certain commercial establishments that had contracted with one of several alarm companies to maintain burglar or fire alarms on the premises. (*Id*. at p. 685.) In those contracts, the alarm companies expressly disclaimed that the alarm systems would prevent burglary or fire loss, and stated that the alarm companies were not insurers, the commercial establishments assumed all risk of loss, and the alarm companies' liability was limited to liquidated damages. (*Id*. at pp. 685-686.) Fires or burglaries occurred at each commercial establishment when the alarm systems failed to function properly. (*Id*. at p. 686.) Fireman's Fund paid its insureds' claims and then sued

the alarm companies, alleging they failed to perform their contractual duties to the insureds, but not alleging that they created the fires or perpetrated the burglaries. (*Id*. at p. 687.) The alarm companies filed demurrers to Fireman's Fund's complaint, which were sustained without leave to amend. (*Id*. at p. 684.)

The Court of Appeal affirmed. Because the alarm companies had not caused the loss, the equities of Fireman's Fund were not superior to those of the alarm companies, and equitable subrogation was unavailable. (*Morse, supra,* 151 Cal.App.3d at pp. 687-688.) The court also observed that the reasonable expectations of the insureds (parties to the alarm service contracts) had not been frustrated because the alarm companies had not represented that their alarms made the insured premises absolutely secure, and that it was for this reason the insureds had procured insurance for the losses they suffered. (*Id*. at p. 688.)

Morse is distinguishable from the matter at hand, because the alarm companies from which subrogation was sought expressly disclaimed any obligation to indemnify Fireman's Fund's insureds, while Cleveland expressly undertook the obligation to indemnify Interstate's insured. Furthermore, while Fireman's Fund's insureds and the alarm companies did not reasonably expect the alarm companies to cover the loss, Interstate's insured and Cleveland did reasonably expect Cleveland to cover the loss, based on the indemnification provision in the Agreement.

In *Bramalea, supra,* 119 Cal.App.4th 468, a real estate developer (Bramalea) was sued by homeowners for construction defects. Bramalea's insurer, Zurich, hired counsel to provide a defense and filed cross-complaints against subcontractors for both equitable indemnity and contractual indemnity, the latter of which was based on a provision in the subcontractor agreement requiring the subcontractors to indemnify Bramalea and hold it harmless from all damages including attorney fees arising from the subcontractors' act or omission. (*Id*. at pp. 470-471.) Eventually, Bramalea tendered its defense to the subcontractors' insurers; the insurers accepted the tender. (*Id*. at p. 471.) The litigation was settled except as to Bramalea's right to recover from the subcontractors attorney fees incurred before its tender of the defense to the subcontractors' insurers. (*Id*. at p. 470.)

The trial court dismissed the cross-complaint on the ground that Bramalea had no standing to recover the attorney fees from the subcontractors because it had not paid the attorney fees. (*Ibid*.) In so ruling, the court concluded: "*This is not an action by Zurich for subrogation*. It is an action [by Bramalea] for indemnity and breach of contract." (*Id*. at p. 471, italics added.) Bramalea appealed.

On appeal, the court affirmed, holding that Bramalea could not maintain a claim against the subcontractors for attorney fees because it had suffered no out-of-pocket loss. (*Bramalea, supra,* 119 Cal.App.4th at pp. 472-473.) The court then proceeded to discuss an issue neither before it on appeal nor ostensibly presented by the case, volunteering that it was "questionable whether Zurich *could* pursue equitable subrogation against the subcontractors." (*Id*. at p. 474.) Noting a conflict of authority, the *Bramalea* court observed that under *Patent Scaffolding,* Zurich would not be entitled to equitable subrogation because the "attorney fees were not caused by the subcontractors' breach of their obligation to indemnify Bramalea" but by the homeowners' lawsuit for construction defects, "which was one of the risks Zurich accepted premiums to cover," and "[w]hether the subcontractors caused the construction defects was not resolved by this litigation." (*Id*. at p. 475 & fn. 4.) The court added that Zurich could presumably pursue an action against the subcontractors for equitable contribution. (*Id*. at p. 475, fn. 5.)

Bramalea is unhelpful to our analysis. First, the language on which Cleveland relies is pure dictum. Second, *Bramalea* is distinguishable from this matter for the same reasons we distinguished *Patent Scaffolding*.

In sum, the allegations of Interstate's amended complaint establish each of the elements for subrogation. The court erred in sustaining the demurrer.

III. *DISPOSITION*

The judgment is vacated and the order sustaining the demurrer to appellant's first amended complaint is reversed. The trial court shall enter a new order overruling the demurrer. Respondent shall pay appellant for appellant's costs on appeal.

NEEDHAM, J.

We concur.

SIMONS, Acting P. J.

BRUINIERS, J.

Interstate Fire & Cas. Ins. Co. v. Cleveland Wrecking Co. (A124920)

Trial court: San Francisco County Superior Court
Trial judge: Hon. Patrick J. Mahoney

Kenney & Markowitz, David W. Gordon for Plaintiff and Appellant

Seyfarth Shaw, Lawrence E. Butler and Jonathan A. Braunstein for Defendant and Respondent

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Patent Scaffolding Co. v. William Simpson Constr. Co.

[Civ. No. 30131. Second Dist., Div. Five. Nov. 29, 1967.]
PATENT SCAFFOLDING CO., Plaintiff and Respondent, v. WILLIAM SIMPSON CONSTRUCTION COMPANY, Defendant and Appellant.

COUNSEL

Hill, Farrer & Burrill, William McD. Miller, A. J. Cathcart and William M. Bitting for Defendant and Appellant.

Joseph Stell and Arthur S. Levin for Plaintiff and Respondent.

OPINION

HUFSTEDLER, J.

The William Simpson Construction Company ("Simpson") appeals from a judgment in favor of The Patent Scaffolding Co. ("Patent") awarding to Patent judgment for $16,481.09, with interest and costs.

procedural and Factual Summary

Three insurance companies, United States Fidelity and Guaranty Company, Niagara Fire Insurance Company, and National Fire Insurance Company ("insurers"), brought the action in the name of their insured, Patent, against Simpson **[256 Cal. App. 2d 508]** and California Institute of Technology ("Caltech") to recover damages for claimed breach of a contract between Patent and Simpson and of a contract between Simpson and Caltech of which Patent claimed to be a third party beneficiary.

Simpson, a general contractor, executed a contract with Caltech to construct a building for Caltech. Simpson entered into a subcontract with Patent whereby Patent was to furnish scaffolding and other equipment for use during construction of the building, to erect the scaffolding and equipment at the job site, and to remove such materials when the job was completed. The written contract, dated November 20, 1959, between Patent and Simpson contained the following paragraph:

"15. Fire Insurance--Subcontractor's work and materials at the site of the project are to be protected from fire loss and damage by insurance procured by the contractor or the owner, without cost to the subcontractor."

During the course of construction a fire of unknown origin destroyed certain items of Patent's equipment and materials at the job site.prior to the commencement of the

action Patent demanded $16,481.09 from Simpson and Caltech to compensate it for its fire loss. Neither Simpson nor Caltech paid Patent for its loss. Simpson did not procure insurance protecting Patent's equipment and materials from fire loss and it did not request or cause Caltech to procure fire insurance upon Patent's materials and equipment.

Prior to Patent's executing the subcontract with Simpson, Patent had procured from the insurers fire insurance on the materials and equipment damaged and destroyed by the fire. The insurers' policies together provided coverage of over $1,000,000 to Patent against loss of its property.

Patent made claims on each of the insurers and the insurers paid Patent the following amounts of money: United States Fidelity and Guaranty and Niagara Fire Insurance Companies paid Patent $5,768.38 each, and National Fire Insurance Company paid $4,944.33, the total of which equaled $16,481.09.

The trial court concluded (1) the insurers were subrogated to Patent's claim upon its contract with Simpson; (2) the insurers were entitled to recover the total sums paid to Patent; (3) the contract between Simpson and Patent was "not a contract merely to obtain fire insurance, but a contract **[256 Cal. App. 2d 509]** of indemnification against fire loss"; (4) the insurers were not entitled to recover against Caltech, because Patent was not a third party beneficiary of the contract between Simpson and Caltech. Judgment was accordingly entered in favor of the nominal plaintiff, Patent, against Simpson, and in favor of Caltech against Patent. No appeal has been taken from that portion of the judgment in favor of Caltech.

The appeal presents the novel question: Are the insurers who compensated Patent for Patent's fire loss equitably subrogated to Patent's cause of action against Simpson for breach of Simpson's contractual duty either to indemnify Patent for fire loss or to procure fire insurance for Patent's benefit?

Equitable Subrogation Elements

[1] The elements of an insurer's cause of action based upon equitable subrogation are these: (1) The insured has suffered a loss for which the party to be charged is liable, either because the latter is a wrongdoer whose act or omission caused the loss or because he is legally responsible to the insured for the loss caused by the wrongdoer; (2) the insurer, in whole or in part, has compensated the insured for the same loss for which the party to be charged is liable; (3) the insured has an existing, assignable cause of action against the party to be charged, which action the insured could have asserted for his own benefit had he not been compensated for his loss by the insurer; (4) the insurer has suffered damages caused by the act or omission upon which the liability of the party to be charged depends; (5) justice requires that the loss should be entirely shifted from the insurer to the party to be charged, whose equitable position is inferior to that of the insurer; and (6) the insurer's damages are in a stated sum, usually the amount it has paid to its insured, assuming the payment was not voluntary and was

reasonable. (Meyers v. Bank of America Nat. Trust & Sav. Assn. (1938) 11 Cal. 2d 92 [77 P.2d 1084]; Offer v. Superior Court (1924) 194 Cal. 114 [228 P. 11]; Liberty Mut. Ins. Co. v. Kleinman (1954) 149 Cal. App. 2d 404 [308 P.2d 347]; American Alliance Ins. Co. v. Capital Nat. Bank (1946) 75 Cal. App. 2d 787 [171 P.2d 449]; Harrington v. Central States Fire Ins. Co. (1934) 169 Okla. 255 [36 P.2d 738, 96 A.L.R. 859]; In re Future Mfg. Coop., Inc. (N.D. Cal. 1958) 165 F. Supp. 111. See also Justice Traynor's dissenting opinion, Anheuser- Busch, Inc. v. Starley **[256 Cal. App. 2d 510]** (1946) 28 Cal. 2d 347, 355-356 [170 P.2d 448, 166 A.L.R. 198].)

[2] No express assignment of the insured's cause of action is required; equitable subrogation is accomplished by operation of law. However, as in cases of assignment, the equitable subrogee is substituted only in respect of a subrogor's causes of action which are not purely personal and, generally, any defenses or counterclaims which could have been asserted against the subrogor-insured can also be asserted against the subrogee-insurer. (Anheuser-Busch, Inc. v. Starley (1946) 28 Cal. 2d 347, 351 [170 P.2d 448, 166 A.L.R. 198]; Royal Indem. Co. v. Security Truck Lines (1963) 212 Cal. App. 2d 61, 65-66 [27 Cal. Rptr. 858]; see also Meyers v. Bank of America Nat. Trust & Sav. Assn., supra, 11 Cal.2d at p. 94.)

Subrogor's Cause of Action

If Patent had had no insurance to compensate it for its loss, Patent could have recovered damages from Simpson for all detriment proximately caused by Simpson's breach of its contractual duty to indemnify or to procure insurance. (Civ. Code, § 3300; see Dutton Dredge Co. v. United States Fid. & Guar. Co. (1934) 136 Cal. App. 574, 581 [29 P.2d 316]; see also Transportation Guar. Co., Ltd. v. Jellins (1946) 29 Cal. 2d 242, 252-253 [174 P.2d 625].)

[3] After Patent was fully compensated for its fire loss, however, could Patent itself have successfully sued Simpson for breach of contract? Patent could recover twice for the same loss only if the "collateral source" rule applies. "When an injured party receives compensation for his losses from a collateral source 'wholly independent of the tortfeasor,' such payment generally does not preclude or reduce the damages to which it is entitled from the wrongdoer. (See Anheuser-Busch, Inc. v. Starley (1946) 28 Cal. 2d 347, 349-350 [170 P.2d 448, 166 A.L.R. 198]; see also Lewis v. County of Contra Costa (1955) 130 Cal. App. 2d 176, 178 [278 P.2d 756].)" City of Salinas v. Souza & McCue Constr. Co., Inc. (1967) 66 Cal. 2d 217, 226 [57 Cal. Rptr. 337, 424 P.2d 921].) Thus, if Patent sued a person whose negligent or willful act caused the fire which destroyed its property, Patent's compensation from its insurers would neither diminish nor defeat the damages which it could recover from the tortfeasor. (E.g., City of Salinas v. Souza & McCue Constr. Co., Inc., supra, 66 Cal.2d 226- 227; Maxwell, The Collateral Source Rule in the **[256 Cal. App. 2d 511]** American Law of Damages (1962) 46 Minn.L.Rev. 669; Fleming, The Collateral Source Rule and Loss Allocation in Tort Law (1966) 54 Cal.L.Rev. 1478.)

The collateral source rule, however, has not been generally applied in cases founded upon breach of contract, unless the "breach has a tortious or wilful flavor." (City of Salinas v. Souza & McCue Constr. Co., Inc., supra, 66 Cal.2d at p. 227; United Protective Workers v. Ford Motor Co. (7th Cir. 1955) 223 F.2d 49, 54 [48 A.L.R.2d 1285].) The collateral source rule is punitive; contractual damages are compensatory. The collateral source rule, if applied to an action based on breach of contract, would violate the contractual damage rule that no one shall profit more from the breach of an obligation than from its full performance. An application of the collateral source rule is particularly indefensible in a situation in which the injured party potentially could make a treble recovery: one from his insurer, one from a defendant who has undertaken contractual liability for the loss, and one from the wrongdoer. (See Justice Traynor's dissenting opinion in Anheuser Busch, Inc. v. Starley, supra, 28 Cal.2d at pp. 355-356.) We conclude that the collateral source rule would be inapplicable in an action brought by Patent for its own benefit after Patent had been paid by the insurers.

Patent suffered no uncompensated detriment caused by Simpson's breach of contract. It was fully paid for its fire loss. It could not recover the cost of the premiums it had paid to the insurers because it did not incur that expense as a consequence of its contract with Simpson or as a result of Simpson's breach of contract. A breach of contract without damage is not actionable. (E.g., Hawkins v. Oakland Title Ins. & Guar. Co. (1958) 165 Cal. App. 2d 116, 122 [331 P.2d 742].) Damages are not recoverable which are not causally connected with the breach of a contract (Civ. Code, § 3300; Southall v. Security Title Ins. etc. Co. (1952) 112 Cal. App. 2d 321, 323-324 [246 P.2d 74].)

Insurers' Equitable Subrogation

[4a] The fact alone that Patent could not recover from Simpson because Patent suffered no loss does not defeat the insurers' subrogation rights. The insurers' loss can be substituted for Patent's if the insurers' loss was proximately caused by the act or omission of Simpson or one for whose acts or omissions Simpson was vicariously liable. The most **[256 Cal. App. 2d 512]** common subrogation action is one brought on behalf of an insurer against a wrongdoer whose wrong caused the loss. (Continental Cas. Co. v. Phoenix Constr. Co. (1956) 46 Cal. 2d 423, 429 [296 P.2d 801, 57 A.L.R.2d 914]; Offer v. Superior Court, supra, 194 Cal. 114; Royal Indem. Co. v. Security Truck Lines, supra, 212 Cal. App. 2d 61.) Liability of the wrongdoer may, of course, be based not only on a tort, but also upon a breach of contract (e.g., Eads v. Marks (1952) 39 Cal. 2d 807 [249 P.2d 257]; Chelini v. Nieri (1948) 32 Cal. 2d 480 [196 P.2d 915]) so long as there exists the necessary causal relationship between the wrong and the damage. (Cf. City of Salinas v. Souza & McCue Constr. Co., Inc., supra, 66 Cal.2d at p. 228.)

The insurers' loss was not caused by Simpson's failure to get insurance or to indemnify Patent. The insurers' loss was caused by the fire, the very risk which each assumed, and Simspon's failure to perform its contractual duty had nothing to do with the fire.

The California cases, with one exception, have not permitted equitable subrogation to insurers whose losses are not causally related to a breach of duty for which the party to be charged may be liable to the insured for a loss compensated by the insurers.

The leading California case is Meyers v. Bank of America Nat. Trust & Sav. Assn., supra, 11 Cal. 2d 92. The nominal plaintiff, Meyers, employed an office manager, who forged Meyers' name upon checks payable to Meyers, negotiated the checks to defendant Wascher, who paid full value therefor. The manager converted the proceeds to his own use. Wascher deposited the checks in his bank account with the defendant bank, which thereafter presented them to the respective drawee banks and received full payment for them. The insurance company prosecuting the action in Meyers' name had executed a fidelity bond indemnifying Meyers against all loss which might result from the wrongful acts of Meyers' office manager. When the office manager's dishonesty was discovered, the insurance company reimbursed Meyers for the loss and commenced this action against Wascher's bank. The Supreme Court reversed judgment in favor of the nominal plaintiff, holding that the insurance company was not equitably subrogated to Meyers' collateral cause of action.

The court concluded: "Here, the indemnitor has discharged its primary contract liability. It has paid what it contracted **[256 Cal. App. 2d 513]** to pay, and has retained to its own use the premiums and benefits of such contracts. It now seeks to recover from the bank the amount thus paid. It must be conceded that the bank is an innocent third party, whose duty to the employer was based upon an entirely different theory of contract, with which the indemnitor was not in privity. Neither the indemnitor nor the bank was the wrongdoer, but by independent contract obligation each was liable to the employer. In equity, it cannot be said that the satisfaction by the bonding company of its primary liability should entitle it to recover against the bank upon a totally different liability." (11 Cal. 2d at 102.) (Accord: Liberty Mut. Ins. Co. v. Kleinman, supra, 149 Cal. App. 2d 404; J. G. Boswell Co. v. W. D. Felder & Co. (1951) 103 Cal. App. 2d 767 [230 P.2d 386]; and American Alliance Ins. Co. v. Capital Nat. Bank, supra, 75 Cal.App.2d at pp. 791-794.)

The court in Meyers relied upon a case which provides an even closer analogy to the facts in our case. In New York Title & Mortg. Co. v. First Nat. Bank (8th Cir. 1931) 51 F.2d 485 [77 A.L.R. 1052], a loan broker, through forgeries and misrepresentations, procured title insurance policies by which a loan association was guaranteed against loss by reason of defects in the mortgagor's title to described real property securing loans. The purported borrower was fictitious. When the broker received a check from the loan association, he forged the name of the payee, deposited it in the drawee bank and converted the proceeds to his own use. The bank thereupon charged the amount of the check to the account of the loan company. The title insurer paid the loss to the loan company and brought suit against the bank for the amount so paid. The court in Meyers quoted with approval from the opinion in New York Title: " 'Plaintiff's payment to the loan company was a discharge of its primary contract liability. ...plaintiff paid the loan company only what it contracted primarily to do, but now, retaining the premiums or benefit of its contract, it seeks reimbursement from the bank, on the theory that the

bank, under a wholly separate and independent contract, was liable to the loan company for having paid checks on forged indorsements. ... If we assume that neither the plaintiff nor the bank was the wrongdoer, but, by independent contract obligation, each was liable to the loan company, then the satisfaction of such primary liability by the plaintiff would not give rise to a right to recover against **[256 Cal. App. 2d 514]** the bank under the doctrine of subrogation, the bank not being a wrongdoer. ... In our view, the equities in favor of the defendant bank constitute an insuperable barrier to plaintiff's right of recovery.' (Italics added.)" (11 Cal.2d at pp. 97-98.)

In the New York Title case, as here, there were two independent contracts, each obligating the contractors to assume liability for the same risk: one contract between the loan company and its insurer indemnifying the loan company from loss caused by forgery, and another contract between the loan company and its bank by which the bank covenanted not to pay its depositor's money upon forged endorsements, for breach of which the bank was liable to indemnify its depositor for the loss. The loss occurred. The insurance company paid and the bank did not. The bank was a "wrongdoer" in the sense that it breached its contract with its depositor, but the bank's breach did not cause the loss. The forger was the miscreant.

There are factual distinctions between Meyers, American Alliance Insurance, New York Title and the case at bench, but they are distinctions without a real difference. We can see no reason why a fidelity insurance bond for this purpose should be different from a fire insurance policy, or why a bank's contract to hold its depositor harmless from loss if it paid upon a forged endorsement is different from Simpson's contract to indemnify or to obtain insurance to indemnify Patent from a fire loss.

The language used in these cases is the verbiage of equity. The lack of any causal connection between the defendant's breach of contract and the insurer's loss is not specifically articulated, but it is implicit in the discussion of the comparative equities of the parties. The rule in equitable phraseology is this: [5] Where two parties are contractually bound by independent contracts to indemnify the same person for the same loss, the payment by one of them to his indemnitee does not create in him equities superior to the nonpaying indemnitor, justifying subrogation, if the latter did not cause or participate in causing the loss.

[4b] The insurers understandably rely heavily upon the one California case permitting an insurer equitable subrogation to its insured's cause of action upon an independent contract: Meyer Koulish Co., Inc. v. Cannon (1963) 213 Cal. App. 2d 419 [28 Cal. Rptr. 757]. The insurer of a consignor **[256 Cal. App. 2d 515]** brought suit in its consignor-insured's name upon a contract between the consignor and the defendant consignees which placed the risk of loss from all hazards upon the consignees for consigned jewelry until the jewelry was returned to the consignor. Without any fault of the consignees the jewelry was stolen from the baggage room of a railroad. The court cited Meyers v. Bank of America Nat. Trust & Sav. Assn., supra, 11 Cal. 2d 92; Liberty Mut. Ins. Co. v. Kleinman, supra, 149 Cal. App. 2d 404; J.G. Boswell Co. v. W. D. Felder & Co., supra, 103 Cal. App. 2d 767; and American Alliance Ins. Co. v. Capital Nat. Bank,

supra, 75 Cal. App. 2d 787, and disposed of those cases simply by stating that they were "distinguishable from the present factual situation." (213 Cal.App.2d at p. 425.) After citing assorted cases from jurisdictions other than California, the court concluded: "Appellants were parties to an express contract whereby they assumed responsibility for the loss of the goods of the respondents. They thereby accepted primary liability and it cannot be said that appellants stand on equal footing with the insurance company. The equities in this matter do not balance but preponderate in favor of the insurer of the bailor." (213 Cal.App.2d at p. 429.) The court does not explain why the insurance company's acceptance of the risk of loss was any different from the consignees' acceptance of the risk of loss or why the consignees' liability was "primary" whereas, presumably, the insurance company's was not. No explanation was offered for its conclusion that the equities preponderated in favor of the insurance company. The court did not discuss the causal connection between the breach of the consignees' contract to assume the loss and the payment by the insurer to its insured upon its policy.

The conclusion of the court in the Meyer Koulish case cannot be squared with the decision by the California Supreme Court in Meyers v. Bank of America Trust & Sav. Assn., and it is out of line with the other California decisions dealing with directly analogous problems.

Upon the facts in this case no public policy is perceivably served by shifting the entire loss from the insurers to Simpson. The shifting of loss is not a deterrent to wrongdoing, as it may be in cases permitting subrogation against a tortfeasor. (City of Salinas v. Souza & McCue Constr. Co., Inc., supra, 66 Cal.2d at p. 227.) Imposition of the loss upon Simpson would be punitive, and punishment is not the objective of **[256 Cal. App. 2d 516]** contractual damages. (City of Salinas v. Souza & McCue Constr. Co., Inc., supra; see also United Protective Workers v. Ford Motor Co., supra, 223 F.2d at p. 54; In re Future Mfg. Coop., Inc., supra, 165 F. Supp. 111, 113.) If subrogation were permitted, the insurers who have accepted premiums to cover the very loss which occurred receive a windfall. There is no evidence in this record that the insurers' acceptance of the risk or their determination of the cost to the insured of the insurance policies was based in any way upon the terms of Simpson's contract with Patent. The contest is not between two insurance companies, each of which has received premiums for bearing the loss which ultimately occurred, but between insurers and a general contractor who received no independent consideration for the assumption of the risk. The insurers, being in the insurance business, are in a position effectively to spread the risk and to gauge their premiums upon their loss experience. Upon the evidence in the record we are unable to say that Simpson occupies a similar position.

We are aware that the denial of equitable subrogation to the insurers compels the insurers to bear the entire loss and that Simpson is relieved of a responsibility which it solemnly assumed. The result appears to reward delay in the payment of just claims because had Simpson first paid, it likewise would be denied equitable subrogation against the insurers. The conclusion in either event does not have the symmetry of perfect justice. fn. 1 The result, however, is not materially different from many other situations in which a person who has suffered a loss for which more than one person is

liable may select one from their number to satisfy the obligation, thereby relieving the remaining parties of their liability. For example, had neither the insurers nor Simpson paid, Patent could have sued both and could have levied execution against either without a right of contribution by the other. (Weinberg Co. v. Heller (1925) 73 Cal. App. 769, 779 [239 P. 358].)

While from the point of view of the debtors Patent's power of selection reduces a sure thing to a fifty-fifty proposition, it does not change the basic injustice that eventually one of the number may have to bear the entire loss. **[256 Cal. App. 2d 517]**

The answer probably lies in the fact that all parties below approached the problem on an "all-or-nothing" basis. Had the insurers claimed equitable contribution rather than equitable subrogation, and had they succeeded in establishing what kind and amount of insurance coverage would have satisfied Simpson's contractual obligation, they may have succeeded in bringing themselves within the principle established in Continental Cas. Co. v. Zurich Ins. Co. (1961) 57 Cal. 2d 27, 35-38 [17 Cal. Rptr. 12, 366 P.2d 455]. The equitable-contribution principle requires an equitable distribution of the loss among those who share liability for it. Equitable contribution cannot be applied to this case because the facts necessary to state a claim based upon that theory were neither pleaded nor proved.

The judgment is reversed.

Kaus, P. J., and Stephens, J., concurred.

FN 1. For discussions of the problems and suggested methods of approach, see King, Subrogation Under Contracts Insuring Property (1951) 30 Tex. L.Rev. 62; Langmaid, Some Recent Subrogation Problems in the Law of Suretyship and Insurance (1934) 47 Harv.L.Rev. 976; Note, Subrogation of the Insurer to Collateral Rights of the Insured (1928) 28 Colum.L.Rev. 202.

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Mid-Century Ins. Co. v. Hutsel (1970)

[Civ. No. 9782. Court of Appeals of California, Fourth Appellate District, Division One. August 31, 1970.]
MID-CENTURY INSURANCE COMPANY et al., Plaintiffs and Respondents, v. JOHN F. HUTSEL, Defendant and Appellant

(Opinion by Ault, J., with Coughlin, Acting P. J., and Whelan, J., concurring.)

COUNSEL

Brown, Schall & Stennett, Arvin H. Brown, Jr., and Henry F. Walker for Defendant and Appellant.

McInnis, Fitzgerald & Wilkey, McInnis, Fitzgerald, Rees & Sharkey and Laurence L. Pillsbury for Plaintiffs and Respondents.

OPINION

AULT, J.

John F. Hutsel appears from a declaratory judgment entered against him and in favor of William H. Cousins, Joseph L. Leakes and Mid-Century Insurance Company (Mid-Century).

There is no dispute as to the facts. Hutsel was Cousins' insurance agent. The previous year he had placed Cousins' automobile liability insurance ($10,000/$20,000 bodily injury and $5,000 property damage) with Transnational Insurance Company. The policy expired on May 24, 1966. Having undertaken to do so, and having collected a premium therefor, Hutsel negligently failed to procure a new and similar liability policy for Cousins with some other insurance company (Hutsel does not dispute this finding on appeal). On May 28, 1966, just four days after Cousins' insurance with Transnational lapsed, his automobile was involved in a multiple injury accident in Connecticut. At the time of the accident, the automobile was being driven by his stepson, Leakes, with Cousins' consent and permission. Leakes carried liability insurance ($10,000/$20,000 bodily injury and $5,000 property damage) with Mid-Century. As a result of the accident several tort actions have been filed against Leakes and Cousins for personal injuries and property damage. None has yet resulted in judgment, but the total claims in the actions exceed the limits of Mid-Century's policy. Mid-Century has undertaken the defense of these actions on behalf of Leakes and Cousins. It also joined with them as a plaintiff in this action to seek a declaration of the respective rights and duties of the parties.

After finding Hutsel negligent in failing to procure liability insurance **[10 Cal. App. 3d 1068]** for Cousins and finding such negligence proximately damaged Cousins and

Leakes by depriving them of insurance protection which would otherwise have been available to them, the trial court concluded all three plaintiffs, Mid-Century, Leakes and Cousins, were entitled to a declaratory judgment against Hutsel. The judgment declared, as to the accident of May 28, 1966, and all claims arising therefrom, Hutsel was to indemnify reimburse or pay Mid-Century, Leakes and Cousins for all reasonable settlements made by them or judgments suffered by them not to exceed $10,000 per claimant, or $20,000 per multiple claimants for personal injury damage, or $5,000 for property damage, plus any costs assessed in favor of any claimant. The judgment further provided Hutsel was to indemnify and reimburse Mid-Century, Leakes and Cousins for all out-of-pocket costs for investigators, adjustors and attorneys, including litigation costs and expenses and, if the principal amounts of settlements or judgments exceeded the $10,000/$20,000 and $5,000 to be paid by Hutsel, such costs would be prorated between Hutsel and Mid-Century in the same proportion each would become ultimately responsible for the payment of the judgments and settlements.

The effect of the judgment is to require Hutsel to pay the first $10,000/$20,000 bodily injury and $5,000 property damage claims arising out of the accident of May 28, 1966, exactly as if he were an insurer who had issued a minimum coverage liability policy to Cousins. Not only does the judgment have the effect of making Hutsel personally and primarily liable for such claims and judgments up to and including the stated amounts, but it also makes Mid-Century's insurance coverage excess insurance, to be resorted to only if and after those limits have been exceeded.

[1a] As we have already stated, Hutsel makes no complaint on appeal concerning the court's finding he negligently failed to procure a minimum coverage liability policy for Cousins, or of the further finding Cousins and Leakes were damaged as a result of that failure by being deprived of insurance protection they would have otherwise had. He does vigorously object to that portion of the judgment which makes him primarily liable to pay the first $10,000/$20,000 bodily injury and $5,000 property damage claims arising out of the accident and which declares Mid-Century is liable only for such claims as exceed those limits. We think his objection is well taken and the judgment erroneous in the respect claimed.

Under the heading "Use of Other Automobile-Broad Form" Leakes' policy of insurance with Mid-Century provides:

"It is agreed that such insurance as is afforded by the policy for Bodily Injury Liability, for Property Damage Liability and for Medical Expense **[10 Cal. App. 3d 1069]** with respect to any automobile owned by the named insured applies with respect to any other automobile, subject to the following provisions:

"1. * * *

"2. * * *

"3. Other Insurance. The insurance for Bodily Injury Liability and for Property Damage Liability shall be excess insurance over any other collectible insurance available to the insured, either as an insured under a policy applicable with respect to the automobile or otherwise, against a loss covered hereunder. The insurance for Medical Expense shall be excess insurance over any other collectible medical expense insurance applicable with respect to the automobile. The insurance is in lieu of the insurance afforded by the policy with respect to a 'non-owned automobile'."

Under the undisputed facts and the plain wording of the "use of other automobile" clause of its policy, Mid-Century's coverage is applicable to claims arising from the May 28, 1966 accident in which its insured, Leakes, was driving Cousins' car. Mid-Century's liability under the policy is primary, becoming excess insurance only if other collectible insurance was available to its insured with respect to the automobile he was driving, or otherwise. There was no other collectible insurance available to its insured. The gravamen of Mid-Century's co-plaintiffs' complaint against Hutsel is that he negligently failed to provide such insurance. Whatever the nature of Hutsel's liability to Cousins, and his permissive driver Leakes, it may not be equated with the words, "other collectible insurance available to the insured," contained in Mid-Century's policy. [2] "The liability of one who breaches a contract to procure insurance is to pay damages, and is not that of an insurer." (Bentley v. Fayas, 260 Wis. 177, 186 [50 N.W.2d 404, 409, 29 A.L.R.2d 205].)

[1b] Holding Mid-Century primarily liable for the claims arising from the accident, to the extent of its policy limits, results in no injustice to it or to Cousins or Leakes. While Mid-Century's liability would have been excess, rather than primary, had Hutsel fulfilled his obligation to procure insurance for Cousins, that obligation does not run to Mid-Century to whom Hutsel owed no duty, contractual or otherwise. Mid-Century's legal liability springs from the terms of its own insurance contract, for which it was paid a premium, and from the fact its insured was the driver involved in the accident. If the claims arising from the accident result in reasonable settlements and judgments totaling less than Mid-Century's insurance coverage, neither Cousins nor Leakes has sustained damage by reason of Hutsel's breach. To that extent, the claims must be paid by Mid-Century, and Cousins' and Leakes' damage is damnum absque injuria. "Where plaintiff **[10 Cal. App. 3d 1070]** has suffered no loss by failure of defendant to procure insurance, plaintiff's damage is damnum absque injuria." (44 C.J.S., Insurance, § 225, p. 940, italics added.)

Mid-Century's liability is defined by the limits of its insurance policy. If the claims arising from the accident cannot be satisfied within its limits, Cousins and Leakes will be damaged because of Hutsel's breach. To the extent such excess claims may be satisfied within the range of the $10,000/$20,000 bodily injury and $5,000 property damage insurance coverage Hutsel undertook, but failed to procure, Hutsel concedes his liability. The judgment should require him to pay any such claims or to indemnify Cousins and Leakes if they, or either of them, are required to pay them.

[3a] Mid-Century's contention it is entitled to reimbursement from Hutsel for the loss it may sustain under the doctrine of equitable subrogation is without merit. Any loss Mid-

Century may sustain will not be caused by Hutsel's failure to procure insurance coverage for Cousins. Its loss, if any, results from the fact Leakes, its insured, negligently caused an automobile accident. Hutsel's failure to procure insurance had nothing to do with the accident. [4] As stated in Patent Scaffolding Co. v. William Simpson Constr. Co., 256 Cal. App. 2d 506, 512 [64 Cal. Rptr. 187], where a similar contention was made under almost identical facts: "The California cases, with one exception, have not permitted equitable subrogation to insurers whose losses are not causally related to a breach of duty for which the party to be charged may be liable to the insured for a loss compensated by the insurers."

[3b] Our review of the Patent Scaffolding Co. case, and the cases upon which it relies, convinces us we should not deviate from the state rule in this case. In equity, it cannot be said Mid-Century should recover from Hutsel for sums it may be required to pay because of the negligence of its own insured.

[1c] Our holding will require a complete turnabout of the judgment, including the portion of it providing for payment of costs and expenses in connection with the litigation and investigations in Connecticut.

The judgment is reversed with directions to the trial court to prepare new findings of fact, conclusions of law and judgment conforming to the views expressed in this opinion.

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Filed 5/13/04 Certified for publication 6/14/04 (order attached)

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

BRAMALEA CALIFORNIA, INC.,

Cross-complainant and Appellant

v.

RELIABLE INTERIORS, INC. et al.,

Cross-defendants and Respondents.

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G032085

(Super. Ct. No. 791388)

O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, Stephen J. Sundvold, Judge. Affirmed.

Cooksey, Toolen, Gage, Duffy & Woog, Philip M. Woog, Paul K. Hoffman and Brian R. VanMorter for Cross-complainant and Appellant.

Murtaugh Miller Meyer & Nelson, Murtaugh Meyer Nelson & Tregiia, Thomas J. Skane and Matthew W. Johnson for Cross-defendant and Respondent Reliable Interiors, Inc.

Klinedinst PC, Donald R. McKillop, Sr. and David N. Bregman for Cross-defendant and Respondent Guaranteed Products Corporation.

Law Offices of Linda M. Libertucci and Mark G. Harris for Cross-Defendants and Respondents Ram-Mar Painting, Inc. and Sahara Waterproofing.

Demler, Armstrong & Rowland, James N. Murphy and Brian C. Dunn for Cross-Defendant and Respondent All Star Electric, Inc.

Bramalea California, Inc. (Bramalea), a residential real estate developer, was sued by homeowners for construction defects. Bramalea cross-complained for breach of contract and indemnity against the involved subcontractors. Both the complaint and the cross-complaint were settled, except the issue of Bramalea's right to recover attorney fees incurred after it tendered its defense to the subcontractors but before it tendered its defense to the subcontractors' insurers. The trial court dismissed the cross-complaint, finding because Bramalea had not actually paid the attorney fees, it had no standing to recover them. We affirm.

FACTS

The homeowners sued Bramalea in March 1998; at that time, Bramalea was in Chapter 11 bankruptcy. Accordingly, the homeowners stipulated in the bankruptcy court to limit their recovery "to any applicable insurance proceeds as well as any assignment of rights by the Debtor against its subcontractors . . . ." Bramalea's insurer, Zurich of Canada, hired counsel to provide a defense and file a cross-complaint against Bramalea's subcontractors, all of whom had signed subcontractors' agreements. The cross-complaint sought relief based on equitable indemnity and breach of the subcontractors' agreements. The agreements required the subcontractors to "indemnify and save Contractor . . . harmless from any and all . . . damages, . . . including, without limitation, attorneys' fees and court costs, which might arise from any act or omission of Subcontractor . . . ." The subcontractors also agreed to maintain liability insurance protecting Bramalea "from all liability relating to all work hereunder," and to pay Bramalea's attorney fees "arising out of this contract, or out of work performed by the Subcontractor on the Project . . . ."

For unexplained reasons, Bramalea delayed making a direct tender of defense directly to the subcontractors' insurance carriers. In March 2000, it tendered its defense to the carriers for Ram-Mar Painting and All Star Electric, Inc., and in September 2000 to the carriers for Guaranteed Products, Sahara Waterproofing, and Reliable

Interiors, Inc. Upon tender, the subcontractors' carriers promptly assumed the cost of defense. In August 2000, the homeowners, Bramalea, and the subcontractors entered into a settlement agreement, resolving all claims between and among the parties except "those claims asserted by [Bramalea] and its insurance carrier against [the subcontractors] and the insurance carriers for all [the subcontractors] relating to the reimbursement of defense fees and costs incurred on behalf of [Bramalea] during the course of the litigation . . . ."

Ram-Mar Painting filed a motion for judgment on the pleadings and Reliable Interiors filed a motion to dismiss the cross-complaint; they were heard together in February 2003. Ram-Mar claimed Bramalea had no standing to recover attorney fees because it lost all contract rights against the subcontractors when it filed for bankruptcy protection in 1995. Reliable Interiors claimed Bramalea was not the real party in interest because its insurer, not Bramalea, had paid the attorney fees. The trial court denied Ram-Mar's motion because it "failed to meet its burden of proof." It granted the motion by Reliable Interiors, finding: "In order for Bramalea to proceed on these theories [of indemnity and breach of contract], it must be shown that Bramalea has paid sums of money to which it is entitled to indemnity or that it has been damaged under its breach of contract theory by the payment of such sums. . . . It is not disputed that Bramalea has paid nothing. . . . Bramalea has no standing. The collateral source rule does not apply here as there is no tort action involved. This is not an action by Zurich for subrogation. It is an action for indemnity and breach of contract."

DISCUSSION

Attorney Fees as Costs

Bramalea argues the trial court was wrong to dismiss the cross-complaint simply because it had not paid the attorney fees out of its own pocket. Citing Code of Civil Procedure sections 1032 and 1033.5,[1] it claims it is entitled to recover attorney fees

[1] All statutory references are to the Code of Civil Procedure.

from the subcontractors as a cost of litigation because they were incurred when it was subjected to the litigation by the homeowners.

Section 1032 provides that the prevailing party is entitled to recover litigation costs as a matter of right; section 1033.5 includes attorney fees, when authorized by contract, statute, or law, as an allowable item of costs. (§ 1032, subd. (b); § 1033.5, subd. (a)(10).) Section 1033.5, subdivision (c)(1) provides that "[c]osts are allowable if incurred, whether or not paid." Bramalea points out that attorney fees have been allowed as costs to a party who has incurred, but not actually paid, the fees. (*Lolley v. Campbell* (2002) 28 Cal.4th 367; *Rapp v. Spring Valley Gold Company* (1888) 74 Cal. 532.)

Bramalea misses the point. It is not seeking to recover its attorney fees as a prevailing party in litigation. Although no liability was admitted, Bramalea and the subcontractors paid the homeowners $1,185,463.37 in exchange for mutual releases of liability, with the exception of Bramalea's claim for indemnity against the subcontractors. Bramalea does not emerge from the homeowner's litigation as the prevailing party. Rather, Bramalea's action against the subcontractors is for breach of contract and indemnity.

Attorney Fees as Breach of Contract Damages

Bramalea admits its attorney fees were entirely paid for by Zurich and it has suffered no out-of-pocket loss. Thus, any recovery it might receive from the subcontractors would be a prohibited double recovery unless allowed by the collateral source rule. The collateral source rule allows an injured person to recover from the wrongdoer for damages suffered even if he has been compensated for the injury "from a source wholly independent of the wrongdoer," such as insurance. (*Anheuser-Busch, Inc. v. Starley* (1946) 28 Cal.2d 347, 349.) But the collateral source rule applies to tort damages, not to damages for breach of contract. (*Plut v. Fireman's Fund Ins. Co.* (2000) 85 Cal.App.4th 98, 107.) This is due to the fundamental differences between tort and

contract damages. (*Id.* at p. 108.) "The collateral source rule is punitive; contractual damages are compensatory. The collateral source rule, if applied to an action based on breach of contract, would violate the contractual damage rule that no one shall profit more from the breach of an obligation than from its full performance." (*Patent Scaffolding Co. v. William Simpson Const.* (1967) 256 Cal.App.2d 506, 511.) In contrast, "'the tortfeasor's responsibility [is] to compensate for all harm that he causes, not confined to the net loss that the injured party receives.'" (*Plut v. Fireman's Fund Ins. Co.*, *supra*, 85 Cal.App.4th at p. 108.)

Bramalea argues its causes of action against the subcontractors should be characterized as sounding in tort, giving rise to the application of the collateral source rule. It asserts, "Having prudently insured against the risk of incurring attorney's fees relating to homeowner tort actions, Bramalea should not now be precluded from recovering the defense costs it incurred as a result of its subcontractors' negligence." But the subcontractors have not been adjudicated as negligent; the action was settled. Bramalea's causes of action against the subcontractors are based entirely in contract.

A breach of contract is not actionable without damage. (*Patent Scaffolding Co. v. William Simpson Const.*, *supra*, 256 Cal.App.2d at p. 511.) In *Patent Scaffolding*, the contract between the contractor and the subcontractor provided that the contractor would procure insurance to protect the subcontractor's materials from fire loss. Before entering into that contract, however, the subcontractor had procured three separate insurance policies covering his materials and equipment. Subsequently, a fire damaged the subcontractor's equipment. The contractor had not procured insurance as promised. The subcontractor collected in full from its insurers, and the insurers brought an action for subrogation in the name of the subcontractor against the contractor.

The court of appeal stated, "If [the subcontractor] had had no insurance to compensate it for its loss, [it] could have recovered damages from [the contractor] for all detriment proximately caused by [his] breach of its contractual duty to indemnify or to

procure insurance." (*Patent Scaffolding Co. v. William Simpson Const.*, *supra*, 256 Cal.App.2d at. p. 510.) But because the subcontractor had been fully compensated for its loss, he could not sue the contractor for his own benefit. (*Ibid.*)[2]

Attorney Fees on behalf of Zurich

Bramalea argues even if it is deemed to have transferred its claim for attorney fees to Zurich, it can pursue the action in its own name. This would be true if Bramalea had assigned the claim to Zurich or if Zurich was seeking to take Bramalea's place to pursue recovery against the subcontractors on an equitable subrogation theory. (*Greco v. Oregon Mut. Fire Ins. Co.* (1961) 191 Cal.App.2d 674, 687.) Bramalea does not contend that either of the former circumstances exists.

Furthermore, it is questionable whether Zurich *could* pursue equitable subrogation against the subcontractors.[3] In *Patent Scaffolding*, the court stated that even if the subcontractor suffered no loss, the loss of the subcontractor's insurers could be substituted "if the insurers' loss was proximately caused by the act or omission of [the contractor] or one for whose acts or omissions [he] was vicariously liable. The most common subrogation action is one brought on behalf of an insurer against a wrongdoer whose wrong caused the loss. [Citations.] Liability of the wrongdoer may, of course, be based not only on a tort, but also upon a breach of contract [citations] so long as there exists the necessary causal relationship between the wrong and the damage. [Citation.]"

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[2] The court also remarked that the subcontractor could not recover for the cost of the premiums paid to its insurers because it did not incur them as a consequence of its contract with the contractor or as a result of the contractor's breach of contract. (*Id.* at p. 511.)

[3] "The elements of an insurer's cause of action based upon equitable subrogation are these: (1) The insured has suffered a loss for which the party to be charged is liable, either because the latter is a wrongdoer whose act or omission caused the loss or because he is legally responsible to the insured for the loss caused by the wrongdoer; (2) the insurer, in whole or in part, has compensated the insured for the same loss for which the party to be charged is liable; (3) the insured has an existing, assignable cause of action against the party to be charged, which action the insured could have asserted for his own benefit had he not been compensated for his loss by the insurer; (4) the insurer has suffered damages caused by the act or omission upon which the liability of the party to be charged depends; (5) justice requires that the loss should be entirely shifted from the insurer to the party to be charged, whose equitable position is inferior to that of the insurer; and (6) the insurer's damages are in a stated sum, usually the amount it has paid to its insured, assuming the payment was not voluntary and was reasonable. [Citations.]" (*Patent Scaffolding Co. v. William Simpson Const.*, *supra*, 256 Cal.App.2d at p. 509.)

(*Patent Scaffolding Co. v. William Simpson Const.*, *supra*, 256 Cal.App.2d at pp. 511-512.)

The court in *Patent Scaffolding* did not find the necessary causal relationship. "Where two parties are contractually bound by independent contracts to indemnify the same person for the same loss, the payment by one of them to his indemnitee does not create in him equities superior to the nonpaying indemnitor, justifying subrogation, if the latter did not cause or participate in causing the loss." (*Patent Scaffolding Co. v. William Simpson Const.*, *supra*, 256 Cal.App.2d at p. 514.) It pointed out, "The insurers' loss was not caused by [the contractor's] failure to get insurance or to indemnify [the subcontractor]. The insurers' loss was caused by the fire, the very risk which each assumed, and [the contractor's] failure to perform its contractual duty had nothing to do with the fire." (*Id.* at p. 512.) The court continued, "If subrogation were permitted, the insurers who have accepted premiums to cover the very loss which occurred receive a windfall. There is no evidence in this record that the insurers' acceptance of the risk or their determination of the cost to the insured of the insurance policies was based in any way upon the terms of [the contractor's] contract with [the subcontractor]. The contest is not between two insurance companies, each of which has received premiums for bearing the loss which ultimately occurred, but between insurers and a general contractor who received no independent consideration for the assumption of the risk." (*Id.* at p. 516.)[4]

Under the reasoning of the *Patent Scaffolding* court, Zurich would not be entitled to equitable subrogation. The attorney fees were not caused by the subcontractors' breach of their obligation to indemnify Bramalea; they were caused by

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[4] *Patent Scaffolding* has been followed by several cases, including *California Food Service Corp. v. Great American Ins. Co.* (1982) 130 Cal.App.3d 892, 899-900. Other cases have held that the terms and circumstances of the indemnity agreement may compel the conclusion that the indemnitor, in equity, should bear the entire loss even though the indemnitor did not cause the loss. (*Fireman's Fund Ins. Co. v. Wilshire Film Ventures, Inc.* (1997) 52 Cal.App.4th 553, 557-559; *Meyer Koulish Co. v. Cannon* (1963) 213 Cal.App.2d 419, 428-429 [disapproved by *Patent Scaffolding*, *supra*, 256 Cal.App.2d at p. 515.)

the lawsuit brought by the homeowners for construction defects, which was one of the risks Zurich accepted premiums to cover. Whether the subcontractors caused the construction defects was not resolved by this litigation. (See also *Mid-Century Ins. Co. v. Hutsel* (1970) 10 Cal.App.3d 1065, 1069-1070.)[5]

DISPOSITION

The judgment of dismissal is affirmed. Respondents are entitled to costs on appeal.

SILLS, P. J.

WE CONCUR:

RYLAARSDAM, J.

BEDSWORTH, J.

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[5] Presumably, Zurich could pursue an action against the subcontractors on its own for equitable contribution as a coinsurer or coindemnitor. "Where multiple insurers or indemnitors share equal contractual liability for the primary indemnification of a loss or the discharge of an obligation, the selection of which indemnitor is to bear the loss should not be left to the often arbitrary choice of the loss claimant, and no indemnitor should have any incentive to avoid paying a just claim in the hope the claimant will obtain full payment from another coindemnitor." (*Fireman's Fund Ins. Co. v. Maryland Cas. Co.* (1998) 65 Cal.App.4th 1279, 1295.)

The subcontractors contend the loss of attorney fees should be blamed on either Bramalea or Zurich because neither tendered the defense to the subcontractors' insurers in a timely manner. But this action (and the hypothetical action by Zurich for equitable contribution) is against the subcontractors, not their insurers. The promise to indemnify is separate from the promise to obtain insurance. (*Chevron U.S.A., Inc. v. Bragg Crane & Rigging Co.* (1986) 180 Cal.App.3d 639, 644.)

Filed 6/14/04

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

BRAMALEA CALIFORNIA, INC., Cross-complainant and Appellant v. RELIABLE INTERIORS, INC. et al., Cross-defendants and Respondents. .	G032085 (Super. Ct. No. 791388) O R D E R

Respondent has requested that our opinion filed May 13, 2004, be certified for publication. It appears that our opinion meets the standards set forth in California Rules of Court, rule 976(b). The request is GRANTED. The opinion is ordered published in the Official Reports.

SILLS, P. J.

WE CONCUR:

RYLAARSDAM, J.
BEDSWORTH, J.

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Filed 7/21/08

IN THE SUPREME COURT OF CALIFORNIA

KIRK CRAWFORD et al.,	)	
	)	
Plaintiffs and Appellants,	)	
	)	S141541
v.	)	
	)	Ct.App. 4/3 G032301
WEATHER SHIELD MFG. INC.,	)	
	)	Orange County
Defendant and Appellant.	)	Super. Ct. Nos. 815154, 815156,
	)	815182, 816278
_____	)	

Standard comprehensive liability insurance policies provide that the insurer must both indemnify and defend the insured against claims within the scope of the policy coverage. The insurer's duty to defend is broader than its duty to indemnify. The latter duty runs only to claims that are actually covered by the policy, while the duty to defend extends to claims that are merely potentially covered. (E.g., *Buss v. Superior Court* (1997) 16 Cal.4th 35, 45-46 (*Buss*); *Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 295.) "The [insurer's] defense duty is a continuing one, arising on tender of defense and lasting until the underlying lawsuit is concluded [citation], or until it has been shown that there is *no* potential for coverage . . . ." (*Montrose*, *supra*, at p. 295.)

Here, however, we address issues concerning the contractual duty to defend in a *noninsurance* context. We consider whether, by their particular terms, the provisions of a pre-2006 residential construction subcontract obliged the

subcontractor to defend its indemnitee — the developer-builder of the project — in lawsuits brought against both parties, insofar as the plaintiffs' complaints *alleged* construction defects arising from the subcontractor's negligence, even though (1) a jury ultimately found that the subcontractor was not negligent, and (2) the parties have accepted an interpretation of the subcontract that gave the builder no right of *indemnity* unless the subcontractor was negligent. We conclude that the answer is yes. We will therefore affirm the judgment of the Court of Appeal.

FACTS AND PROCEDURAL BACKGROUND

The basic facts are not in dispute. J.M. Peters Co. (JMP) was the developer, builder, and general contractor of a large Huntington Beach residential project. Weather Shield Manufacturing Co., Inc. (Weather Shield), contracted with JMP to manufacture and supply wood-framed windows for the project. In the contract, Weather Shield promised (1) "to indemnify and save [JMP] harmless against all claims for damages . . . loss, . . . and/or theft . . . growing out of the execution of [Weather Shield's] work," *and* (2) "at [its] own expense to *defend any suit or action* brought against [JMP] *founded upon* the claim of such damage[,] . . . loss or theft." (Italics added.)

In September and October 1999, 220 owners of 122 finished homes in the project sued JMP, Weather Shield, and other participants in the project's construction. The defendants included Darrow the Framing Corporation (Darrow), the project's principal subcontractor, whose responsibilities included framing the structures and installing the windows. The complaints alleged numerous construction defects, including electrical, plumbing, roofing, chimney, framing, and other structural problems. As relevant here, they also asserted that, because of improper design, manufacture, and installation, windows in the homes,

including those supplied by Weather Shield, leaked and fogged, causing extensive damage. Theories of negligence, strict liability, breach of warranty, and breach of contract were set forth.[1]

In April 2000, JMP cross-complained against Weather Shield, Darrow, and all the other project subcontractors sued by the homeowners. The cross-complaints asserted, among other things, that under the pertinent subcontract provisions — all of which had been drafted by JMP and were identical on the point — the subcontractors owed JMP duties of indemnity and defense against the homeowners' complaints. The cross-complaints sought declaratory relief with respect to JMP's alleged indemnity and defense rights.[2]

JMP, and all the subcontractors except Weather Shield and Darrow, settled before trial. The "sliding scale" settlement agreement provided the homeowners a minimum payment of $2.55 million, and guaranteed an additional sum of $1.45 million against any recovery from the nonsettling subcontractors. The settling defendants also agreed to assist the homeowners in prosecuting their claims against the nonsettling parties. JMP and the settling subcontractors mutually

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[1] The cases were consolidated for pretrial and trial purposes.

[2] JMP's cross-complaints alleged that the cross-defendant subcontractors had a "present" duty to provide, and JMP had a "present" right to receive, a contractual defense. Each cross-complaint also recited that "[b]y way of this Cross-Complaint, [JMP] hereby tenders the defense of this action to the Cross-Defendants, and each of them, pursuant to the applicable subcontracts. [JMP] is informed and believed and based thereon alleges that the Cross-Defendants, and each of them have and/or will reject, ignore, or fail to properly accept the tender of defense." The record is silent as to whether JMP had previously tendered defense of the homeowners' actions to the cross-defendant subcontractors, or any of them. Weather Shield does not urge on appeal that it was absolved of any duty to defend by reason of JMP's failure to timely tender the defense of the homeowners' actions.

released all claims, demands, and liabilities among themselves. All complaints and cross-complaints were dismissed except as to Weather Shield and Darrow.

In July 2002, during final pretrial proceedings, Weather Shield moved to dismiss the homeowners' strict liability causes of action. The motion cited then extant case law holding that a subcontractor hired by a developer — even a subcontractor that supplied a component product rather than a service — could not be strictly liable for defects in mass-produced homes, unless the subcontractor also owned or controlled the housing development. (See, e.g., *Casey v. Overhead Door Corp.* (1999) 74 Cal.App.4th 112, 119-120 (*Casey*); *La Jolla Village Homeowners' Assn. v. Superior Court* (1989) 212 Cal.App.3d 1131, 1146 (*La Jolla Village*).) The court granted the motion, subject to a reevaluation of prejudice in the event of an intervening change in the law.

The window leak and framing issues went to trial against Weather Shield and Darrow on the remaining theories of negligence and breach of warranty. In October 2002, the jury returned general verdicts against Darrow and in favor of Weather Shield. The jury awarded the homeowners approximately $1 million in damages against Darrow. Following the jury verdict, Darrow settled all the complaints against it.

Thereafter, in March 2003, JMP's cross-complaint against Weather Shield was separately tried to the court. JMP sought both (1) express indemnity for amounts paid to the homeowners in settlement, and (2) under the duty-to-defend provisions of Weather Shield's subcontract, attorney fees and expenses incurred by JMP in defending itself against the homeowners' suit.

The trial court ruled that the subcontract's terms obliged Weather Shield to indemnify JMP for amounts paid to the homeowners only if Weather Shield was found negligent. Thus, the court determined, the jury's verdict that Weather Shield was not negligent absolved Weather Shield of indemnity liability in this

case. On the other hand, the court concluded, the subcontract did give Weather Shield responsibility for JMP's legal defense against the homeowners' claims, insofar as those claims concerned the windows supplied by Weather Shield, regardless of whether Weather Shield was ultimately found negligent.

JMP presented evidence that it had incurred $375,069 in attorney fees to defend the homeowners' claims, and that 70 percent of the homeowner settlement amount was attributable to the window problems. JMP therefore urged that, under their subcontracts, Weather Shield and Darrow were together liable for 70 percent of JMP's defense fees, or $262,548. The court apportioned this amount equally between Darrow and Weather Shield, and therefore awarded JMP $131,274 in damages against Weather Shield. The court also found Weather Shield contractually liable to JMP, as the prevailing party on JMP's cross-complaint, for $46,734 in attorney fees incurred by JMP to prosecute the cross-action.

Meanwhile, in December 2002, this court held in *Jimenez v. Superior Court* (2002) 29 Cal.4th 473 (*Jimenez*) that, contrary to the teaching of such cases as *Casey*, *supra*, 74 Cal.App.4th 112, and *La Jolla Village*, *supra*, 212 Cal.App.3d 1131, the manufacturer or supplier of a component part installed in a mass-produced home may be held strictly liable when a defect in the component causes damage to other parts of the structure. (*Jimenez*, *supra*, at p. 484.)

Following entry of judgment in this case in March 2003, the homeowners moved for a judgment notwithstanding the verdict (judgment NOV) (Code Civ. Proc., §§ 629, 659) and a new trial (*id.*, §§ 657, 659) against Weather Shield. Among other things, the homeowners asserted that, under *Jimenez*, they were entitled to try their previously dismissed strict liability causes of action. In May 2003, the court denied the motion for a judgment NOV, but granted a new trial against Weather Shield on the issue of strict liability.

Weather Shield appealed (1) the new trial order, and (2) the declaratory relief judgment insofar as it required Weather Shield to reimburse JMP's expense of defending the homeowners' action and prosecuting JMP's cross-complaint. Two of the groups of homeowner plaintiffs filed protective cross-appeals from the judgment against them, and in Weather Shield's favor, on the construction-defect claims. JMP did not appeal the order absolving Weather Shield from contractual indemnity liability for amounts paid by JMP to the homeowners.[3]

In a divided decision, the Court of Appeal affirmed the orders and judgments challenged by Weather Shield, and dismissed the cross-appeals as moot. On the issue of Weather Shield's liability for JMP's defense, regardless of its own negligence, the majority reasoned, in essence, that Weather Shield's promise "to defend" JMP against suits founded upon claims arising out of the execution of Weather Shield's work necessarily contemplated an immediate duty to provide a service, which duty arose at the time such a suit was brought and a defense was therefore needed. Thus, the majority concluded, the duty could not depend upon the outcome of issues to be litigated in the very action Weather Shield was obliged to defend.

The concurring and dissenting opinion argued that the contract language did not compel the majority's interpretation of the duty to defend. Moreover, the concurring and dissenting opinion urged, policy concerns weigh against allowing

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[3] We were informed by the parties that, following the trial court judgment, JMP assigned all its rights thereunder to the homeowners. The homeowners then defended JMP's defense-cost award in the Court of Appeal. In this court as well, the homeowners have briefed the defense-cost issue as assignees of JMP's rights under the defense-cost award.

a builder or developer with superior bargaining power to impose contractual defense obligations on a nonnegligent subcontractor.

Weather Shield sought review, raising both the new-trial and defense-cost issues. We granted review, limited to the following issue: Did a contract under which a subcontractor agreed "to defend any suit or action" against a developer "founded upon" any claim "growing out of the execution of the work" require the subcontractor to provide a defense to a suit against the developer even if the subcontractor was not negligent?[4] We turn to that issue.

DISCUSSION

Parties to a contract, including a construction contract, may define therein their duties toward one another in the event of a third party claim against one or both arising out of their relationship. Terms of this kind may require one party to *indemnify* the other, under specified circumstances, for moneys paid or expenses incurred by the latter as a result of such claims. (See Civ. Code, § 2772 ["Indemnity is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person."].)[5] They may also assign one party, pursuant to the contract's language, responsibility for the other's *legal defense* when a third party claim is made against the latter.

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[4] Subsequent to our grant of review, an issue arose whether, despite our limitation of issues, the pendency of review precluded further proceedings in the trial court under the new trial order, the propriety of which order we did not intend to address. Concluding that there was no reason to delay the homeowners' strict-liability trial while we considered the defense-cost issue, we therefore dismissed review with respect only to the order granting a new trial on that issue, as affirmed by the Court of Appeal. We directed the Court of Appeal to issue a partial remittitur in accordance with the partial dismissal order.

[5] All further unlabeled statutory references are to the Civil Code.

(See *Mel Clayton Ford v. Ford Motor Co.* (2004) 104 Cal.App.4th 46, 49, 55 (*Mel Clayton Ford*).)

As befits the contractual nature of such arrangements, but subject to public policy and established rules of contract interpretation, the parties have great freedom to allocate such responsibilities as they see fit. (*E.L. White, Inc. v. City of Huntington Beach* (1978) 21 Cal.3d 497, 507 (*E.L. White, Inc.*); *Heppler v. J.M. Peters Co.* (1999) 73 Cal.App.4th 1265, 1276-1277 (*Heppler*).) "When the parties knowingly bargain for the protection at issue, the protection should be afforded." (*Rossmoor Sanitation, Inc. v. Pylon, Inc.* (1975) 13 Cal.3d 622, 633 (*Rossmoor*); see *Heppler*, *supra*, at p. 1277.) Hence, they may agree that the promisor's indemnity and/or defense obligations will apply only if the promisor was negligent, or, conversely, even if the promisor was not negligent. (*Heppler*, *supra*, at p. 1277; *Continental Heller Corp. v. Amtech Mechanical Services, Inc.* (1997) 53 Cal.App.4th 500, 505 (*Continental Heller*); *Peter Culley & Associates v. Superior Court* (1992) 10 Cal.App.4th 1484, 1492 (*Peter Culley & Associates*).)

In general, such an agreement is construed under the same rules as govern the interpretation of other contracts. Effect is to be given to the parties' mutual intent (§ 1636), as ascertained from the contract's language if it is clear and explicit (§ 1638). Unless the parties have indicated a special meaning, the contract's words are to be understood in their ordinary and popular sense. (§ 1644; *Continental Heller*, *supra*, 53 Cal.App.4th 500, 504; accord, *Centex Golden Construction Co. v. Dale Tile Co.* (2000) 78 Cal.App.4th 992, 996-997 (*Centex Golden*).)

Though indemnity agreements resemble liability insurance policies, rules for interpreting the two classes of contracts do differ significantly. Ambiguities in a policy of insurance are construed against the insurer, who generally drafted the policy, and who has received premiums to provide the agreed protection. (See,

e.g., *Buss, supra,* 16 Cal.4th 35, 47-48; *La Jolla Beach & Tennis Club, Inc. v. Industrial Indemnity Co.* (1994) 9 Cal.4th 27, 37-38.) In noninsurance contexts, however, it is the *indemnitee* who may often have the superior bargaining power, and who may use this power unfairly to shift to another a disproportionate share of the financial consequences of its own legal fault. (E.g., *Goldman v. Ecco-Phoenix Elec. Corp.* (1964) 62 Cal.2d 40, 49 (*Goldman*); see *Regan Roofing Co. v. Superior Court* (1994) 24 Cal.App.4th 425, 436 (*Regan Roofing*).)

This public policy concern influences to some degree the manner in which noninsurance indemnity agreements are construed. For example, it has been said that if one seeks, in a noninsurance agreement, to be indemnified for his or her own active negligence, or regardless of the indemnitor's fault — protections beyond those afforded by the doctrines of implied or equitable indemnity — language on the point must be particularly clear and explicit, and will be construed strictly against the indemnitee. (E.g., *E.L. White, Inc., supra,* 21 Cal.3d 497, 507; *Rossmoor, supra,* 13 Cal.3d 622, 628; *Goldman, supra,* 62 Cal.2d 40, 44; *Centex Golden, supra,* 78 Cal.App.4th 992, 998; *Heppler, supra,* 73 Cal.App.4th 1265, 1278.)

For similar public policy reasons, statutory law imposes some absolute limits on the enforceability of noninsurance indemnity agreements in the construction industry. At the time Weather Shield contracted with JMP, a party to a construction contract could not validly agree to indemnify the promisee for the latter's *sole* negligence or willful misconduct. (§ 2782, subd. (a); see also § 1668.)

Finally, Civil Code section 2778, unchanged since 1872, sets forth general rules for the interpretation of indemnity contracts, "unless a contrary intention appears." If not forbidden by other, more specific statutes, the obligations set forth in section 2778 thus are deemed included in every indemnity agreement unless the parties indicate otherwise. Several subdivisions of this statute touch

specifically on the indemnitor's obligations with respect to the indemnitee's defense against third party claims.

In this regard, the statute first provides that a promise of *indemnity* against claims, demands, or liability "embraces the *costs of defense* against such claims, demands, or liability" insofar as such costs are incurred reasonably and in good faith. (§ 2778, subd. 3, italics added.) Second, the section specifies that the indemnitor "is bound, on request of the [indemnitee], *to defend* actions or proceedings brought against the [indemnitee] in respect to the matters embraced by the indemnity," though the indemnitee may choose to conduct the defense. (*Id.*, subd. 4, italics added.) Third, the statute declares that if the indemnitor declines the indemnitee's tender of defense, "a recovery against the [indemnitee] suffered by him in good faith, is conclusive in his favor against the [indemnitor]." (*Id.*, subd. 5.) On the other hand, section 2778 provides, if the indemnitor got no reasonable notice of the action, or was not allowed to control the indemnitee's defense, recovery by the third party against the indemnitee is only presumptive evidence against the indemnitor. (*Id.*, subd. 6.)

With these principles in mind, we examine the pertinent terms of Weather Shield's subcontract with JMP. We agree with the Court of Appeal majority that, even if strictly construed in Weather Shield's favor, these provisions expressly, and unambiguously, obligated Weather Shield to defend, from the outset, any suit against JMP insofar as that suit was "founded upon" claims *alleging* damage or loss arising from Weather Shield's negligent role in the Huntington Beach residential project. Weather Shield thus had a contractual obligation to defend such a suit even if it was later determined, as a result of this very litigation, that Weather Shield was not negligent.

We focus on the particular language of the subcontract. Its relevant terms imposed two distinct obligations on Weather Shield. First, Weather Shield agreed

"to indemnify and save [JMP] harmless against all claims for damages to persons or to property and claims for loss, damage and/or theft . . . growing out of the execution of [Weather Shield's] work." Second, Weather Shield made a separate and specific promise "at [its] own expense *to defend any suit or action* brought against [JMP] *founded upon* the claim of such damage . . . loss, . . . or theft." (Italics added.)

A contractual promise to "defend" another against specified claims clearly connotes an obligation of active responsibility, from the outset, for the promisee's defense against such claims. The duty promised is to render, or fund, the *service* of providing a defense on the promisee's behalf — a duty that necessarily arises as soon as such claims are made against the promisee, and may continue until they have been resolved. This is the common understanding of the word "defend" as it is used in legal parlance. (See, e.g., Black's Law Dict. (8th ed. 2004) p. 450, col. 2 ["2. To represent (someone) as an attorney . . ."]; Merriam Webster's Collegiate Dict. (11th ed. 2004) p. 326, col. 1 ["3: to act as attorney for . . ."]; Random House Webster's College Dict. (2d rev. ed. 2001) p. 348, col. 2 ["4. to serve as attorney for (a defendant) . . ."]; American Heritage Dict. (4th ed. 2000) p. 475, col. 2 ["4. *Law* a. To represent (a defendant) in a civil or criminal action . . ."].)

A duty to defend another, stated in that way, is thus different from a duty expressed simply as an obligation to pay another, after the fact, for defense costs the other has incurred in defending itself. Section 2778, the statute governing the construction of all indemnity agreements, makes the distinction clear. On the one hand, as noted above, the section specifies that a basic contractual *indemnity* against particular claims, demands, or liabilities "embraces the costs of defense" against such claims, demands, or liabilities. (*Id.*, subd. 3.) On the other hand, the statute separately specifies the indemnitor's duty actually "to defend," upon the

indemnitee's request, proceedings against the latter "in respect to the matters embraced by the indemnity," though "the person indemnified has the right to conduct such defenses if he chooses to do so." (*Id.*, subd. 4.) Finally, section 2778 sets forth how the indemnitor's obligations will be affected if the indemnitor fails to accept an indemnitee's tender of defense or, alternatively, if the indemnitor is denied an opportunity to assume and control the defense. (*Id.*, subds. 5, 6.)[6]

By virtue of these statutory provisions, the case law has long confirmed that, unless the parties' agreement expressly provides otherwise, a contractual indemnitor has the obligation, upon proper tender by the indemnitee, to accept and assume the indemnitee's active defense against claims encompassed by the indemnity provision. Where the indemnitor has breached this obligation, an indemnitee who was thereby forced, against its wishes, to defend itself is entitled to reimbursement of the costs of doing so.

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6 Pursuant to subdivision 5 of section 2778, if a contractual indemnitor declines the indemnitee's tender of defense of a third party claim against the latter, the third party's later judgment against the indemnitee may be conclusive evidence, against the indemnitor, of the indemnitee's liability to the third party, and the amount thereof, while the indemnitee's good faith settlement of the third party claim may be presumptive evidence against the indemnitor on that issue. (See, e.g., *Isaacson v. California Ins. Guarantee Assn.* (1988) 44 Cal.3d 775, 791; *Peter Culley & Associates*, *supra*, 10 Cal.App.4th 1484, 1495-1497.) In other words, a contractual indemnitor's failure to assume the indemnitee's defense and, with it, control of the underlying litigation may restrict the indemnitor's later ability to separately litigate issues pertaining to its own *indemnity* liability. In this case, as indicated above, no issue is presented of the effect of JMP's settlement with the homeowners on Weather Shield's indemnity liability. We confront the separate question whether the express terms of Weather Shield's subcontract required Weather Shield, at its own expense, to assume JMP's defense, and, having failed to do so, to reimburse JMP after the fact for the latter's actual defense costs, *regardless* of Weather Shield's liability to indemnify JMP for amounts paid to the homeowners in settlement.

Thus, in *Safeway Stores, Inc. v. Massachusetts Bonding & Ins. Co.* (1962) 202 Cal.App.2d 99 (*Safeway Stores*), one King undertook, by written agreement, to act as general contractor in the construction of a new Safeway store. The agreement included King's obligation to indemnify Safeway against any claims, demands, or suits for damage, loss, or injury " 'result[ing] from or occur[ring] in connection with the performance of [the] contract.' " (*Id.*, at p. 105.) Construction workers employed by King sued Safeway for injuries they sustained when recently installed roof trusses collapsed. The workers alleged that Safeway had negligently permitted the installation of trusses it knew to be defective. King offered Safeway a defense, which Safeway initially accepted. However, it thereafter became apparent that the attorney furnished by King was serving King's conflicting interests; in discussions between the parties, King indicated he would deny indemnity liability if Safeway was found negligent. Safeway thereupon retained its own attorney to defend the workers' action, and later sought reimbursement of its defense costs from King.

The Court of Appeal agreed with Safeway. The court noted that "under the contract of indemnity, no contrary intent appearing, *King was bound to defend the actions*. (Civ. Code, § 2778, subd. 4.)" (*Safeway Stores*, *supra*, 202 Cal.App.2d 99, 114, italics added.) However, the court reasoned, in light of the obvious conflict between Safeway's litigation interests and King's position on the indemnity issue, Safeway had reasonably inferred that, despite King's technical proffer, King did not intend to honor his contractual obligation to provide Safeway with a complete defense. Under these circumstances, the court concluded, Safeway did not act as a volunteer in assuming its own defense, and was entitled to reimbursement for King's breach of the duty to defend.

Similarly, in *Buchalter v. Levin* (1967) 252 Cal.App.2d 367, the court acknowledged that subdivision 4 of section 2778 "establishes an indemnitor's

obligation to *defend* the indemnitee *upon request, even though the indemnity agreement does not expressly so provide . . . .*" (*Buchalter, supra*, at p. 374, italics added.) However, the court concluded, the subdivision's provision that the indemnitee may "conduct his own defense 'if he chooses to do so' " (*ibid.*) does not mean the indemnitee ordinarily may refuse the indemnitor's good faith proffer of a complete defense, then still collect reimbursement from the indemnitor for the defense costs the indemnitee has voluntarily incurred. (*Id.*, at pp. 374-375; cf. *Goodman v. Severin* (1969) 274 Cal.App.2d 885, 897.)

In *Gribaldo, Jacobs, Jones & Associates v. Agrippina Versicherunges A.G.* (1970) 3 Cal.3d 434 (*Gribaldo*), a majority of this court carefully distinguished between the "costs of defense" described in subdivision 3 of section 2778, on the one hand, and the duty "to defend" the indemnitee, as set forth in subdivision 4 of the statute, on the other. There, an errors and omissions indemnity policy provided for a deductible of $2,500, said nothing about a duty to defend, gave the underwriters the *right* to assume the insureds' defense, specified that the insureds need not contest any legal claim unless counsel mutually chosen by the parties advised otherwise, and prohibited either party from settling a claim against the insureds without the other's consent. The policy further stated that if the insureds refused a settlement offer against the underwriters' recommendation, and elected to contest the claim further, the underwriters' liability would not exceed the amount for which the claim could have been settled, plus costs and expenses incurred by the insureds with the underwriters' consent.

After the insureds settled a third party claim, they sought declaratory relief against the underwriters on the issue of liability for defense costs. The insureds contended that under subdivision 4 of section 2778, the policy included, and the underwriters had breached, an "actual duty to defend" (*Gribaldo, supra*, 3 Cal.3d 434, 441) any claim, of a type covered by the policy, in which the *initial demand*

exceeded the $2,500 deductible. Hence, the insureds insisted, the underwriters were now obliged to pay the insureds' costs of defending such claims in full, regardless of the amounts for which the claims were actually resolved.

The trial court disagreed. It reasoned that, under the particular terms of the policy, the underwriters were not obliged to defend the insureds. Hence, the court concluded, any liability of the underwriters for the insureds' defense costs arose solely under subdivision 3 of section 2778, as part of any indemnity the underwriters otherwise owed the insureds. That obligation, the court held, applied only to costs incurred by the insureds to defend claims "embraced within the provisions of the policy, that is, those claims in excess of $2,500 actually paid by [the insureds]." (*Gribaldo, supra,* 3 Cal.3d 434, 441.)

This court affirmed. The majority agreed "that under the provisions of subdivision 4 of section 2778 the indemnitor is required to defend matters embraced by the indemnity if . . . requested to do so by the indemnitee." (*Gribaldo, supra*, 3 Cal.3d 434, 448.) However, the majority noted, the policy at issue indicated a contrary intent, as section 2778 permits. By its plain terms, the policy *allowed* the underwriters, at *their option*, to assume the insureds' defense, and it "require[d] [the insureds] to defend claims where so advised by counsel." (*Ibid.*) Moreover, the majority noted, even assuming the policy did not, at the outset, exclude a duty to defend, the insureds had, contrary to the policy, incurred defense costs without first obtaining the underwriters' consent, and had failed, as required by subdivision 4 of section 2778, to *request* a defense. (*Gribaldo, supra*, at pp. 448-449.)

Accordingly, the majority reasoned, the underwriters had breached no duty under subdivision 4 of section 2778 to defend any and all claims in which the demand exceeded the $2,500 deductible. Instead, the majority concluded, the trial court had acted correctly in calculating the underwriters' defense-cost liability

under subdivision 3 of the statute. Under the latter provision, the majority held, the underwriters' defense-cost liability was limited to the insureds' expense of defending claims as to which the underwriters otherwise owed indemnity — i.e., those claims actually paid by the insureds in amounts exceeding the $2,500 deductible. (*Gribaldo, supra*, 3 Cal.3d 434, 447-450.)

Recently, *City of Watsonville v. Corrigan* (2007) 149 Cal.App.4th 1542 observed once again that subdivision 4 of section 2778 "describes the indemnitor's duty *to defend* . . . actions or proceedings brought against the indemnitee if the latter requests the defense." (*City of Watsonville, supra*, at p. 1549, original italics.) However, the Court of Appeal held that by failing to request a defense, or to notify the indemnitor of the third party action, and by unilaterally deciding to conduct its own defense, the indemnitee does not necessarily forfeit its contractual right to reimbursement of its defense *costs* under the *indemnity* provisions of subdivision 3 of the statute.

Thus, as these decisions indicate, subdivision 4 of section 2778, by specifying an indemnitor's duty "to defend" the indemnitee upon the latter's request, places in every indemnity contract, unless the agreement provides otherwise, a duty to assume the indemnitee's defense, if tendered, against all claims "embraced by the indemnity." The indemnitor's failure to assume the duty to defend the indemnitee upon request (§ 2778, subd. 4) may give rise to damages in the form of reimbursement of defense costs the indemnitee was thereby forced to incur. But this duty is nonetheless distinct and separate from the contractual obligation to pay an indemnitee's defense costs, after the fact, as part of any indemnity owed under the agreement. (*Id.*, subd. 3.)

Implicit in this understanding of the duty to defend an indemnitee against all claims "embraced by the indemnity," as specified in subdivision 4 of section 2778, is that the duty arises immediately upon a proper tender of defense by the

indemnitee, and thus before the litigation to be defended has determined whether indemnity is actually owed. This duty, as described in the statute, therefore cannot depend on the outcome of that litigation. It follows that, under subdivision 4 of section 2778, claims "embraced by the indemnity," as to which the duty to defend is owed, include those which, at the time of tender, *allege* facts that would give rise to a duty of indemnity.[7] Unless the indemnity agreement states otherwise, the statutorily described duty "to defend" the indemnitee upon tender of the defense thus extends to all such claims.

Here, the subcontract at issue not only failed to limit or exclude Weather Shield's duty "to defend" JMP, as otherwise provided by subdivision 4 of section 2778, it confirmed this duty. In language similar to that of the statute, the subcontract explicitly obligated Weather Shield both to *indemnify* JMP against certain claims, and "at [its] own expense *to defend*" JMP against "any suit or action . . . founded upon" such claims. (Italics added.) The duty "to defend" expressly set forth in Weather Shield's subcontract thus clearly contemplated a duty that arose when such a claim was made,[8] and was not dependent on whether the very litigation to be defended later established Weather Shield's obligation to pay indemnity.

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[7] We do not suggest that the indemnitor's duty to defend would *continue* even if, during the progress of the third party proceeding against the indemnitee, all claims potentially subject to the contractual indemnity obligation were eliminated, or if the promisor otherwise conclusively established that the claims were not among those "embraced by the indemnity" (§ 2778, subd. 4). Such issues are not before us, and we express no views thereon.

[8] Unlike subdivision 4 of Civil Code section 2778, Weather Shield's subcontract did not expressly condition the duty "to defend" upon the indemnitee's *request* for a defense. In any event, as noted above (fn. 1, *ante*), Weather Shield does not contend it was absolved of a duty to defend on account of any failure by JMP to make such a request.

Moreover, the subcontract at issue included a further express indication that the express duty "to defend" actions against JMP was not strictly limited to those claims on which, in the end, Weather Shield actually owed indemnity. The indemnity and defense clauses of the subcontract contained linguistic differences that conform to the logical distinctions between the two duties. On the one hand, the subcontract obligated Weather Shield to "indemnify . . . [JMP] . . . against" all claims for injury, damage, loss, or theft arising from performance of the subcontract, while, on the other, it required Weather Shield "to defend *any suit or action* . . . against [JMP] *founded upon* the claim" of such injury, damage, loss, or theft. (Italics added.)

One can only indemnify against "claims for damages" that have been resolved against the indemnitee, i.e., those as to which the indemnitee has actually sustained liability or paid damages. Indemnification, after all, is the act of saving another from the legal *consequence* of an act. (§ 2772.) Hence, a clause requiring Weather Shield to indemnify JMP "against" defined claims clearly indicated that the indemnity obligation would apply only if JMP ultimately incurred such a legal consequence as a result of covered claims.

By contrast, as noted above, the subcontract required Weather Shield "to defend" JMP against "*any suit or action . . . founded upon* the claim of such damage . . . ." (Italics added.) Under this language, the duty to defend arose, as it logically must, as soon as a "suit or action" was brought against JMP that was "founded upon" a covered claim, i.e., that asserted a claim within the coverage of both clauses. Necessarily, a duty expressed in this manner did not require a final determination of the issues, including the issue of Weather Shield's negligence, before Weather Shield was required to mount and finance a defense on JMP's behalf.

The Court of Appeal majority so concluded. Dissenting on this point, Justice O'Leary conceded at the outset that "the word 'defend,' as defined in the abstract, would ordinarily mean providing legal services for a pending claim." Nonetheless, she stressed, noninsurance indemnity contracts, unlike liability insurance policies, are construed to limit the obligations imposed, and the duties undertaken must be stated with particular clarity and specificity. Examined in that light, she asserted, Weather Shield's subcontract did not make absolutely clear that Weather Shield's duty to defend, unlike its duty to indemnify, arose regardless of its negligence.

To conclude that, absent greater specificity, the indemnity and defense obligations stated in the subcontract both required a finding of Weather Shield's negligence, Justice O'Leary reasoned as follows: The indemnity and defense obligations in Weather Shield's subcontract were "described in a single sentence" with two clauses. The first clause, stating the indemnity obligation, covered " 'claims for damages . . . growing out of the execution of [Weather Shield's] work . . . .' Everyone (the litigants, trial court, and majority) seems to agree [that] matters embraced by this indemnity clause [were] narrowly limited to damages *caused* by [Weather Shield's] own *negligent* work on the project." (Original italics.) The second clause, defining the defense duty, confined that responsibility to suits or actions founded upon " 'the claim of such damage . . . .' The qualifying phrase, 'claim of such damage' clearly refer[red] to the earlier language limiting the scope of claims embraced by the indemnity, i.e., 'all claims for damages . . . growing out of the execution of the work[.]' Therefore, both obligations appear to be dependent on the same coverage terms."

But Justice O'Leary's analysis overlooks the clear differences in the two clauses that we have described above. In particular, Weather Shield's express contractual duty to defend suits "founded upon" the kinds of claims specified in

the agreement necessarily extended to suits that *alleged* such claims, not just suits in which they were proven. Assuming, as we must, that Weather Shield's subcontract obligated it to indemnify JMP against claims arising from Weather Shield's negligent performance of the subcontract, it follows that Weather Shield's contractual duty to defend JMP encompassed suits or actions that alleged such negligence on Weather Shield's part. Weather Shield could not avoid this duty on the ground that the very litigation to be defended might later result in a finding Weather Shield was, in fact, not negligent.

Parties to an indemnity contract can easily disclaim any responsibility of the indemnitor for the indemnitee's defense, or the costs thereof. Short of that, they can specify that the indemnitor's sole defense obligation will be to reimburse the indemnitee for costs incurred by the latter in defending a particular claim. However, the instant subcontract did neither. On the contrary, it specified that Weather Shield would be required, "at [its] own expense," to "defend" JMP against suits "founded upon" claims arising from Weather Shield's performance of its subcontract. This language indicated a more immediate obligation, one that would necessarily arise before the litigation to be defended could determine whether Weather Shield owed indemnity to JMP.

In arguing otherwise, Weather Shield relies heavily on *Heppler*, *supra*, 73 Cal.App.4th 1265. There, in connection with another of JMP's large residential construction projects, Mueller-Lewis Concrete (Mueller) signed a JMP-drafted subcontract containing indemnity and defense clauses identical to those at issue here. Homeowners sued JMP, Mueller, and others for construction defects. Mueller declined JMP's tender of defense. In a global settlement, JMP assigned its contractual rights against Mueller to plaintiff homeowners. As JMP's assignees, they sought to recover against Mueller under both the indemnity and defense provisions. The defect, indemnity, and defense issues went to trial against

Mueller. The trial court ruled that plaintiffs must prove negligence and causation against Mueller in order to trigger Mueller's contractual indemnity obligations. The jury returned a general verdict for Mueller.

On appeal, plaintiffs challenged the lower court's ruling that Mueller's negligence was a prerequisite to its contractual duty of indemnity. The Court of Appeal affirmed the judgment in Mueller's favor. For a number of reasons, the court concluded that the language of the subcontract triggered Mueller's indemnity obligation only if Mueller itself was found negligent. (*Heppler*, *supra*, 73 Cal.App.4th 1265, 1275-1281.)[9]

However, the plaintiffs in *Heppler* did not contend that, even if the indemnity clause in Mueller's subcontract was triggered only by Mueller's actual negligence, the duty-to-defend clause applied more broadly. Accordingly, the *Heppler* court never separately addressed the defense clause of the subcontract, or considered how the particular language of that clause might distinguish it from the indemnity clause. In affirming the general verdict for Mueller, the court simply assumed that the indemnity and defense provisions of the subcontract were congruent.[10]

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9 This aspect of the ruling in *Heppler*, *supra*, 73 Cal.App.4th 1265, may be what has dissuaded the homeowners in this case, acting in JMP's stead, from challenging on appeal the trial court's ruling that the identical indemnity clause in Weather Shield's subcontract required Weather Shield's negligence as a condition of its indemnity liability.

10 This assumption is confirmed by *Baldwin Builders v. Coast Plastering Corp.* (2005) 125 Cal.App.4th 1339, where the same Court of Appeal panel broadly stated the holding of *Heppler* as being that "an indemnitor/subcontractor generally will not be liable *or have a duty to defend its general contractor* pursuant to the terms of an indemnity agreement unless it was negligent in performing its work under the subcontract." (*Baldwin Builders*, *supra*, at p. 1347, italics added.) But this passage in *Baldwin Builders* is dictum; the case had

(Footnote continued on next page.)

Here, by contrast, we directly confront the relationship, and the distinctions, between the two clauses. Upon examination, as explained above, their language differs in a way suggesting that, even if the indemnity obligation is triggered only by an ultimate finding of the indemnitor's fault, the defense obligation applies before, and thus regardless of, any finding to be made in the course of the litigation for which a defense is owed. Hence, whatever *Heppler*'s merits on the issues actually considered in that case, we do not find the decision helpful or persuasive on the narrow question before us.

Similarly, *Goldman*, *supra*, 62 Cal.2d 40, cited by Weather Shield, is of little use in construing the particular defense clause at issue in this case. Our opinion *noted* a duty-to-defend clause, phrased in language different from that we address here, that might bind the subcontractor in that case. (See *id.*, at p. 43, fn. 2). We also indicated that the indemnitee had demanded both indemnity and a defense from the subcontractor. (*Id.*, at p. 42.) However, our decision addressed only the subcontractor's duties under the separate indemnity clause at issue in the case. Our holding was simply that if one seeks contractual indemnity protection for his own active negligence, the language providing such protection must be

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(Footnote continued from previous page.)

nothing to do with an indemnitor's duty, regardless of fault, to defend its indemnitee. The sole question was whether, having proved in the underlying construction defect litigation that it was not negligent, and thus owed no indemnity under the terms of its subcontract, the subcontractor/indemnitor could recover, under the contractual attorney-fee reciprocity statute (§ 1717, subd. (a)), its attorney fees incurred in so establishing. The Court of Appeal concluded that the answer was yes, reasoning that these were fees expended by the subcontractor/indemnitor to enforce the indemnity agreement itself, i.e., to prove that it owed no contractual indemnity.

particularly clear and explicit. (*Id.*, at p. 44.) Here, upon close examination of Weather Shield's subcontract, we find it did clearly and explicitly create a defense duty not dependent on the ultimate resolution of issues, such as Weather Shield's fault, that would only be determined after the duty arose.

Nor, under close examination, is *Mel Clayton Ford*, *supra*, 104 Cal.App.4th 46, helpful to Weather Shield's cause. Weather Shield suggests *Mel Clayton Ford* stands for the proposition that a duty-to-defend clause in a noninsurance agreement does not extend to mere allegations that would trigger an indemnity obligation only if proven. We do not so interpret the decision. In our view, Weather Shield takes out of context the passage on which it relies.

In *Mel Clayton Ford*, an agreement between a vehicle manufacturer and its retail dealer specified that the manufacturer would defend and indemnify the dealer against any third party suits, complaints, or claims " '*concerning* . . . injury or . . . damage arising out of an occurrence caused *solely* by' " a manufacturing or design defect in a vehicle supplied to the dealer by the manufacturer. (*Mel Clayton Ford, supra*, 104 Cal.App.4th 46, 49, italics added.) Thus, the manufacturer excluded from its defense obligation any suit or claim that alleged dealer negligence, or any theory other than manufacturing or design defect, as a sole or contributing cause of the injury or damage.

In 1989, the plaintiff purchased from the dealer a truck supplied by the manufacturer. Thereafter, the dealer performed maintenance on the vehicle. In 1997, while the plaintiff was driving the truck, it burst into flames, seriously injuring him. He sued both the manufacturer and the dealer, alleging not only a defectively designed and manufactured product, but also claims based on failure to warn, breach of warranty, and " 'theories of [the dealer's] direct or active negligence in the maintenance of the vehicle.' " (*Mel Clayton Ford, supra*, 104 Cal.App.4th 46, 50.)

The Court of Appeal held that the manufacturer had no duty to undertake the dealer's defense under such circumstances. This was because "[t]he indemnity provision required [the manufacturer] to defend the Dealer only where the occurrence was caused *solely* by a production defect, and not whenever product liability was *one of the allegations* of the underlying complaint." (*Mel Clayton Ford*, *supra*, 104 Cal.App.4th 46, 55, second italics added.)

Thus, in *Mel Clayton Ford*, it was not an allegations-versus-proof distinction that negated the duty to defend. Rather, given the word "solely" in the indemnity/defense clause there at issue, the crucial fact was that the suit for which a defense was sought included allegations *other than* those to which the manufacturer had limited its defense duty — design or production defects attributable to the manufacturer itself.[11]

Here, Weather Shield's contractual duty was not similarly limited. Weather Shield promised to defend JMP against any suit "founded upon" a "claim of . . . damage" "growing out of the execution of [Weather Shield's] work." The contract did not specify, or even hint, that no defense duty would exist unless the suit was *solely* concerned with Weather Shield's performance under its own subcontract and included no other claims or allegations. Nor does Weather Shield so claim. Hence, nothing decided in *Mel Clayton Ford* establishes that until Weather Shield's faulty performance of its work was proven, it had no duty to defend JMP.

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11 To the extent there is any ambiguity in *Mel Clayton Ford*'s holding on this point, it cannot be resolved by further examination of the Court of Appeal's opinion in that case. Except for the summary passage quoted above, the Court of Appeal's discussion of this interpretive issue appeared in the unpublished portion of its partially published opinion.

Finally, we are not persuaded by *Regan Roofing*, *supra*, 24 Cal.App.4th 425, insofar as that decision suggests that a contractual duty to defend specified classes of claims, expressed in such terms, necessarily depends on the promisor's ultimate liability for indemnity on those claims.

In *Regan Roofing*, after a housing developer, Pacific Scene, was sued for construction defects, it cross-complained against numerous project subcontractors to establish its contractual indemnity and defense rights. Each of these agreements required the subcontractor to indemnify Pacific Scene against all mechanic's liens related to the subcontractor's work, as well as " 'any other liability, cost or expense of any nature or kind arising out of or in any way connected with Subcontractor's performance, . . . save and except only such liability, cost or expense caused by [Pacific Scene's] sole negligence or sole willful misconduct.' " (*Regan Roofing*, *supra*, 24 Cal.App.4th at p. 430, italics added.) " 'Pursuant to the . . . foregoing,' " the subcontracts declared, " 'Subcontractor shall indemnify and hold harmless [Pacific Scene] from any costs and expenses for attorney's fees . . . resulting to [Pacific Scene] from such claims or liens.' " (*Ibid*., italics omitted.) Finally, each agreement separately provided that " '[i]n the event any suit on any claim is brought against [Pacific Scene], subject to the provision, Subcontractor shall defend said suit at Subcontractor's own cost and expense . . . .' " (*Ibid*., italics omitted.)

Pacific Scene sought pretrial summary adjudication of a number of issues, including rulings on the subcontractors' duties to indemnify and defend. The trial court determined that the indemnity provision of the subcontracts included coverage for Pacific Scene's own negligence. However, the court found that the question whether the subcontractors actually owed indemnity was premature, because, among other things, Pacific Scene had not yet incurred liability or paid claims subject to indemnity. On the other hand, the court concluded, under the

language of the agreements and section 2778, each subcontractor did have an immediate duty to defend claims " 'brought against [Pacific Scene] in respect to matters embraced by the indemnity clause.' " (*Regan Roofing*, *supra*, 24 Cal.App.4th 425, 432.)

The Court of Appeal reversed on the latter point. The appellate court indicated that "summary adjudication of the duty to defend and its relationship to the duty to indemnify (i.e., the scope of 'the matters embraced by the indemnity') is premature. No determination has yet been made as to whether the subcontractors were negligent in the performance of their work, giving rise to a duty to indemnify *and a related duty to defend*. Pacific Scene has not clearly established that under this indemnity clause, the duty to defend against claims of liability is entirely free-standing of the duty to indemnify for liability arising out of a subcontractor's negligence. [Citation.]" (*Regan Roofing*, *supra*, 24 Cal.App.4th 425, 436, italics added.)

In reaching this conclusion, however, the Court of Appeal erred. The court seems to have assumed that, under subdivision 4 of section 2778, and unless the agreement at issue clearly provides otherwise, an indemnitor's duty to defend the indemnitee upon request in matters "embraced by the indemnity" is not, in the court's words, "free-standing," but extends only to claims as to which indemnity is actually owed. (*Regan Roofing*, *supra*, 24 Cal.App.4th 425, 436.) And the court found no such explicit contrary intent in the subcontracts there under consideration.

However, as we have explained, the duty to defend upon the indemnitee's request, as set forth in subdivision 4 of section 2778, *is* distinct from, and broader than, the duty expressed in subdivision 3 of the statute to reimburse an indemnitee's defense costs as part of any indemnity otherwise owed. Moreover, the subcontracts at issue in *Regan Roofing*, like the one before us here, did

explicitly indicate a separate and distinct duty to defend the indemnitee, at the indemnitor's own cost and expense, against *suits raising claims* covered by the indemnity. That duty — like Weather Shield's in this case — necessarily arose when such a claim was made against the indemnitee, and thus did not depend on whether the conditions of indemnity were, or were not, later established.

Regan Roofing was therefore mistaken insofar as it concluded that, under the agreements there at issue, the subcontractors' defense duties arose only if the subcontractors became liable for indemnity. We will disapprove the *Regan Roofing* decision to that extent.[12]

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[12] We realize that *Regan Roofing*'s finding of prematurity was also substantially influenced by the practical difficulties of sorting out multiple, and potentially conflicting, duties to assume the active defense of litigation then in progress. (See *Regan Roofing*, *supra*, 24 Cal.App.4th 425, 437.) Weather Shield and its amici curiae raise similar concerns. But the case before us does not present such problems. JMP cross-complained against Weather Shield and other subcontractors on indemnity and duty-to-defend issues, but the trial on these issues was postponed until after most of the subcontractors had settled with JMP, and after the underlying construction defect litigation against the remaining parties, including Weather Shield, was concluded. Thus, while the trial court correctly held that Weather Shield's contractual duty to defend *arose* when a suit *alleging* covered claims was brought against JMP, and that the duty thus did not depend on whether the conditions for indemnity were later established, the court was able to assess *after the fact* Weather Shield's proportionate liability for breach of its duty to defend.

The instant parties apparently saw no impropriety in this procedure, and neither do we. At least with respect to pre-2006 residential construction subcontracts, and subject to any future contrary or inconsistent legislation, the following procedures seem appropriate: When a party sues one or more other persons, seeking to establish a contractual right to a defense against litigation not yet concluded, these issues may, if the parties agree, be deferred until the underlying litigation is complete. If any party moves for summary judgment or adjudication (Code Civ. Proc., § 437c) with respect to the duty to defend against litigation still in progress, the court may proceed as it deems expedient. For example, the court may resolve legal issues then ripe for adjudication, such as whether any of the contracts at issue

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Weather Shield and its amici curiae raise numerous, and substantial, policy concerns about an indemnity agreement that requires a subcontractor to defend a residential developer or builder in a construction defect suit, before and regardless of whether the subcontractor itself is found to be at fault. Arguments asserted include the following: Large builders and developers use their superior bargaining power, and self-drafted contract terms, unfairly to shift the financial consequences of their own legal liability to faultless subcontractors, who are not compensated for the risk and agree only because they need the work.[13] Such shifting discourages builders and developers themselves from taking proper care in construction oversight. Small subcontractors, moreover, lack the resources to fund a developer's defense "up front" while often simultaneously defending themselves in the same lawsuit, where the developer typically pursues the hostile and conflicting strategy of pinning blame on them. The developer can demand a defense from a single subcontractor among many, and the latter may later be unable to obtain contribution from other subcontractors. Further, subcontractors,

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include a duty to defend, and, if so, whether the underlying suit or proceeding as to which a defense is sought falls within the scope of any of the parties' contractual duty to defend. If the court finds that an ongoing duty to defend is owed by one or more parties, but the affected parties, acting in good faith, then cannot agree on how such a defense should be provided or financed, the court may, in its discretion, permit the underlying litigation to proceed with counsel chosen and paid by the party to whom the duty is owed, subject to a later determination of how damages for breach of the duty to defend should be apportioned among the breaching parties.

13 By noting this argument, we do not dismiss the possibility that in many instances, subcontractors may *prefer* to assume, and control, the defense of suits against builders, developers, or other contractors, especially when the claims raised may expose the subcontractors themselves to direct or indirect liability.

unlike liability insurers, lack defense attorney "panels" available at favorable fee rates. Because of privilege and conflict-of-interest issues, they may also lack access to the developer's attorney billing records. As a result, a subcontractor may be forced to pay exorbitant and unreasonable legal costs for the developer's defense. Finally, the vagaries of construction defect litigation in California have caused many insurers to leave the market. Thus, and contrary to the Court of Appeal's assumption, "backup" insurance to cover subcontractors' contractual defense burdens is not readily available at reasonable cost.

As Weather Shield and its amici curiae point out, statutes effective January 1, 2006, and January 1, 2008, respectively, were adopted to address just such concerns. These new laws, which apply to residential construction contracts entered *after* their effective dates, void any term in such a contract that obliges a subcontractor to indemnify certain other project participants, "including the cost to defend," against construction defect claims "to the extent" the claims "arise out of, pertain to, or relate to" the negligence of those other entities. (§ 2782, subds. (c), (d), as added by Stats. 2005, ch. 394, § 1; see *id.*, subd. (e), as added by Stats. 2007, ch. 32, § 1.)[14] However, Weather Shield and its amici curiae assert

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14 As noted above, section 2782, subdivision (a) has long provided that a party to a construction contract cannot agree to indemnify another project participant for the latter's *sole* negligence or willful misconduct. Subdivision (c) of section 2782, as adopted in 2005 and slightly amended in 2007, additionally provides in pertinent part: "For all construction contracts, and amendments thereto, entered into after January 1, 2006, for residential construction . . . , all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any construction contract, and amendments thereto, that purport to indemnify, including the cost to defend, the builder . . . by a subcontractor against liability for claims of construction defects are unenforceable to the extent the claims arise out of, pertain to, or relate to the negligence of the builder or the builder's other agents, other servants, or other independent contractors who are directly responsible to the builder, or for defects in design furnished by those

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that, unless we hold otherwise, California's 10-year statute of limitations for construction defects (Code Civ. Proc., § 337.15) still exposes numerous subcontractors who signed earlier agreements to unfair and burdensome defense demands by developers.

In effect, Weather Shield and its amici curiae ask us to conclude as a matter of law that, in a pre-2006 residential construction contract, a term which expressly obliges a subcontractor "to defend" a builder, developer, or general contractor against claims "founded upon" the subcontractor's negligent work, but says nothing further about the scope of the duty, means only that the subcontractor must *reimburse* the promisee, after the fact, for the promisee's legal expenses as

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persons . . . . This section shall not be waived or modified by contractual agreement, act, or omission of the parties. Contractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties."

Subdivision (d) of section 2782, also adopted in 2005 and effective January 1, 2006, provides in pertinent part: "Subdivision (c) does not prohibit a subcontractor and builder from mutually agreeing to the timing or immediacy of the defense and provisions for reimbursement of defense fees and costs, so long as that agreement, upon final resolution of the claims, does not waive or modify the provisions of subdivision (c)."

Subdivision (e) of section 2782, as added in 2007 and effective for residential construction contracts entered after January 1, 2008, uses parallel language to expand the categories of project participants as to whom a subcontractor cannot be made contractually responsible for construction defect indemnity, including defense costs, "to the extent" such claims "arise out of, pertain to, or relate to" the negligence of those entities or their agents, their servants, or the independent contractors directly responsible to them. Under subdivision (e), the categories of project participants who may not obtain such contractual indemnity from a subcontractor now include not only the builder, but also "the general contractor or contractor that is not affiliated with the builder."

part of any *indemnity* ultimately owed by the subcontractor to the promisee. They suggest that to produce a contrary result, the subcontract should say, in so many words, that the duty to defend arises immediately when a claim is asserted against the promisee, is not limited to later reimbursement of the promisee's legal expenses, and applies regardless, and independent, of any duty of indemnity for which the subcontractor may later become liable.

We are sensitive to the policy issues raised by Weather Shield and its amici curiae. Nonetheless, for reasons stated at length above, we decline the holding they propose. Even applying the rule of strict construction they espouse, the instant contract already sets forth, in unambiguous terms, an immediate and independent duty to defend. As we have indicated, an express promise "to defend" another against claims "founded upon" the promisor's acts or omissions *inherently* incorporates the characteristics they insist must be set forth in additional explicit terms. And if the parties intended only to give the indemnitee a right to after the fact reimbursement of its legal expenses as a component of any indemnity otherwise owed by the indemnitor, they would need no language to say so. That right is already included in every indemnity contract, unless otherwise specifically provided, under subdivision 3 of section 2778.[15]

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15 Amicus curiae Jeld-Wen, Inc., suggests "[t]here is good reason to believe" that section 2778's reference to "contract[s] of indemnity" was never intended to apply to anything but insurance contracts. Jeld-Wen notes that section 2778, adopted in 1872, traces its lineage to a similar 1865 New York statute which also used that term. This nomenclature, Jeld-Wen asserts, was commonly employed in the mid-19th century to refer to insurance contracts. Jeld-Wen further notes that early cases interpreting the 1865 New York law all concerned bonds or insurance policies. We reject the contention for several reasons. First, section 2778, governing "contract[s] of indemnity," appears in a portion of the Civil Code (title 12 of part 4 of division 3, commencing with section 2772) simply entitled "Indemnity." Section 2772 defines "indemnity" as "a contract by which one

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Finally, Weather Shield does not suggest that, as applied to it, the subcontract was either procedurally or substantively unconscionable. Nor does Weather Shield otherwise imply that it is a relatively small and powerless subcontractor overwhelmed by JMP's superior bargaining power. Furthermore, Weather Shield does not claim it naively signed the instant subcontract without understanding the terms. Indeed, in its opening brief, Weather Shield describes itself as "the out-of-state manufacturer of the . . . wood windows" installed in the Huntington Beach residential development — a development that included at least 122 homes. This description suggests a multistate scale of operations, and a consequent sophistication, that would undermine any such assertions.[16]

We therefore conclude that the duty "to defend" JMP against claims "founded upon" damage or loss caused by Weather Shield's negligent

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engages to save another from a legal consequence of the conduct of one of the parties, or of some other person." That definition is not confined to insurance agreements. Second, this same title includes a number of statutes that expressly apply to the indemnity provisions of *noninsurance* contracts. (See, e.g., §§ 2782-2784 [construction contracts], 2784.5 [hauling, trucking, or cartage contracts].) Third, California cases too numerous to mention have assumed, virtually since the inception of section 2778, that it applies to indemnity agreements outside the insurance context. (See, e.g., *Davis v. Air Technical Industries, Inc.* (1978) 22 Cal.3d 1, 6, fn. 6; *Pacific Gas & E. Co. v. G. W. Thomas Drayage etc. Co.* (1968) 69 Cal.2d 33, 41, fn. 9; *Eva v. Andersen* (1913) 166 Cal. 420, 424-425; *Showers v. Wadsworth* (1889) 81 Cal. 270, 273-274; *Peter Culley & Associates*, *supra*, 10 Cal.App.4th 1484, 1494-1496; *Buchalter v. Levin*, *supra*, 252 Cal.App.3d 367, 371-375.) The Legislature has never indicated otherwise. No reason appears to disturb this settled construction.

16 Questioned on this subject at oral argument, Weather Shield's counsel did not deny that Weather Shield is a sizeable multistate purveyor of manufactured windows.

performance of its work, as set forth in Weather Shield's subcontract, imposed such duties on Weather Shield as soon as a suit was filed against JMP that asserted such claims, and regardless of whether it was ultimately determined that Weather Shield was actually negligent. Accordingly, we affirm the judgment of the Court of Appeal.

CONCLUSION

The judgment of the Court of Appeal is affirmed. The decision in *Regan Roofing Co. v. Superior Court*, *supra*, 24 Cal.App.4th 425, is disapproved to the extent it conflicts with the conclusions set forth in this opinion.

BAXTER, J.

WE CONCUR:

GEORGE, C.J.
KENNARD, J.
WERDEGAR, J.
CHIN, J.
MORENO, J.
CORRIGAN, J.

See last page for addresses and telephone numbers for counsel who argued in Supreme Court.

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Attorneys for Appellant:

Sedgwick, Detert, Moran & Arnold, Christina J. Imre, Stephanie Rae Williams, Orly Degani and Maureen M. Home for Defendant and Appellant.

Summers & Shives and Robert V. Closson for California Farming Contractor's Association as Amicus Curiae on behalf of Defendant and Appellant.

Crawford & Bangs, E. Scott Holbrook, Jr., and Joshua J. Wes for American Subcontractors Association as Amicus Curiae on behalf of Defendant and Appellant.

Horvitz & Levy, Lisa Perrochet and John A. Taylor, Jr., for California Professional Association of Specialty Contractors, Pacific Rim Drywall Association and Southern California Contractors Association as Amici Curiae on behalf of Defendant and Appellant.

McAtee • Harmeyer and Jeff G. Harmeyer for Jeld-Wen, inc., as Amicus Curiae on behalf of Defendant and Appellant.

Stephan, Oringher, Richman, Theodora & Miller, Theodora Oringher Miller & Richman, Harry W. R. Chamberlain and Robert M. Dato for American Architectural Manufacturers Association as Amicus Curiae on behalf of Defendant and Appellant.

Attorneys for Respondent:

Anderson & Kriger, Clayton Anderson, Philip Y. Kim; and Richard H. Benes for Plaintiff and Appellant Kirk Crawford.

Kabateck & Garris, Kabateck Brown Kellner, Brian S. Kabateck, Alfredo Torrijos and Richard L. Kellner for Plaintiff and Appellant Parviz Alai.

Attorneys for Respondent:

Cooper, White & Cooper, Kathleen F. Carpenter and Carol J. Stair for California Building Industry Association as Amicus Curiae on behalf of Plaintiffs and Appellants.

Green & Hall, Brian C. Plante and Samuel M. Danskin for Capital Pacific Holdings, Inc., as Amicus Curiae on behalf of Plaintiffs and Appellants.

Newmeyer & Dillion, Thomas F. Newmeyer, Jay B. Freedman and Michael B. McClellan for Standard Pacific Corp., KB Home, The Irvine Company, Alexander Communities, Inc., Taylor Woodrow Homes, Inc., and William Lyon Homes, Inc., as Amici Curiae on behalf of Plaintiffs and Appellants.

Counsel who argued in Supreme Court (not intended for publication with opinion):

Christina J. Imre
Sedgwick, Detert, Moran & Arnold
801 South Figueroa Street, 19th Floor
Los Angeles, CA 90017-5556
(213) 426-6900

Richard L. Kellner
Kabateck Brown Kellner
350 South Grand Avenue, 39th Floor
Los Angeles, CA 90071
(213) 217-5000

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CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

DOUGLAS M. HODGE et al., Plaintiffs and Respondents, v. KIRKPATRICK DEVELOPMENT, INC., et al., Defendants and Respondents, STATE FARM GENERAL INSURANCE COMPANY, Movant and Appellant.	G034361 (Super. Ct. No. 03CC00428) O P I N I O N

Appeal from an order of the Superior Court of Orange County, C. Robert Jameson, Judge. Reversed.

Luce, Forward, Hamilton & Scripps, Charles A. Bird, Charles A. Danaher and Peter H. Klee for Movant and Appellant.

Irell & Manella, Richard J. McNeil and Mark S. Afrasiabi for Plaintiffs and Respondents.

No appearance for Defendants and Respondents.

* * *

I. INTRODUCTION

Did the trial court err in denying the motion of State Farm General Insurance Company (State Farm) for leave to intervene in a construction defect lawsuit brought by State Farm's insureds, Douglas M. Hodge and Kylie Schuyler Hodge (the Hodges), against third party tortfeasors? State Farm obtained partial subrogation rights against the third parties by paying a portion of the Hodges' claims for property damage to their house. We hold State Farm has a statutory right to intervene under Code of Civil Procedure section 387, subdivision (b) and therefore reverse.

II. FACTS AND PROCEEDINGS IN THE TRIAL COURT

State Farm issued the Hodges a homeowners insurance policy (the Policy) covering certain risks to their house in Laguna Beach. The Policy grants State Farm subrogation rights against third parties who cause losses for which the Policy provides benefits. The subrogation paragraph in the Policy's conditions states, in part: "An insured may waive in writing before a loss all rights of recovery against any person. If not waived, we may require an assignment of rights of recovery for a loss to the extent that payment is made by us."

In December 2002, the Hodges submitted a claim to State Farm under the Policy for water and mold damage to their house allegedly caused by the negligence of third parties. The Hodges contended the cost to repair the water damage was about $685,000. The Hodges made a total demand on State Farm for water and mold damage in the policy limits amount of $1,699,680. State Farm denied the Hodges' claim for mold damage and paid the Hodges about $150,000 on the claim for water damage. State Farm contended it is still adjusting the water damage claim.

In September 2003, the Hodges filed a construction defect lawsuit, Orange County Superior Court case No. 03CC00428 (the construction defect lawsuit), against the

former owner, the developer, the general contractor, and one subcontractor who constructed the Hodges' house. The complaint in the construction defect lawsuit alleged defendants caused the water and mold damage by performing defective work, violating building codes, failing to comply with plans and specifications, using unauthorized or unqualified subcontractors, failing to repair defective work, conducting inadequate repair work, and negligently supervising construction of the house.[1]

In November 2003, the Hodges filed a complaint for bad faith against State Farm, Orange County Superior Court case No. 03CC13890 (the bad faith lawsuit). The complaint in the bad faith lawsuit alleged water infiltration caused a covered loss to the Hodges' house and that State Farm in bad faith denied coverage under the Policy and refused to pay the Policy benefits. The trial court denied State Farm's motion to consolidate the construction defect lawsuit and the bad faith lawsuit.

State Farm moved for leave to intervene in the construction defect lawsuit to file a subrogation complaint. The Hodges, as well as three of the four defendants in the construction defect lawsuit, opposed State Farm's motion. One defendant (RESG, Inc.) filed nothing in response to State Farm's motion.

At the hearing on State Farm's motion for leave to intervene, the trial court announced a tentative ruling to deny the motion because "the diversion or complication of adding State Farm would outweigh any prejudice to State Farm by not allowing an intervention." On August 5, 2004, the trial court issued a minute order denying State Farm's motion for leave to intervene "for reasons as stated on the record."

[1]Attached to the respondents' brief is a document from the construction defect lawsuit entitled "Plaintiffs' Preliminary Defect List" purporting to list the construction defects in the Hodges' house. We decline to consider the preliminary defect list because it is not part of the record on appeal and attaching the list to the respondents' brief violates rule 14(d) of the California Rules of Court.

State Farm timely appealed from the order denying its motion for leave to intervene. An order denying a motion for leave to intervene is directly appealable because it finally and adversely determines the moving party's right to proceed in the action. (*Bame v. City of Del Mar* (2001) 86 Cal.App.4th 1346, 1363.)

III. AS A PARTIALLY SUBROGATED INSURER, STATE FARM HAS A RIGHT TO INTERVENE IN THE INSUREDS' LAWSUIT UNDER CODE OF CIVIL PROCEDURE SECTION 387, SUBDIVISION (b).

Intervention is governed by Code of Civil Procedure section 387. Subdivision (a) of section 387 states in relevant part, "[u]pon timely application, any person, who has an interest in the matter in litigation, or in the success of either of the parties, or an interest against both, may intervene in the action or proceeding."

Intervention is mandatory (as of right) or permissive. A nonparty has a right under Code of Civil Procedure section 387, subdivision (b) to intervene in a pending action "if the person seeking intervention claims an interest relating to the property or transaction which is the subject of the action and that person is so situated that the disposition of the action may as a practical matter impair or impede that person's ability to protect that interest, unless that person's interest is adequately represented by existing parties."[2]

[2]The trial court has discretion under Code of Civil Procedure section 387, subdivision (a) to permit a nonparty to intervene if: (1) the proper procedures have been followed; (2) the nonparty has a direct and immediate interest in the action; (3) the intervention will not enlarge the issues in the litigation; and (4) the reasons for the intervention outweigh any opposition by the parties presently in the action. (*Reliance Ins. Co. v. Superior Court* (2000) 84 Cal.App.4th 383, 386; *Truck Ins. Exchange v. Superior Court* (1997) 60 Cal.App.4th 342, 346.)

A. *THE REQUIREMENTS FOR INTERVENTION AS OF RIGHT UNDER CODE OF CIVIL PROCEDURE SECTION 387, SUBDIVISION (b)*

1. *Interest Related to the Property or Transaction That is the Subject of the Underlying Lawsuit*

State Farm, as a partially subrogated insurer, has an interest "relating to the property or transaction" that is the subject of the construction defect lawsuit. Under the doctrine of subrogation, when an insurer pays money to its insured for a loss caused by a third party, the insurer succeeds to its insured's rights against the third party in the amount the insurer paid. (*Rossmoor Sanitation, Inc. v. Pylon, Inc.* (1975) 13 Cal.3d 622, 633-634.) Upon subrogation, the insurer steps into the shoes of its insured. (*Allstate Ins. Co. v. Mel Rapton, Inc.* (2000) 77 Cal.App.4th 901, 908 (*Mel Rapton*).) "'Subrogation is the insurer's right to be put in the position of the insured, in order to recover from third parties who are legally responsible to the insured for a loss paid by the insurer.'" (*Plut v. Fireman's Fund Ins. Co.* (2000) 85 Cal.App.4th 98, 104 (*Plut*).) Partial payment to the insured results in partial subrogation; the insurer is subrogated in the amount of the insurance proceeds. (*Ferraro v. Southern Cal. Gas Co.* (1980) 102 Cal.App.3d 33, 43 (*Ferraro*).)

Deutschmann v. Sears, Roebuck & Co. (1982) 132 Cal.App.3d 912 (*Deutschmann*) supports the position that State Farm has an interest in the litigation sufficient to support intervention as a matter of right. In that case, the insured sued the retailer Sears, Roebuck & Company for personal injury and property damages resulting from a fire caused by a defective television set. (*Id.* at p. 914.) The insurer became subrogated to the insured by paying policy proceeds for property damage and intervened in the insured's lawsuit. (*Ibid.*) The trial court dismissed the action, including the insurer's complaint in intervention, on the ground the insured had failed to file the proof of service of summons in a timely manner. (*Id.* at pp. 914-915.)

The Court of Appeal reversed. The court held dismissal of the insurer's intervention complaint was erroneous because the insurer, having timely intervened, was entitled to proceed with the lawsuit notwithstanding the insured's failure to timely file the proof of service of summons. (*Deutschmann, supra,* 132 Cal.App.3d at p. 915.) The court stated that to intervene under Code of Civil Procedure section 387, the proposed intervener must have a direct interest in the success of one of the parties to the litigation or an interest against both of them. (*Deutschmann, supra,* at p. 915.) "It is clear under the facts of this case," the court concluded, "that [the insurer] has a direct pecuniary interest in the outcome of the litigation between plaintiff and respondent." (*Ibid.*) The insurer was subrogated to the rights of the insured in the amount the insurer had paid the insured for the loss suffered, and "[a]s such subrogee, [the insurer] may intervene in a pending action for damages brought by the insured." (*Ibid*.)

While *Deutschmann* does not state whether such intervention would be permissive or as of right, the case supports the proposition a subrogated insurer has an interest related to the transaction that is the subject of the underlying lawsuit. Indeed, the *Deutschmann* court recognized a subrogated insurer has "a direct pecuniary interest" in the outcome of the litigation between the insured and the responsible third party. (*Deutschmann, supra,* 132 Cal.App.3d at p. 915.)

Relying on *California Physicians' Service v. Superior Court* (1980) 102 Cal.App.3d 91 (*California Physicians' Service*), the Hodges contend subrogation does not give the insurer an interest in the property or transaction that is the subject of the lawsuit in which intervention is sought. We disagree. In *California Physicians' Service,* the trial court denied the motion of a health insurer to intervene in its insured's medical malpractice action. The appellate court denied the insurer's petition for writ of mandate, stating "[a] cause of action in tort would not qualify as 'property'" under Code of Civil Procedure section 387. (*California Physicians' Service, supra,* at p. 96.) The insurer's lack of subrogation rights was due to a provision of the Civil Code applicable to medical

malpractice actions. (*Id.* at p. 94 & fn. 2; Civ. Code, § 3333.1, subd. (b).) Because the insurer lacked a right of subrogation, its interest in the case was merely that of a creditor under the insurance contract and under a settlement agreement reached with the plaintiff. (*California Physicians' Service*, *supra*, 102 Cal.App.3d at pp. 93-95.)

In *Mylan Laboratories Inc. v. Soon-Shiong* (1999) 76 Cal.App.4th 71, 79 (*Mylan Laboratories*), the court cited *California Physicians' Service* for the proposition a tort cause of action does not qualify as property for purposes of intervention. *Mylan Laboratories* did not concern the intervention rights of a subrogated insurer. The issue in *Mylan Laboratories* was whether a nonparty's desire to preserve the confidentiality of a memorandum and assert privileges qualified as an interest supporting intervention. (*Id.* at p. 78.) The court held the memorandum did not constitute "'property . . . which is the subject of the action'" under Code of Civil Procedure section 387. (*Mylan Laboratories, supra,* at p. 79.)

Here, in contrast to *California Physicians' Service* and *Mylan Laboratories*, State Farm has subrogation rights by operation of law and under the terms of the Policy. State Farm is not merely a creditor; rather, State Farm has stepped into the Hodges' shoes and, to the extent it has made payments under the Policy, has the same rights as the Hodges against the various defendants and tortfeasors in the construction defect lawsuit. As an insurance carrier with a right of partial subrogation, State Farm has a direct pecuniary interest in the Hodges' action against the allegedly responsible third parties.

2. *Disposition of the Action May as a Practical Matter Impair or Impede Ability to Protect Interest*

Is State Farm so situated that the disposition of the construction defect lawsuit may, "as a practical matter impair or impede" State Farm's ability to protect its subrogation rights within the meaning of Code of Civil Procedure section 387, subdivision (b)? Yes.

It is the insurer's duty to protect subrogation rights. (*Mel Rapton, supra*, 77 Cal.App.4th at pp. 913, 914.) It is generally acknowledged the insurer's safest course to protect those rights is to seek intervention in the insured's lawsuit against the legally responsible third party. (*Plut, supra*, 85 Cal.App.4th 98, 104, citing 3 Cal. Insurance Law & Practice (1996 rev.) § 35.11[8][d], pp. 35-52.17 to 35-52.19.)

Intervention is the safest course because the other courses may, as a practical matter, "impair or impede" the insurer's ability to protect its subrogation rights. In theory, there are two possible alternatives to subrogation: (1) a separate lawsuit against the responsible third party, or (2) recoupment of payments directly out of the insured's recovery from the responsible third party. (*Plut, supra*, 85 Cal.App.4th at p. 104; *Mel Rapton, supra*, 77 Cal.App.4th at p. 908; *Ferraro, supra*, 102 Cal.App.3d at pp. 42-43.) Thus, "[w]here a subrogation provision exists, an insurer may recoup its payments directly from the tortfeasor or from the proceeds of the insured's action against a tortfeasor." (*Pacific Gas & Electric Co. v. Superior Court* (1994) 28 Cal.App.4th 174, 183.) Or, in a partial subrogation, "[t]he insured retains the right to sue the responsible party for any loss not fully compensated by insurance, and the insurer has the right to sue the responsible party for the insurer's loss in paying on the insurance policy." (*Mel Rapton, supra*, 77 Cal.App.4th at p. 908.)

Both alternatives are, in practice, inadequate or inconsistent with the purpose of intervention. The first alternative—bringing a second lawsuit against the responsible third party—impairs or impedes the insurer's ability to protect subrogation rights because the responsible third party can defeat the subrogated insurer's lawsuit by asserting the defense of splitting a cause of action.[3] (*Mel Rapton, supra*, 77 Cal.App.4th

[3]The Hodges argue State Farm waived arguments based on splitting a cause of action and res judicata because it did not raise them in the trial court. State Farm did not specifically argue that filing a second lawsuit to enforce its subrogation rights would violate the rule against splitting a cause of action. But State Farm did argue it could lose

at p. 908.) The rule against splitting a single cause of action prohibits a plaintiff from turning a single cause of action into the basis of several suits. (*Id.* at p. 907; *Ferraro, supra,* 102 Cal.App.3d at p. 41.) A single cause of action arises when a single tortious act causes several items of property damage, while two causes of action arise when a single tortious act causes the plaintiff to suffer both personal injury and property damage.[4] (*Mel Rapton, supra,* 77 Cal.App.4th at p. 909.)

When, as here, the insurer partially compensates the insured for the loss, thereby becoming partially subrogated, the subrogation doctrine "results in two or more parties having a right of action for recovery of damages based upon the same underlying cause of action." (*Ferraro, supra,* 102 Cal.App.3d at p. 41; see also *Mel Rapton, supra,* 77 Cal.App.4th at p. 908.) The insured can sue the responsible party for any loss not fully compensated by insurance, and the insurer can sue the responsible party for the insurer's loss in the amount paid on the insurance policy. (*Mel Rapton, supra,* 77 Cal.App.4th at p. 908.)

The Hodges' complaint alleges a single cause of action for property damage to their house. The construction defect lawsuit defendants therefore could defeat a separate lawsuit by State Farm with a plea in abatement asserting State Farm is splitting a cause of action. In that event, State Farm, unable to intervene in the construction defect

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its subrogation rights if the court did not permit State Farm to intervene. If State Farm failed to raise arguments based on splitting a cause of action and res judicata, the facts germane to those arguments are essentially undisputed, and so we exercise our discretion to resolve them as a matter of law. (*Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 24; *Raphael v. Bloomfield* (2003) 113 Cal.App.4th 617, 621.)

[4] "Thus, some jurisdictions have found there is no impermissible splitting of a cause of action where an insurer brings an action to recover the amount it paid the insured for property damage and the insured brings a separate action for personal injuries." (*Mel Rapton, supra,* 77 Cal.App.4th at p. 909.) State Farm paid the Hodges for property damage, and their complaint alleges only property damage.

lawsuit, would be left with the second alternative of suing its own insureds. As explained below, that option is not practical.

The Hodges assert filing a second lawsuit is a viable option for State Farm because the construction defect lawsuit defendants waived the defense of splitting a cause of action by opposing State Farm's motion for leave to intervene. A defendant may waive the defense of splitting a cause of action; "[h]owever, a waiver generally arises when the tortfeasor has been sued in two actions and could have avoided the multiplicity of actions by bringing a plea in abatement in response to the *second action* while the first action was pending." (*Mel Rapton, supra,* 77 Cal.App.4th at p. 910; see also *Ferraro, supra,* 102 Cal.App.3d at pp. 43-44 ["[t]he defense that a plaintiff has split a cause of action is an affirmative defense, which must be pleaded by a defendant in abatement"].) It is not certain the construction defect lawsuit defendants' actions in the insured's lawsuit would necessarily be found to constitute a waiver of a defense in a second, yet unfiled, lawsuit by State Farm. One of the four defendants (RESG, Inc.) filed nothing in response to State Farm's motion.

Waiver is an intensely factual determination. (*Plut, supra*, 85 Cal.App.4th at p. 110.) The trial court in this case made no finding, express or implied, of waiver. As an appellate court, we decline to do so.

A subrogated insurer's right to intervene should not depend on a predetermination whether the defense of splitting a cause of action will succeed; it is enough the defense is available in a second lawsuit and may, in the statute's words, "as a practical matter impair or impede" (Code Civ. Proc., § 387, subd. (b)) the subrogated insurer's ability to protect its rights. Denying the subrogated insurer the right to intervene because of the mere possibility the responsible third party might withhold or waive the defense of splitting a cause of action in a second lawsuit would give that third party the ability to force the insureds and the insurers to pursue their claims through two separate lawsuits. That result would defeat "[t]he legislative purpose of Code of Civil

Procedure section 387, to reduce the burden on our already overcrowded dockets." (*Deutschmann, supra,* 132 Cal.App.3d at p. 917.)

The second alternative—recouping payments directly from the insured's recovery—also would, as a practical matter, impair or impede the insurer's ability to protect its subrogation rights. This alternative might not be permissible: "Although there is little California case authority regarding the status of an insurer's subrogation rights when the insurer foregoes participating in the underlying action, the weight of foreign case authority supports the proposition that, in some circumstances, an insurer may recover funds paid to the insured by a legally responsible third party, even though the insurer did not participate in the insured's legal action against the third party." (*Plut, supra,* 85 Cal.App.4th at p. 104, citing 16 Couch on Insurance (2d ed. 1983) § 61:47, p. 130 & 44 Am.Jur.2d (1982) Insurance, § 1820, p. 808.)

Assuming an insurer's nonparticipation in the insured's action does not, as a matter of law, preclude the insurer from recouping its payment to the insured from the insured's recovery (see *Plut, supra,* 85 Cal.App.4th at p. 111), that procedure, as a practical matter, would impair or impede State Farm's ability to protect its interest. "It is a general equitable principle of insurance law that, absent an agreement to the contrary, an insurance company may not enforce a right to subrogation until the insured has been fully compensated for [his or] her injuries, that is, has been made whole." (*Barnes v. Independent Auto. Dealers of California* (9th Cir. 1995) 64 F.3d 1389, 1394; see also *Sapiano v. Williamsburg Nat. Ins. Co.* (1994) 28 Cal.App.4th 533, 536.) Thus, absent intervention, the insurer is to a large extent at the mercy of its insured's efforts and success in recovering from the responsible third party. As the *Deutschmann* court observed, "[i]t is true that the failure of the plaintiff to recover from a defendant would likewise deprive an intervener of the right to recover, since a decision on the merits would affect the rights of both plaintiff and intervener to collect from defendant." (*Deutschmann, supra,* 132 Cal.App.3d at p. 916.)

State Farm would not be able to assert its rights of recoupment against the Hodges until they fully recovered from the construction defect lawsuit defendants, and then only to the extent the Hodges recovered more than the amount of their uninsured loss. As explained below, the Hodges' interests are not necessarily aligned with State Farm's. The Hodges would have little incentive to invest time, effort, and fees pursuing defendants to recovery for covered claims.

Granted, intervention is unnecessary to protect State Farm's subrogation rights from being destroyed by settlement of the construction defect lawsuit. The construction defect lawsuit defendants know of State Farm's subrogation rights by virtue of State Farm's motion for leave to intervene. Thus, a settlement between the Hodges and defendants would not bar State Farm's recovery from defendants, unless State Farm consented to the settlement. (*Griffin v. Calistro* (1991) 229 Cal.App.3d 193, 195-196.) Intervention would, however, be necessary to serve the legislative purpose of preventing multiple litigation. (*Deutschmann, supra*, 132 Cal.App.3d at p. 917.) Further, it makes no sense to conclude State Farm defeated its intervention rights by bringing the necessary motion for leave to intervene notifying the construction defect defendants of its subrogation rights.

Significantly, the standard under Code of Civil Procedure section 387, subdivision (b) is not whether, absent intervention, disposition of the action will *destroy* the putative intervener's interest in the property or transaction which is the subject of the underlying lawsuit. Rather, the standard is whether disposition of the action will *as a practical matter impair or impede* the intervener's *ability to protect* that interest. That standard is met in this case: Disposition of the construction defect lawsuit will as a practical matter *impair or impede* State Farm's ability to protect its subrogation rights. As a practical matter, neither a lawsuit against the construction defect lawsuit defendants nor a lawsuit for reimbursement against the Hodges is a viable means for State Farm to protect those rights.

3. *Interest Adequately Represented by Existing Parties*

Finally, State Farm's interests are not adequately represented by the existing parties to the construction defect lawsuit for two reasons. First, as explained above, State Farm cannot recoup its payment to the Hodges until the Hodges have been made whole from their recovery against defendants in the construction defect lawsuit. (*Plut, supra,* 85 Cal.App.4th at pp. 104-105 ["the insurer is entitled to subrogation only after the insured has recouped his loss *and* some or all of his litigation expenses incurred in the action against the tortfeasor"]; see also *Sapiano v. Williamsburg Nat. Ins. Co., supra,* 28 Cal.App.4th at p. 536; *Barnes v. Independent Auto. Dealers of California, supra,* 64 F.3d at p. 1394.) As a result, the Hodges have a disincentive to use their resources to seek damages beyond what is necessary to make themselves whole.

Second, and in a similar vein, the Hodges have an incentive to prove their losses resulted from mold damage caused by defendants' negligence and a disincentive to prove their losses resulted from water damage. State Farm denied the Hodges' claims for mold damage and paid part of the Hodges' claim for water damage. The Hodges' interest therefore is to establish their damages resulted from mold damage rather than water damage; State Farm's interest is to establish the Hodges' losses to the extent of the insurance payment were caused by water damage.

That is not to say the Hodges or their counsel would intentionally thwart State Farm's rights. The Policy requires the Hodges "do nothing after a loss to prejudice [State Farm's subrogation] rights," and if the Hodges breached that provision, State Farm could resort to an action against them for impairment of its subrogation rights. (*Mel Rapton, supra,* 77 Cal.App.4th at p. 913.) But the standard in deciding intervention is whether existing parties adequately represent the intervener's interest in the filed lawsuit, not whether the intervener has a remedy outside of intervention if the existing parties fail to adequately represent the intervener's rights. The Policy requirements reflect the

recognition the Hodges and State Farm might have differing interests in the event of a loss, and indeed, the conflict between the Hodges' and State Farm's interests in the outcome of the construction defect lawsuit is palpable and real. State Farm's interests are not adequately represented by the Hodges because they have an incentive to advance their interests in the construction defect lawsuit at the expense of protecting State Farm's subrogation rights.

B. *INTERVENTION AS OF RIGHT UNDER FEDERAL LAW*

Rule 24(a) of the Federal Rules of Civil Procedure (28 U.S.C.S.) establishes intervention as of right on virtually identical terms as Code of Civil Procedure section 387, subdivision (b). Rule 24(a) states: "Upon timely application anyone shall be permitted to intervene in an action: (1) when a statute of the United States confers an unconditional right to intervene; or (2) when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately represented by existing parties." Several federal cases have recognized a subrogated insurer has a right to intervene under rule 24(a)(2) to protect the insurer's subrogation rights. (*McDonald v. E. J. Lavino Co.* (5th Cir. 1970) 430 F.2d 1065, 1070-1071; *Black v. Texas Employers Ins. Assn.* (10th Cir. 1964) 326 F.2d 603, 604; see also *Cummings v. United States* (9th Cir. 1983) 704 F.2d 437 [trial court abused discretion in denying as untimely the subrogated insurer's application for intervention as of right]; *Public Service Co. v. Black & Veatch* (10th Cir. 1972) 467 F.2d 1143 [partially subrogated insurer that does not intervene is subject to compulsory joinder].)

When the Legislature adopts the substance of a non-California statute, the Legislature is presumed to have acted with knowledge and in light of decisions interpreting the adopted statute. (*Buckley v. Chadwick* (1955) 45 Cal.2d 183, 193.)

Subdivision (b) of Code of Civil Procedure section 387 was adopted in 1977. (See Historical and Statutory Notes, 14 West's Ann. Code Civ. Proc. (2004 ed.) foll. § 387, p. 383.) Rule 24 of the Federal Rules of Civil Procedure was adopted in 1938, and rule 24(a) was amended to its present form in 1966. (See Notes of Advisory Com. on Rules, History; Ancillary Laws and Directives, reprinted at U.S.C.S. Court Rules (1998 ed.) foll. Fed. Rules Civ. Proc., rule 24 (28 U.S.C.S.), p. 105 et seq.; 7C Wright et al., Federal Practice and Procedure (2d ed. 1986) § 1903.)

Subdivision (b) of Code of Civil Procedure section 387 is in substance an exact counterpart to rule 24(a) of the Federal Rules of Civil Procedure; "'[t]herefore, the Legislature must have intended that they should have the same meaning, force and effect as have been given the federal rules by the federal courts [citations].'" (*Kahn v. Kahn* (1977) 68 Cal.App.3d 372, 384.) Accordingly, the Legislature, in adopting subdivision (b) of Code of Civil Procedure section 387, intended it be interpreted consistently with Federal cases interpreting rule 24(a)(2) as giving a subrogated insurer a right to intervene in its insured's lawsuit against the responsible third party.

C. *Similarity to Compulsory Joinder of Indispensable Parties Under Code of Civil Procedure Section 389*

The description of an indispensable party under the compulsory joinder statute is virtually identical to the description of a party who may intervene as of right. The California compulsory joinder statute, Code of Civil Procedure section 389, subdivision (a), states: "A person who is subject to service of process and whose joinder will not deprive the court of jurisdiction over the subject matter of the action shall be joined as a party in the action if (1) in his absence complete relief cannot be accorded among those already parties or (2) he claims an interest relating to the subject of the action and is so situated that the disposition of the action in his absence may (i) as a practical matter impair or impede his ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring double, multiple, or

otherwise inconsistent obligations by reason of his claimed interest. If he has not been so joined, the court shall order that he be made a party."[5]

The similarity in language between the intervention and compulsory joinder statutes supports the conclusion State Farm could intervene as of right in the construction defect lawsuit. In *Bank of Orient v. Superior Court* (1977) 67 Cal.App.3d 588, the court held a partially subrogated insurer is an indispensable party and must be joined as a party plaintiff under Code of Civil Procedure section 389. In that case, a manager of plaintiff savings and loan embezzled money from it and deposited the money in the defendant bank. (*Bank of Orient v. Superior Court, supra,* 67 Cal.App.3d at pp. 591-592.) The plaintiff was insured for the losses, and the insurer paid the plaintiff's claims in exchange for an assignment of rights. (*Id*. at p. 592.) The plaintiff sued the bank to recover the embezzled funds. (*Ibid.*) After discovery revealed the assignment to the insurer, the defendant bank moved to compel joinder of the insurer as a plaintiff. (*Ibid.*) The trial court denied the motion. (*Id.* at p. 593.) The Court of Appeal issued a writ of mandate and held the insurer, as a partial assignee and subrogee of the savings and loan, was an indispensable party whose joinder was compulsory under Code of Civil Procedure section 389, subdivision (a). (*Bank of Orient v. Superior Court, supra,* 67 Cal.App.3d at pp. 595-596.) "The objection to the omission of indispensable parties is so fundamental that it need not be raised by the parties themselves; the court may, of its own motion, dismiss the proceedings, or refuse to proceed, until indispensable parties are brought in [citations]." (*Id*. at p. 595.)

[5]The 1966 amendment to rule 24(a) of the Federal Rules of Civil Procedure drew upon the amendments made the same year to rule 19, dealing with joinder. (7C Wright et al., Federal Practice and Procedure, *supra,* § 1903.) The description in rule 24(a)(2) of those allowed to intervene as of right is nearly identical to the description in rule 19(a)(2)(i) of those whose joinder is compulsory. (*Ibid*.)

Compulsory joinder differs from intervention as of right in some respects. The compulsory joinder statute, unlike the mandatory intervention statute, does not require a showing the putative party's interests would not be adequately represented by existing parties. As in *Bank of Orient v. Superior Court*, compulsory joinder usually is invoked by the defendant for its own protection. But the underlying principle of *Bank of Orient*—that partial subrogees are indispensable parties—supports the proposition the indispensable partial subrogee may intervene as of right. Since a partial subrogee's rights are "so fundamental" that the court may to refuse to proceed without joinder (*Bank of Orient v. Superior Court*, *supra*, 67 Cal.App.3d at p. 595), it follows the partial subrogee's rights are of such a nature as to give the subrogee the right to intervene.

D. *Exception for Nominal Payment by Insurer as Pretext for Intervention*

The Hodges argue permitting State Farm to intervene as of right would give an insurer the ability to interfere with its insured's lawsuit by paying a nominal sum on a policy claim to obtain intervention rights. State Farm so far has paid the Hodges about $150,000—less than the amount of the Hodges' claim, but not an insubstantial sum. Nothing we say in this opinion should preclude a trial court from concluding an insurer does not have a right to intervene based on a finding the insurer paid a nominal amount on a claim solely as a pretext to intervene in the insured's lawsuit.

Disposition

The order denying State Farm's motion for leave to intervene is reversed. The matter is remanded for further proceedings consistent with this opinion, including

entry of an order granting State Farm leave to intervene. Appellant to recovery costs incurred on appeal.

FYBEL, J.

WE CONCUR:

RYLAARSDAM, ACTING P. J.

MOORE, J.

“8”

Patent Scaffolding Co. v. William Simpson Constr. Co.

[Civ. No. 30131. Second Dist., Div. Five. Nov. 29, 1967.]
PATENT SCAFFOLDING CO., Plaintiff and Respondent, v. WILLIAM SIMPSON CONSTRUCTION COMPANY, Defendant and Appellant.

COUNSEL

Hill, Farrer & Burrill, William McD. Miller, A. J. Cathcart and William M. Bitting for Defendant and Appellant.

Joseph Stell and Arthur S. Levin for Plaintiff and Respondent.

OPINION

HUFSTEDLER, J.

The William Simpson Construction Company ("Simpson") appeals from a judgment in favor of The Patent Scaffolding Co. ("Patent") awarding to Patent judgment for $16,481.09, with interest and costs.

procedural and Factual Summary

Three insurance companies, United States Fidelity and Guaranty Company, Niagara Fire Insurance Company, and National Fire Insurance Company ("insurers"), brought the action in the name of their insured, Patent, against Simpson **[256 Cal. App. 2d 508]** and California Institute of Technology ("Caltech") to recover damages for claimed breach of a contract between Patent and Simpson and of a contract between Simpson and Caltech of which Patent claimed to be a third party beneficiary.

Simpson, a general contractor, executed a contract with Caltech to construct a building for Caltech. Simpson entered into a subcontract with Patent whereby Patent was to furnish scaffolding and other equipment for use during construction of the building, to erect the scaffolding and equipment at the job site, and to remove such materials when the job was completed. The written contract, dated November 20, 1959, between Patent and Simpson contained the following paragraph:

"15. Fire Insurance--Subcontractor's work and materials at the site of the project are to be protected from fire loss and damage by insurance procured by the contractor or the owner, without cost to the subcontractor."

During the course of construction a fire of unknown origin destroyed certain items of Patent's equipment and materials at the job site.prior to the commencement of the

action Patent demanded $16,481.09 from Simpson and Caltech to compensate it for its fire loss. Neither Simpson nor Caltech paid Patent for its loss. Simpson did not procure insurance protecting Patent's equipment and materials from fire loss and it did not request or cause Caltech to procure fire insurance upon Patent's materials and equipment.

Prior to Patent's executing the subcontract with Simpson, Patent had procured from the insurers fire insurance on the materials and equipment damaged and destroyed by the fire. The insurers' policies together provided coverage of over $1,000,000 to Patent against loss of its property.

Patent made claims on each of the insurers and the insurers paid Patent the following amounts of money: United States Fidelity and Guaranty and Niagara Fire Insurance Companies paid Patent $5,768.38 each, and National Fire Insurance Company paid $4,944.33, the total of which equaled $16,481.09.

The trial court concluded (1) the insurers were subrogated to Patent's claim upon its contract with Simpson; (2) the insurers were entitled to recover the total sums paid to Patent; (3) the contract between Simpson and Patent was "not a contract merely to obtain fire insurance, but a contract **[256 Cal. App. 2d 509]** of indemnification against fire loss"; (4) the insurers were not entitled to recover against Caltech, because Patent was not a third party beneficiary of the contract between Simpson and Caltech. Judgment was accordingly entered in favor of the nominal plaintiff, Patent, against Simpson, and in favor of Caltech against Patent. No appeal has been taken from that portion of the judgment in favor of Caltech.

The appeal presents the novel question: Are the insurers who compensated Patent for Patent's fire loss equitably subrogated to Patent's cause of action against Simpson for breach of Simpson's contractual duty either to indemnify Patent for fire loss or to procure fire insurance for Patent's benefit?

Equitable Subrogation Elements

[1] The elements of an insurer's cause of action based upon equitable subrogation are these: (1) The insured has suffered a loss for which the party to be charged is liable, either because the latter is a wrongdoer whose act or omission caused the loss or because he is legally responsible to the insured for the loss caused by the wrongdoer; (2) the insurer, in whole or in part, has compensated the insured for the same loss for which the party to be charged is liable; (3) the insured has an existing, assignable cause of action against the party to be charged, which action the insured could have asserted for his own benefit had he not been compensated for his loss by the insurer; (4) the insurer has suffered damages caused by the act or omission upon which the liability of the party to be charged depends; (5) justice requires that the loss should be entirely shifted from the insurer to the party to be charged, whose equitable position is inferior to that of the insurer; and (6) the insurer's damages are in a stated sum, usually the amount it has paid to its insured, assuming the payment was not voluntary and was

reasonable. (Meyers v. Bank of America Nat. Trust & Sav. Assn. (1938) 11 Cal. 2d 92 [77 P.2d 1084]; Offer v. Superior Court (1924) 194 Cal. 114 [228 P. 11]; Liberty Mut. Ins. Co. v. Kleinman (1954) 149 Cal. App. 2d 404 [308 P.2d 347]; American Alliance Ins. Co. v. Capital Nat. Bank (1946) 75 Cal. App. 2d 787 [171 P.2d 449]; Harrington v. Central States Fire Ins. Co. (1934) 169 Okla. 255 [36 P.2d 738, 96 A.L.R. 859]; In re Future Mfg. Coop., Inc. (N.D. Cal. 1958) 165 F. Supp. 111. See also Justice Traynor's dissenting opinion, Anheuser- Busch, Inc. v. Starley **[256 Cal. App. 2d 510]** (1946) 28 Cal. 2d 347, 355-356 [170 P.2d 448, 166 A.L.R. 198].)

[2] No express assignment of the insured's cause of action is required; equitable subrogation is accomplished by operation of law. However, as in cases of assignment, the equitable subrogee is substituted only in respect of a subrogor's causes of action which are not purely personal and, generally, any defenses or counterclaims which could have been asserted against the subrogor-insured can also be asserted against the subrogee-insurer. (Anheuser-Busch, Inc. v. Starley (1946) 28 Cal. 2d 347, 351 [170 P.2d 448, 166 A.L.R. 198]; Royal Indem. Co. v. Security Truck Lines (1963) 212 Cal. App. 2d 61, 65-66 [27 Cal. Rptr. 858]; see also Meyers v. Bank of America Nat. Trust & Sav. Assn., supra, 11 Cal.2d at p. 94.)

Subrogor's Cause of Action

If Patent had had no insurance to compensate it for its loss, Patent could have recovered damages from Simpson for all detriment proximately caused by Simpson's breach of its contractual duty to indemnify or to procure insurance. (Civ. Code, § 3300; see Dutton Dredge Co. v. United States Fid. & Guar. Co. (1934) 136 Cal. App. 574, 581 [29 P.2d 316]; see also Transportation Guar. Co., Ltd. v. Jellins (1946) 29 Cal. 2d 242, 252-253 [174 P.2d 625].)

[3] After Patent was fully compensated for its fire loss, however, could Patent itself have successfully sued Simpson for breach of contract? Patent could recover twice for the same loss only if the "collateral source" rule applies. "When an injured party receives compensation for his losses from a collateral source 'wholly independent of the tortfeasor,' such payment generally does not preclude or reduce the damages to which it is entitled from the wrongdoer. (See Anheuser-Busch, Inc. v. Starley (1946) 28 Cal. 2d 347, 349-350 [170 P.2d 448, 166 A.L.R. 198]; see also Lewis v. County of Contra Costa (1955) 130 Cal. App. 2d 176, 178 [278 P.2d 756].)" City of Salinas v. Souza & McCue Constr. Co., Inc. (1967) 66 Cal. 2d 217, 226 [57 Cal. Rptr. 337, 424 P.2d 921].) Thus, if Patent sued a person whose negligent or willful act caused the fire which destroyed its property, Patent's compensation from its insurers would neither diminish nor defeat the damages which it could recover from the tortfeasor. (E.g., City of Salinas v. Souza & McCue Constr. Co., Inc., supra, 66 Cal.2d 226- 227; Maxwell, The Collateral Source Rule in the **[256 Cal. App. 2d 511]** American Law of Damages (1962) 46 Minn.L.Rev. 669; Fleming, The Collateral Source Rule and Loss Allocation in Tort Law (1966) 54 Cal.L.Rev. 1478.)

The collateral source rule, however, has not been generally applied in cases founded upon breach of contract, unless the "breach has a tortious or wilful flavor." (City of Salinas v. Souza & McCue Constr. Co., Inc., supra, 66 Cal.2d at p. 227; United Protective Workers v. Ford Motor Co. (7th Cir. 1955) 223 F.2d 49, 54 [48 A.L.R.2d 1285].) The collateral source rule is punitive; contractual damages are compensatory. The collateral source rule, if applied to an action based on breach of contract, would violate the contractual damage rule that no one shall profit more from the breach of an obligation than from its full performance. An application of the collateral source rule is particularly indefensible in a situation in which the injured party potentially could make a treble recovery: one from his insurer, one from a defendant who has undertaken contractual liability for the loss, and one from the wrongdoer. (See Justice Traynor's dissenting opinion in Anheuser Busch, Inc. v. Starley, supra, 28 Cal.2d at pp. 355-356.) We conclude that the collateral source rule would be inapplicable in an action brought by Patent for its own benefit after Patent had been paid by the insurers.

Patent suffered no uncompensated detriment caused by Simpson's breach of contract. It was fully paid for its fire loss. It could not recover the cost of the premiums it had paid to the insurers because it did not incur that expense as a consequence of its contract with Simpson or as a result of Simpson's breach of contract. A breach of contract without damage is not actionable. (E.g., Hawkins v. Oakland Title Ins. & Guar. Co. (1958) 165 Cal. App. 2d 116, 122 [331 P.2d 742].) Damages are not recoverable which are not causally connected with the breach of a contract (Civ. Code, § 3300; Southall v. Security Title Ins. etc. Co. (1952) 112 Cal. App. 2d 321, 323-324 [246 P.2d 74].)

Insurers' Equitable Subrogation

[4a] The fact alone that Patent could not recover from Simpson because Patent suffered no loss does not defeat the insurers' subrogation rights. The insurers' loss can be substituted for Patent's if the insurers' loss was proximately caused by the act or omission of Simpson or one for whose acts or omissions Simpson was vicariously liable. The most **[256 Cal. App. 2d 512]** common subrogation action is one brought on behalf of an insurer against a wrongdoer whose wrong caused the loss. (Continental Cas. Co. v. Phoenix Constr. Co. (1956) 46 Cal. 2d 423, 429 [296 P.2d 801, 57 A.L.R.2d 914]; Offer v. Superior Court, supra, 194 Cal. 114; Royal Indem. Co. v. Security Truck Lines, supra, 212 Cal. App. 2d 61.) Liability of the wrongdoer may, of course, be based not only on a tort, but also upon a breach of contract (e.g., Eads v. Marks (1952) 39 Cal. 2d 807 [249 P.2d 257]; Chelini v. Nieri (1948) 32 Cal. 2d 480 [196 P.2d 915]) so long as there exists the necessary causal relationship between the wrong and the damage. (Cf. City of Salinas v. Souza & McCue Constr. Co., Inc., supra, 66 Cal.2d at p. 228.)

The insurers' loss was not caused by Simpson's failure to get insurance or to indemnify Patent. The insurers' loss was caused by the fire, the very risk which each assumed, and Simspon's failure to perform its contractual duty had nothing to do with the fire.

The California cases, with one exception, have not permitted equitable subrogation to insurers whose losses are not causally related to a breach of duty for which the party to be charged may be liable to the insured for a loss compensated by the insurers.

The leading California case is Meyers v. Bank of America Nat. Trust & Sav. Assn., supra, 11 Cal. 2d 92. The nominal plaintiff, Meyers, employed an office manager, who forged Meyers' name upon checks payable to Meyers, negotiated the checks to defendant Wascher, who paid full value therefor. The manager converted the proceeds to his own use. Wascher deposited the checks in his bank account with the defendant bank, which thereafter presented them to the respective drawee banks and received full payment for them. The insurance company prosecuting the action in Meyers' name had executed a fidelity bond indemnifying Meyers against all loss which might result from the wrongful acts of Meyers' office manager. When the office manager's dishonesty was discovered, the insurance company reimbursed Meyers for the loss and commenced this action against Wascher's bank. The Supreme Court reversed judgment in favor of the nominal plaintiff, holding that the insurance company was not equitably subrogated to Meyers' collateral cause of action.

The court concluded: "Here, the indemnitor has discharged its primary contract liability. It has paid what it contracted **[256 Cal. App. 2d 513]** to pay, and has retained to its own use the premiums and benefits of such contracts. It now seeks to recover from the bank the amount thus paid. It must be conceded that the bank is an innocent third party, whose duty to the employer was based upon an entirely different theory of contract, with which the indemnitor was not in privity. Neither the indemnitor nor the bank was the wrongdoer, but by independent contract obligation each was liable to the employer. In equity, it cannot be said that the satisfaction by the bonding company of its primary liability should entitle it to recover against the bank upon a totally different liability." (11 Cal. 2d at 102.) (Accord: Liberty Mut. Ins. Co. v. Kleinman, supra, 149 Cal. App. 2d 404; J. G. Boswell Co. v. W. D. Felder & Co. (1951) 103 Cal. App. 2d 767 [230 P.2d 386]; and American Alliance Ins. Co. v. Capital Nat. Bank, supra, 75 Cal.App.2d at pp. 791-794.)

The court in Meyers relied upon a case which provides an even closer analogy to the facts in our case. In New York Title & Mortg. Co. v. First Nat. Bank (8th Cir. 1931) 51 F.2d 485 [77 A.L.R. 1052], a loan broker, through forgeries and misrepresentations, procured title insurance policies by which a loan association was guaranteed against loss by reason of defects in the mortgagor's title to described real property securing loans. The purported borrower was fictitious. When the broker received a check from the loan association, he forged the name of the payee, deposited it in the drawee bank and converted the proceeds to his own use. The bank thereupon charged the amount of the check to the account of the loan company. The title insurer paid the loss to the loan company and brought suit against the bank for the amount so paid. The court in Meyers quoted with approval from the opinion in New York Title: " 'Plaintiff's payment to the loan company was a discharge of its primary contract liability. ...plaintiff paid the loan company only what it contracted primarily to do, but now, retaining the premiums or benefit of its contract, it seeks reimbursement from the bank, on the theory that the

bank, under a wholly separate and independent contract, was liable to the loan company for having paid checks on forged indorsements. ... If we assume that neither the plaintiff nor the bank was the wrongdoer, but, by independent contract obligation, each was liable to the loan company, then the satisfaction of such primary liability by the plaintiff would not give rise to a right to recover against **[256 Cal. App. 2d 514]** the bank under the doctrine of subrogation, the bank not being a wrongdoer. ... In our view, the equities in favor of the defendant bank constitute an insuperable barrier to plaintiff's right of recovery.' (Italics added.)" (11 Cal.2d at pp. 97-98.)

In the New York Title case, as here, there were two independent contracts, each obligating the contractors to assume liability for the same risk: one contract between the loan company and its insurer indemnifying the loan company from loss caused by forgery, and another contract between the loan company and its bank by which the bank covenanted not to pay its depositor's money upon forged endorsements, for breach of which the bank was liable to indemnify its depositor for the loss. The loss occurred. The insurance company paid and the bank did not. The bank was a "wrongdoer" in the sense that it breached its contract with its depositor, but the bank's breach did not cause the loss. The forger was the miscreant.

There are factual distinctions between Meyers, American Alliance Insurance, New York Title and the case at bench, but they are distinctions without a real difference. We can see no reason why a fidelity insurance bond for this purpose should be different from a fire insurance policy, or why a bank's contract to hold its depositor harmless from loss if it paid upon a forged endorsement is different from Simpson's contract to indemnify or to obtain insurance to indemnify Patent from a fire loss.

The language used in these cases is the verbiage of equity. The lack of any causal connection between the defendant's breach of contract and the insurer's loss is not specifically articulated, but it is implicit in the discussion of the comparative equities of the parties. The rule in equitable phraseology is this: [5] Where two parties are contractually bound by independent contracts to indemnify the same person for the same loss, the payment by one of them to his indemnitee does not create in him equities superior to the nonpaying indemnitor, justifying subrogation, if the latter did not cause or participate in causing the loss.

[4b] The insurers understandably rely heavily upon the one California case permitting an insurer equitable subrogation to its insured's cause of action upon an independent contract: Meyer Koulish Co., Inc. v. Cannon (1963) 213 Cal. App. 2d 419 [28 Cal. Rptr. 757]. The insurer of a consignor **[256 Cal. App. 2d 515]** brought suit in its consignor-insured's name upon a contract between the consignor and the defendant consignees which placed the risk of loss from all hazards upon the consignees for consigned jewelry until the jewelry was returned to the consignor. Without any fault of the consignees the jewelry was stolen from the baggage room of a railroad. The court cited Meyers v. Bank of America Nat. Trust & Sav. Assn., supra, 11 Cal. 2d 92; Liberty Mut. Ins. Co. v. Kleinman, supra, 149 Cal. App. 2d 404; J.G. Boswell Co. v. W. D. Felder & Co., supra, 103 Cal. App. 2d 767; and American Alliance Ins. Co. v. Capital Nat. Bank,

supra, 75 Cal. App. 2d 787, and disposed of those cases simply by stating that they were "distinguishable from the present factual situation." (213 Cal.App.2d at p. 425.) After citing assorted cases from jurisdictions other than California, the court concluded: "Appellants were parties to an express contract whereby they assumed responsibility for the loss of the goods of the respondents. They thereby accepted primary liability and it cannot be said that appellants stand on equal footing with the insurance company. The equities in this matter do not balance but preponderate in favor of the insurer of the bailor." (213 Cal.App.2d at p. 429.) The court does not explain why the insurance company's acceptance of the risk of loss was any different from the consignees' acceptance of the risk of loss or why the consignees' liability was "primary" whereas, presumably, the insurance company's was not. No explanation was offered for its conclusion that the equities preponderated in favor of the insurance company. The court did not discuss the causal connection between the breach of the consignees' contract to assume the loss and the payment by the insurer to its insured upon its policy.

The conclusion of the court in the Meyer Koulish case cannot be squared with the decision by the California Supreme Court in Meyers v. Bank of America Trust & Sav. Assn., and it is out of line with the other California decisions dealing with directly analogous problems.

Upon the facts in this case no public policy is perceivably served by shifting the entire loss from the insurers to Simpson. The shifting of loss is not a deterrent to wrongdoing, as it may be in cases permitting subrogation against a tortfeasor. (City of Salinas v. Souza & McCue Constr. Co., Inc., supra, 66 Cal.2d at p. 227.) Imposition of the loss upon Simpson would be punitive, and punishment is not the objective of **[256 Cal. App. 2d 516]** contractual damages. (City of Salinas v. Souza & McCue Constr. Co., Inc., supra; see also United Protective Workers v. Ford Motor Co., supra, 223 F.2d at p. 54; In re Future Mfg. Coop., Inc., supra, 165 F. Supp. 111, 113.) If subrogation were permitted, the insurers who have accepted premiums to cover the very loss which occurred receive a windfall. There is no evidence in this record that the insurers' acceptance of the risk or their determination of the cost to the insured of the insurance policies was based in any way upon the terms of Simpson's contract with Patent. The contest is not between two insurance companies, each of which has received premiums for bearing the loss which ultimately occurred, but between insurers and a general contractor who received no independent consideration for the assumption of the risk. The insurers, being in the insurance business, are in a position effectively to spread the risk and to gauge their premiums upon their loss experience. Upon the evidence in the record we are unable to say that Simpson occupies a similar position.

We are aware that the denial of equitable subrogation to the insurers compels the insurers to bear the entire loss and that Simpson is relieved of a responsibility which it solemnly assumed. The result appears to reward delay in the payment of just claims because had Simpson first paid, it likewise would be denied equitable subrogation against the insurers. The conclusion in either event does not have the symmetry of perfect justice. fn. 1 The result, however, is not materially different from many other situations in which a person who has suffered a loss for which more than one person is

liable may select one from their number to satisfy the obligation, thereby relieving the remaining parties of their liability. For example, had neither the insurers nor Simpson paid, Patent could have sued both and could have levied execution against either without a right of contribution by the other. (Weinberg Co. v. Heller (1925) 73 Cal. App. 769, 779 [239 P. 358].)

While from the point of view of the debtors Patent's power of selection reduces a sure thing to a fifty-fifty proposition, it does not change the basic injustice that eventually one of the number may have to bear the entire loss. **[256 Cal. App. 2d 517]**

The answer probably lies in the fact that all parties below approached the problem on an "all-or-nothing" basis. Had the insurers claimed equitable contribution rather than equitable subrogation, and had they succeeded in establishing what kind and amount of insurance coverage would have satisfied Simpson's contractual obligation, they may have succeeded in bringing themselves within the principle established in Continental Cas. Co. v. Zurich Ins. Co. (1961) 57 Cal. 2d 27, 35-38 [17 Cal. Rptr. 12, 366 P.2d 455]. The equitable-contribution principle requires an equitable distribution of the loss among those who share liability for it. Equitable contribution cannot be applied to this case because the facts necessary to state a claim based upon that theory were neither pleaded nor proved.

The judgment is reversed.

Kaus, P. J., and Stephens, J., concurred.

FN 1. For discussions of the problems and suggested methods of approach, see King, Subrogation Under Contracts Insuring Property (1951) 30 Tex. L.Rev. 62; Langmaid, Some Recent Subrogation Problems in the Law of Suretyship and Insurance (1934) 47 Harv.L.Rev. 976; Note, Subrogation of the Insurer to Collateral Rights of the Insured (1928) 28 Colum.L.Rev. 202.

Section 8.

West Coast Casualty's
Construction Defect Seminar
May 16th 17th and 18th, 2018

Grand Ballroom

Thursday May 17th 2018
11:45 – 12:00 PM

Awards Presentation

Jerrold Oliver Award of Excellence

Legends Award

Silver Star Awards

Section 9.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th, and 18th, 2018

Grand Ballroom

Thursday, May 17th 2018
1:30 PM – 2:30 PM

Course Title:
What Comes Around (Sometimes) Goes Around: Dealing with Recalcitrant Carriers

Elaine Fresch. Esq., Karen Rice, John Thompson, Carolyn Crawford and Jay Sever, Esq.

What Comes Around Goes Around (Sometimes): *Dealing with Recalcitrant Insurers*

Karen Rice, XL Catlin
John Thompson, HDI-Global
Carolyn Crawford, Nationwide Insurance Company
Elaine Fresch, Selman Breitman LLP
Jay R. Sever, Phelps Dunbar LLP

This presentation addresses and analyzes how to prevent, confront and resolve disputes involving (and between) liability primary and excess insurers. We will consider the inefficiencies and perils associated with an insurer being recalcitrant. The panel will provide the following: (1) an analysis and description of what is and what is not a "recalcitrant insurer;" (2) an in-depth analysis of the types of disputes among insurers that arise from recalcitrance; (3) a discussion of the potential consequences, intended and unintended, which arise from insurer recalcitrance; and (4) detailed recommendations for ways to prevent and resolve such problems. The purpose of the panel is to assist insurance professionals, insureds and attorneys in identifying and addressing insurer recalcitrance to protect their financial interests. In so doing, the panel will address ethical constraints on both insurer representatives and attorneys.

PART ONE: WHAT IS A RECALCITRANT INSURER?

1. *Not* an insurer who correctly refuses to defend or indemnify.

2. *Not* an insurer who defends but appropriately reserves rights.[1]

3. *Not* an insurer who is aggressive in its defense or indemnity positions and/or files a declaratory judgment action.[2]

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[1] *Am. Eagle Ins. Co. v. Nettleton,* 932 S.W.2d 169 (Tex. App. 1996)(liability insurer's refusal to tender unconditional defense did not breach duty to defend insureds against covered and uncovered claims; it was proper to provide a defense under reservation of rights.

[2] *Great Am. Ins. Co. v. Superior Court*, 178 Cal. App. 4th 221, 225, 100 Cal. Rptr. 3d 258, 262 (2009)(explaining that when a liability insurer providing a defense to its insured believes there is no longer a potential for coverage and, therefore, it is no longer required to defend, it may bring a declaratory relief action to obtain a judicial declaration that it need no longer do so).

4. *Not* an insurer who refuses to contribute at settlement amounts based on legitimate liability, damages and coverage defenses.[3]

5. Rather, a recalcitrant insurer is a carrier who unfairly refuses to pay for the defense or settlement of a matter, whether its actions are technically allowed by law or not.[4]

PART TWO: INSURERS WHO REFUSE TO DEFEND

Why do insurers refuse to pay their fair share of the defense or adequately defend?

A) **Non-Contribution States**: Where the courts do not require or compel defense contribution among insurers, recalcitrant insurers abound.

1. Why do the courts allow/require this? Does it make sense? Florida.[5] South Carolina.[6]

2. Solutions among insurers: What can be done in these states? Should an insurer ever accept the defense first? Proactive letter writing and teleconferences. Role of coverage counsel? Role of insured? Are there ethical constraints on defense counsel? Are there ethical constraints on insurance claims representatives?

3. Other Options: Developers and GCs suing all potential AI insurers to prevent recalcitrance. Does this work?

B) **Time on the Risk Arguments:** Can an insurer pay only its time on the risk?

[3] *Crisci v. Sec. Ins. Co. of New Haven, Conn.,* 66 Cal. 2d 425, 426 P.2d 173 (1967)(Liability based on an implied covenant exists whenever insurer refuses to settle claim against insured in an appropriate case and that liability may exist when insurer **unwarrantedly refuses** an offered settlement where the most reasonable manner of disposing the claim is by accepting the settlement).
[4] *See Liberty Mut. Ins. Co. v. Mid-Continent Ins. Co.,* 405 F.3d 296, 304 (5th Cir. 2005).
[5] *See Penn. Lummberman's Mut. Ins. Co. v. Indiana Lumberman's Mut. Ins. Co.*, 43 So. 3d 182 (Fla. 4th DCA 2010).
[6] *See Auto-Owners Ins. Co, v. Travelers Cas. & Sur. Co. of America,* No. 14-1837 (4th Cir. 2014).

1. States that support or compel time on the risk allocation.

2. How is time on the risk calculated?

    a. Is "insufficient information" a valid argument?[7]
    b. Is *per capita* a better rule?

3. Targeted tender states (California, Texas, Illinois).

4. Uninsured years - Can the insured receive an allocation? (Louisiana, New York)

5. Ethical constraints: how does defense counsel manage these diputes?

C) Tender Issues:

1. Is a formal tender from an insured required to trigger duty to defend? Texas.[8]

2. Should an insurer reject participation in a defense if formal tender is required?[9]

D) Excess / Primary Issues:

1. What happens when primary carrier refuses to fully and adequately defend? Failure to hire adequate counsel. Failure to hire experts, etc.

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[7] *St. Paul Mercury Ins. Co. v. Mountain West Farm Bureau Mut. Ins. Co.,* 210 Cal. App. 4th 645 (Cal. Ct. App. 2012).

[8] In *Mountain West*, the recalcitrant insurer asserted an argument that its duty to defend was not triggered until the framing deficiencies were alleged in the underlying plaintiff's first amended cross-complaint, and it was only obligated to pay those defense costs incurred after the plaintiff filed the first amended cross-complaint. Mountain West, 210 Cal. App. 4th at 663. The court rejected that argument, ruling that Mountain West's duty to defend "arose upon tender," which was before the date upon which the plaintiff filed the first amended cross-complaint. *Mountain West,* 210 Cal. App. 4th 645, at 663.

[9] "The mere fact that a recalcitrant insurer's contractual duty to provide a defense, as opposed simply to pay for it, did not arise until a particular time does not mean that it is not obligated to reimburse others for previously incurred defense costs as required by statute." See *Crawford v. Weathershield,* 187 P.3d 424, 434-35, (Cal. 2008).

2. Solutions: Role of monitoring counsel. Who does monitoring counsel represent? Role of coverage counsel for excess or insured.

E) **Defense Cost Issues**: Can an insurer be forced to accept certain costs associated with the defense – e.g., jury consultants, mock juries, experts, etc.

1. Some Courts hold that an insurer will only be required to pay for costs specifically stated in the policy.[10]

a. Ethical Notes:
i. Counsel must ensure that a recalcitrant carrier who reluctantly defends does not seek to reduce fees/costs to the detriment of the insured.
ii. While the insurer may have a contractual right to select defense counsel, the insurer's desire to limit expenses must yield to the attorney's professional judgment and his or her responsibility to provide competent, ethical representation to the insured.[11]

F) Consequences of Refusing to Pay Fair Share of Defense

1. Loss of *Buss* contribution rights? [12]

2. Bad faith damages.

PART THREE: INSURERS WHO REFUSE TO PAY THEIR FAIR SHARE OF INDEMNITY

Why do insurers refuse to fairly contribute to settlement?

A) **Trigger and Allocation Disputes.**

[10] "While an insurer must defend the entire action, it may reserve the right to recoup defense fees from the insured upon showing that the insurer incurred those fees solely in the defense of claims that the policy did not potentially cover." *Buss v. Superior Court,* 939 P.2d 766, 16 Cal. App. 4t 61 n.27.
[11] *Finley v. Home Ins. Co.,* 90 Haw. 25, 34, 975 P.2d 1145, 1154 (1998).
[12] *St. Paul Mercury Insurance Co. v. Mountain West Farm Bureau Mutual Insurance Co.,* 210 Cal. App. 4th 645 (Cal. Ct. App. 2012)(holding the recalcitrant insurer loses the right to seek reimbursement from the insured).

1. Overlap with defense arguments above.

2. Role of defense counsel in addressing necessary facts. Conflicts?[13]

B) **Coverage Disputes:**

1. Role of ROR

    a. Ethical notes:
        i. It is important to remember that even if an insurer is defending with a reservation of rights, an attorney client relationship still exists. Thus counsel still has the ethical duties to the insured including keeping the insured fully apprised of the status of the litigation.
        ii. However, counsel engaged by insured and paid for insurer, after insurer reserved its rights to deny coverage, does have duties to disclose to insurer all information concerning action except privileged matters relevant to coverage disputes and to timely inform and consult with insurer on all matters relating to action, but those duties do not create attorney-client relationship with insurer, and insurer may not remedy breaches of such duties by moving to disqualify counsel; rather, insurer's remedy would lie in claims such as breach of covenant of good faith and fair dealing.[14]

[13] In *St. Paul Mercury Insurance Co. v. Mountain West Farm Bureau Mutual Insurance Co.,* 210 Cal. App. 4th 645 (Cal. Ct. App. 2012), the recalcitrant insurer, Mountain West, claimed that it lacked information to show that the general contractor's alleged liability arose from the work of the framer, Mountain West's named insured. Mountain West argued that the framer was not a party to the action and that Mountain West had not received copies of expert reports linking the alleged property damage to defects in the framing. The court rejected these arguments because Mountain West "rejected numerous attempts by St. Paul Mercury's attorneys to share evidence showing the damage alleged by [the general contractor] that arose out of [the] framing work." *Id*. at 651.

[14] *Employers Ins. of Wausau v. Albert D. Seeno Const. Co.,* 692 F. Supp. 1150 (N.D. Cal. 1988).

2. Waiver arguments[15]

C) **Excess / Primary Disputes:**

1. Does the primary insurer have a duty to report to excess?[16]

2. Does defense counsel have an obligation to report to excess?

3. Role of "hammer letter," or demand letter.

D) **Mediation Issues: Getting recalcitrant insurers to the table.**

1. Are early mediations wise?[17]

2. Role of defense counsel and mediator.

3. Requiring attendance of claims representatives. Local stand-ins?

E) **Consequences of Refusing to Appropriately Contribute to Settlement**

1. Insurer may not be allowed to challenge "reasonableness."[18]

2. Other Key Defenses Become Heavy Burdens.[19]

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[15] To combat the "insufficient information" defense, a prosecuting insurer need prove only that the defense-triggering information was known or, upon reasonable inquiry, knowable to the recalcitrant insurer. See, e.g., *State Farm Fire & Cas. Co. v. First Nat'l Bank & Trust Co.,* 277 N.E.2d 536 (Ill. Ct. App. 1972) (affirming that insurer's failure to investigate the insured's material misstatements waived a defense).

[16] Although primary insurer under marine policy owed good-faith duty to consider excess insurer's interests while evaluating its settlement decisions, primary insurer did not owe an independent duty to excess insurer but, rather, single duty to insured whose rights, if any, excess insurer acquired through equitable subrogation. *Bohemia, Inc. v. Home Ins. Co.,* 725 F.2d 506 (9th Cir. 1984).

[17] Bad faith of primary insurer for failing to settle claim against insured could not be equated with duplicity, deceitful conduct, or concealment, could not be used interchangeably with either negligence or fraud, but meant arbitrary, reckless, indifferent, or intentional disregard of interests of excess insurer. *Commercial Union Ins. Co. v. Liberty Mut. Ins. Co.,* 426 Mich. 127, 393 N.W.2d 161 (1986).

[18] The California Supreme Court decision in *Crawford v. Weathershield,* 187 P.3d 424 (Cal. 2008), held that an insurer that breached its contractual duty to defend was obligated to pay for all defense costs of the contractual indemnitee, even the costs incurred before the tender. That said, although a nonparticipating coinsurer waives its right to challenge the reasonableness of the amount of a settlement, it retains its right to raise other coverage defenses as affirmative defenses in a contribution action, which means that the recalcitrant coinsurer has the burden of proof on those issues. *Safeco Ins. Co. of Am. v. Superior Court*, 140 Cal. App. 4th 874, 44 Cal. Rptr. 3d 841 (2006).

[19] Once a nonparticipating insurer is deemed recalcitrant because its breach of the duty to defend has been established, key defenses once available to it become heavy burdens. The recalcitrant insurer cannot require the aggrieved insurer to prove actual coverage, but instead must itself disprove coverage when the court has already found a potential for coverage and when evidence to meet its burden is not easily available because it did not previously participate in the defense. *See, Safeco Ins. Co v. Superior Ct.* (2006), 140 Cal. App. 4th 874, 880.

Section 10.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th, and 18th, 2018

Grand Ballroom

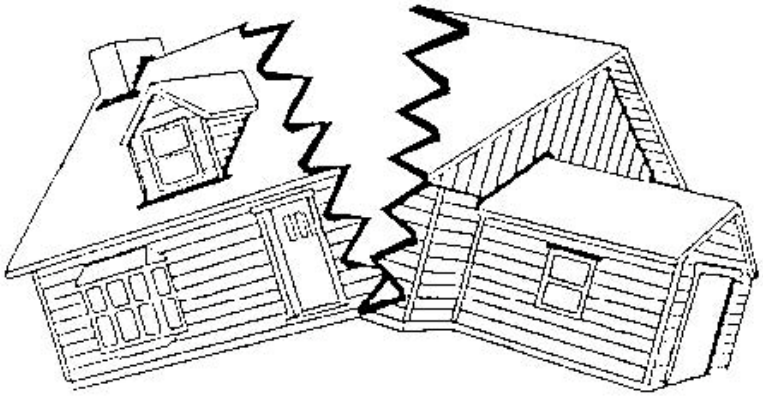
Thursday, May 17th 2018
3:00 PM – 4:00 PM

Course Title:
Effective Use of Experts

Adrienne Cohen, Hon. Rex Heeseman (Ret.), Ken Kasdan Esq.,
Joyia Greenfield Esq., Denise Anderson Esq. and Tim Fitzpatrick

25TH ANNIVERSARY

1993 - 2018



Thursday, May 17th, 2018
3:00 PM – 4:00 PM Effective Use of Experts

Hon. Rex Heeseman (Ret.)
JAMS ADR

Ken Kasdan
Kasdan LippSmith Weber Turner LLP

Joyia Greenfield
Lorber, Greenfield & Polito, LLP

Denise Anderson
Butler Weihmuller Katz Craig, LLP

Adrienne Cohen, Esq.
The Law Offices of Adrienne Cohen

Tim Fitzpatrick,
Axis Construction Consulting, Inc.

People v. Sanchez & Construction Defect Litigation: A Practical Guide to A Post-*Sanchez* World

By Adrienne D. Cohen and Caroline Fawley, Law Offices of Adrienne D. Cohen

"*Sanchez* announced a 'paradigm shift' regarding how out-of-court statements used as expert testimony basis are treated under California hearsay law."
(*People v. Ochoa* (2017) 7 Cal.App.5th 575, 588.)

In *People v. Sanchez* ("*Sanchez*") (2016) 63 Cal.4th 665, the California Supreme Court held that an expert witness cannot relay to the jury case-specific out-of-court statements about which the expert has no independent knowledge. Such statements constitute inadmissible hearsay unless they are authenticated or they fall under one of California's hearsay exceptions. *Id*. at 686.

Prior to *Sanchez*, expert witnesses were generally able under California Evidence Code § 801(b)[1] to introduce case-specific out-of-court statements to the jury if those statements were a type of evidence that was reasonably relied upon by experts in that particular field in forming their opinions. *Id*. at 678. Trial courts held the discretion to limit the introduction of this hearsay, either through instructing the jury that the statements were not to be considered for their truth, or by banning the statements outright if the probative value of the inadmissible evidence was outweighed by the risk that the jury might improperly consider it as independent proof of certain facts. *Id*. at 679. *Sanchez* rolled back this judicial discretion.

This article will address the ruling in *Sanchez*, its applicability to civil law and its potential impact on construction defect litigation.

I. The *Sanchez* Decision

Sanchez was a criminal law case, wherein two Santa Ana police officers chased the defendant, Marcos Arturo Sanchez upstairs into a stranger's apartment, where he was arrested. A loaded gun and a plastic baggie containing 14 bindles of heroin and 4 baggies of methamphetamine were located on a tarp on the ground below the apartment's window. *Id*. at 671. Sanchez was charged with possession of a firearm by a felon, possession of drugs while armed with a loaded firearm, active participation in the "Delhi" street gang, and commission of a felony for the benefit of the gang. *Id*.

Crucial to the prosecution's case was showing that Sanchez was a member of the Delhi street gang. During the trial, the prosecution called Santa Ana Police Detective David Stow, who testified as a gang expert. In his testimony, Stow relayed to the jury certain out-of-court statements contained in police reports and a STEP notice, which was a correspondence given by the police to identified gang members putting them on notice of their gang activity and increased penalties if convicted. *Id*. 672.

Stow described the STEP notices generally then specifically addressed the contents of the notice given to Sanchez. The prosecutor asked whether Sanchez told the police officer in the STEP notice that he "kicked

[1] Evidence Code § 801(b) allows an expert to render an opinion, "[b]ased on matter (including his special knowledge, skill, experience, training, and education) perceived by or personally known to the witness or made known to him at or before the hearing, *whether or not admissible, that is of a type that reasonably may be relied upon by an expert in forming an opinion upon the subject to which his testimony relates*, unless an expert is precluded by law from using such matter as a basis for his opinion." (Emphasis added.)

it with guys from Delhi" and "got busted with two guys from Delhi"? Stow responded in the affirmative. *Id*. The prosecutor then asked Stow about four other police contacts with Sanchez, and Stow relayed further out-of-court statements contained in those associated police documents. *Id*. at 672-673.

The prosecutor ended by asking Stow a hypothetical question that had him assume all of the specific facts that he relayed from Sanchez's STEP notice and the aforementioned police documents. Assuming those case-specific out-of-court statements, Stow opined that the Delhi gang had, indeed, benefited from Sanchez's conduct. *Id*.

On cross-examination, Stow admitted that he had never met Sanchez and was not present when Sanchez received the STEP notice or when any of the police documents were written. Stow's entire knowledge was based on his analysis of the out-of-court statements contained in the STEP notice and police documents. *Id*.

In reviewing the Court of Appeals' reversal of Sanchez's conviction for active gang participation, the California Supreme Court addressed two hearsay issues:

1. Whether Stow's description of Sanchez's past contacts with police were admitted for their truth (i.e. hearsay); and
2. If the statements were offered for their truth, whether the statements constituted testimonial hearsay in violation of the 6th Amendment's Confrontation Clause.

In analyzing the first issue, the Supreme Court distinguished between general and case-specific hearsay:

> "The hearsay rule has traditionally not barred an expert's testimony regarding this general knowledge in his field of expertise. The common law recognized that experts frequently acquired their knowledge from hearsay, and that to reject a professional physician or mathematician because the fact or some facts to which he testified are known to him only upon the authority of others would be to ignore the accepted methods of professional work and to insist on impossible standards." *Id*. at 676. (Internal quotes omitted.)

But:

> "By contrast, an expert has traditionally been precluded from relating *case-specific* facts about which the expert has no independent knowledge. Case-specific facts are those relating to the particular events and participants alleged to have been involved in the case being tried. Generally, parties try to establish the facts on which their theory of the case depends by calling witnesses with personal knowledge of those case-specific facts." *Id*. (Emphasis in original.)

Thus, the Supreme Court reasoned that the expert can rely on case-specific facts in forming his or her opinion, he or she just cannot supply those case-specific facts if he or she has no personal knowledge. *Id*.

In illustrating the difference between background and case-specific information, the Supreme Court gave the following examples:

1. 15 feet of skid marks that were measured at an auto accident scene would be case-specific facts that could be established through the testimony of the person who

measured the marks. How automobile skid marks are left on pavement, and the equation to estimate the speed of the car that left those skid marks could be background information that an expert could provide.

2. That hemorrhaging in the eyes of a suspected homicide victim was noted during the autopsy would be case-specific facts, the authentication of which could be established by the attending autopsy surgeon of by photographs. What circumstances might cause such hemorrhaging would be background information that an expert could provide.
3. That an associate of the defendant had a diamond tattoo on his arm would be a case-specific fact that could be established by a witness who saw the tattoo or by a photograph. That the diamond is a symbol adopted by a certain street gang would be background information that an expert could provide.
4. That an adult party to a lawsuit suffered a serious head injury at age four would be a case-specific fact that could be established by a witness who saw the injury or a doctor who treated the party for the injury. How such an injury might be caused or its long-term effects would be background information that an expert could provide. *Id*. at 676.

The Supreme Court explained that the distinction between background and case-specific facts was getting eroded in recent caselaw. It reasoned that "if the expert testifies to case-specific out-of-court statements to explain the bases for his opinion, then those statements are necessarily considered by the jury for their truth, thus rendering them hearsay." *Id.* at 684. As with all hearsay evidence, those statements must be properly admitted either through a hearsay exception or through authentication by an appropriate witness. *Id*.

Thus, before turning to the Court's second prong of analysis—whether the case-specific out-of-court statements constituted 'testimonial hearsay' that would violate the Confrontation Clause under the Sixth Amendment—the Supreme Court issued the following:

> "In sum, we adopt the following rule: When any expert relates to the jury case-specific out-of-court statements, and treats the content of those statements as true and accurate to support the expert's opinion, the statements are hearsay. It cannot be logically maintained that the statements are not being admitted for their truth." *Id*. at 686.

II. Application to Civil Law

Given the far-reaching implications of the *Sanchez* rule—particularly for trial attorneys who previously relied on experts to introduce out-of-court facts with an associated limiting jury instruction-it is crucial to assess whether *Sanchez* is even applicable to civil cases.

Arguably, *Sanchez* is a criminal case addressing testimonial hearsay in light of *Crawford v. Washington* ("*Crawford*") (2004) 541 U.S. 36 and the Sixth Amendment's right of the criminally accused to confront his or her accusers. The Sixth Amendment, of course, has no counterpart in civil law. Indeed, the opening sentence specifically addresses criminal law: "In [*Crawford*], the United States Supreme Court held…that the admission of *testimonial hearsay against a criminal defendant* violates the Sixth Amendment right to confront and cross-examine witnesses." *Id*. at 671. (Emphasis added.) Furthermore, the Supreme Court in *Sanchez* only cites criminal caselaw and never pointedly states that its holding applies to civil law. In fact, the Court does not mention civil law at all.

However, *contra*, the Supreme Court failed to narrowly tailor its holding to just criminal law. In light of its opening sentence that includes the descriptor "criminal defendant," the blanket holding fails to include a similar criminal law identification, rendering it potentially applicable to both criminal and civil law. Indeed, textually the Supreme Court makes no distinction between civil and criminal law in its analysis of common law hearsay and the background versus case-specific facts discussion, lending credibility to broad applicability. Moreover, of the four examples of case-specific facts that the Court gives to illustrate proper admissibility, arguably two involve civil personal injury litigation (car skid marks and toddler head injury). It is curious that the Court would give civil lawsuit examples if it did not intend for civil application.

In fact, recent civil cases have begun to apply the reasoning in *Sanchez*. (See *People ex rel. Reisig v. Acuna* (2017) 9 Cal.App.5th 1, 10 (*Sanchez* applied to expert testimony in civil nuisance case.) (See also *Conservatorship of K.W.* (2017) 13 Cal.App.5th 1274, 1282 ("*Sanchez* is not, however, limited in its application to criminal proceedings.") (cf. *J.H. v. Superior Court* (2018) 20 Cal.App.5th 530, 537 (refusing to apply *Sanchez* to child dependency proceedings as, "criminal defendants and parents in dependency proceedings are *not* similarly situated."))

III. Impact on Construction Defect Litigation

So, what does *Sanchez* hold for a technically complex legal sector, such as construction defect litigation, that relies heavily on expert witnesses to relay their opinions to jurors? Undoubtedly, *Sanchez* will have quite a significant impact on both time and resources. Trial attorneys will now need to take additional steps to ensure that any case-specific out-of-court statements that their expert witnesses plan to use in forming their opinions are authenticated or fall under a recognized hearsay exception. And, as construction defect litigation often involves multiple layers of potential hearsay within one document, such as a monthly project update that contains schedules, change orders, submittals, correspondence that incorporates prior correspondence, testing reports, permits and other relevant attachments, each layer of hearsay will need to be individually addressed.

IV. Next Steps

Now, more than ever, civil litigators in construction defect litigation need to be familiar with the California evidentiary rules addressing hearsay.

California Evidence Code § 1200 (a) states that "'[h]earsay evidence' is evidence of a statement that was made other than by a witness while testifying at the hearing and that is *offered to prove the truth of the matter stated*." (Emphasis added.)

Is an expert going to rely on case-specific out-of-court statements to form his or her opinion? If yes, then pursuant to *Sanchez*, that expert is going to offer hearsay. An attorney now has three options to admit that hearsay:

1. Stipulate;
2. Authenticate; or
3. Find an exception.

Assuming the hearsay statements are not in contention, potentially the most efficient method to admit hearsay is through a stipulation. However, if the parties cannot stipulate to the out-of-court statements, an attorney can authenticate the statements through various methods (Evidence Code § 1400 et seq.),

such as testimony of a witness with personal knowledge (§ 1413), a handwriting expert (§ 1418), a custodian of business records (§ 1550), or through self-authenticating documents (e.g. public records, newspapers, and official publications) (§ 1450 et seq., § 1530 et seq., § 1562).

Lastly, attorneys should refresh their memory as to the various exceptions pursuant to Evidence Code § 1220 et seq. Relevant for construction defect litigation may be exceptions for business records (§ 1270-1272), official records (§ 1280-1284), confessions and admissions (§ 1220-1228.1), prior inconsistent statements (§ 1235-1238), and declarations against an interest (§ 1230).

Until the Court gives guidance on applicability in civil cases, attorneys should file stipulations and/or well written motions in limine addressing the applicability of *Sanchez* and articulating what hearsay they are attempting to admit and why it should be admitted.

People v. Sanchez

Court of Appeal of California, Sixth Appellate District

November 9, 2016, Opinion Filed

H040503

Reporter
2016 Cal. App. Unpub. LEXIS 9485 *; 2016 WL 6610311

THE PEOPLE, Plaintiff and Respondent, v. UBALDO SANCHEZ, Defendant and Appellant.

Subsequent History: Time for Granting or Denying Review Extended *People v. Sanchez, 2017 Cal. LEXIS 829 (Cal., Feb. 3, 2017)*

Review denied by *People v. Sanchez, 2017 Cal. LEXIS 1426 (Cal., Feb. 15, 2017)*

Prior History: **[*1]** Superior Court of Monterey County, No. SSC120001A.

Core Terms

trial court, interview, murder, killed, ranch, shotgun, fine, defense counsel, time of death, confession, drinking, remember, drive, convictions, impeachment, restitution, drunk, beer, admissible, restitution fine, cross-examination, admitting, witness', argues, lived, adoptive admission, arrived, walked, drove, knife

Judges: Premo, J.; Rushing, P. J., Elia, J. concurred.

Opinion by: Premo, J.

Opinion

On May 17, 1982, the body of Manuel Pesqueira Sandoval was found near a cluster of worker housing at Rancho Lejos[1] in southern Monterey County. Sandoval had been shot in the chest at close range with a shotgun.

In 2013,[2] defendant Ubaldo Sanchez was convicted by a jury of first degree murder. (*Pen. Code, § 187, subd. (a)*.)[3] The jury also found true the allegation that Sanchez personally used a firearm, specifically a shotgun, when he killed Sandoval. (*§ 12022.5, subd. (a)*.)

On December 13, 2013, the court sentenced Sanchez to a term of 25 years to life for the murder along with a consecutive term of two years for the firearm enhancement for a total term of 27 years to life. The trial court imposed a restitution fine of $4,000 under *section 1202.4, subdivision (b)*, and victim restitution in an amount to be determined by the probation department under *section 1202.4, subdivision (f)*. The court imposed an additional restitution fine of $4,000 under *section 1202.45* but ordered that fine suspended pending successful completion of parole, if any.

On appeal, Sanchez argues the trial court committed multiple evidentiary errors, specifically: (1) admitting evidence of incriminating hearsay statements made in Sanchez's **[*2]** presence as adoptive admissions; (2) admitting evidence of a

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[1] Rancho Lejos was also referred to as Deerwood Stock Farm.

[2] The People assert, without citation to the record, that "[l]aw enforcement investigators actively looked for [Sanchez] as a suspect in the homicide in 1982. Until 2008, however, the investigation was dormant." We mention this only because the parties have otherwise failed to explain the delay between Sandoval's death in 1982 and Sanchez's conviction in 2013.

[3] Unspecified statutory references are to the Penal Code.

prior uncharged incident in which Sanchez threatened someone with a knife; (3) admitting testimony that Sanchez, in an ongoing family dispute, had threatened to kill the family members involved; (4) admitting the statements he made to investigating officers; and (5) admitting expert testimony by a witness regarding time of death. In connection with these claimed evidentiary errors, Sanchez also argues his trial counsel was ineffective and that his due process rights were violated. Sanchez further argues the trial court erred in refusing to either set aside the verdict against him or grant him a new trial after the prosecution belatedly disclosed that a witness had prior misdemeanor convictions for crimes of moral turpitude. Finally, Sanchez challenges the restitution fines and direct victim restitution imposed under *sections 1202.4* and *1202.45*.

We find no merit to any of Sanchez's arguments relating to his trial and conviction, but agree that the trial court improperly imposed a restitution fine and direct victim restitution under *section 1202.4, subdivisions (b)* and *(f)*, as well as the restitution fine imposed but suspended under *section 1202.45* as neither of those statutes were in effect at **[*3]** the time of the underlying offense. Accordingly, we will reverse and remand to allow the trial court to consider whether to impose a restitution fine under the law in effect at the time of the offense, specifically former *Government Code section 13967, subdivision (a)*. (Stats. 1981, ch. 102, § 54, p. 710.)

I. FACTUAL AND PROCEDURAL BACKGROUND

A. Prosecution's case

1. Jose Munoz's testimony

In May 1982, Jose Munoz was living and working at Cuidado Ranch, but had previously lived and worked with Sandoval at Ranchos Lejos. On the Saturday before Sandoval died, Munoz drove to a bar in Avenal with Sandoval and a third man who worked with Sandoval. Munoz could not remember the name of the third man, but recalled the man was shorter than Sandoval. At the bar, Munoz met up with some other friends. He did not know if Sandoval and the third man were drinking together.

On the ride home, Munoz was driving and Sandoval was in the front passenger seat, with the third man sitting in the back. Sandoval and the other man began arguing. The man told Sandoval, "I'm going to kill you," and Sandoval told Munoz to stop the car. Sandoval climbed into the back seat with the third man and they continued to argue, but there was no physical fight between the two. **[*4]** Munoz thought they argued for about 10 or 15 minutes overall, and Munoz believed the men fell asleep at some point during the drive.

When they arrived at Rancho Lejos, Sandoval and the third man went to their respective homes. Munoz spent the night at Rancho Lejos with his brother-in-law, Cristovol Lovatos. The next day, Munoz saw Sandoval at work.

2. Cristovol's testimony

Cristovol and his brother, Ricardo Lovatos (Ricardo), lived and worked at Rancho Lejos in 1982. Cristovol met Sanchez when he worked at Rancho Lejos, and he met Sanchez's brother, Octavio, when he was invited to a party in San Miguel. Cristovol said Sanchez and Alfredo Briones lived in the same building at Rancho Lejos.

On the day before the killing, a Sunday, Sanchez asked Cristovol and Briones for a ride to a party in San Miguel. After they arrived, Octavio invited Cristovol to stay at the party, but Cristovol said he left shortly thereafter, without Sanchez. He did not go back to San Miguel that day to pick up Sanchez.

At about 6:30 a.m. the following day, Cristovol testified he started moving his belongings to another residence on the ranch. As he returned, he saw Sanchez, Octavio and a third man by Octavio's car. **[*5]** Octavio asked Cristovol where Sandoval was. Cristovol replied he thought Sandoval was home drunk. He assumed Sandoval was home because he could hear music coming from his room.

Octavio and Sanchez remained by the car while the third man walked behind the building where Sandoval lived. The third man returned and said, "That's it. Let's go." Either Sanchez or Octavio told Cristovol to tell the foreman Sanchez was not going to be at work that day. Cristovol could tell Sanchez had been drinking because his eyes were red and he smelled of alcohol. However, Sanchez was not swaying, spoke clearly and generally seemed aware of his surroundings. The three men got back in the car and left.

At some point after the three men left, Briones told Cristovol that Sandoval was asleep behind the house. Cristovol and Briones went to help Sandoval back to his room. When Cristovol grabbed Sandoval's arm, he realized Sandoval was dead. There was blood on his stomach and his body was very stiff. The evening before, Cristovol had not heard any unusual sounds and he said the ranch was normally quiet at night.

3. Police interviews with Cristovol

Spanish-speaking Deputy Sheriff Luis Alvarez interviewed Cristovol **[*6]** in May 1982. In that interview, Cristovol told Alvarez that he and his "cousin," Ricardo, left on Sunday at about 10:00 a.m. to drive to Paso Robles. On the way back, Cristovol and Ricardo, along with Munoz, stopped in San Miguel at about 1:30 p.m. where they saw Sanchez and some other people in the park. The three men, joined by Sanchez, returned to the ranch where they drank together for a little while. At about 3:00 p.m., Munoz drove Sanchez back to San Miguel, then the two of them returned to the ranch that same afternoon.

Cristovol told Alvarez that Sandoval came by while they were drinking and Sanchez insisted he join them for a beer. Sandoval initially refused, but then stayed to drink one beer before returning to work. After work, Sandoval rejoined the group until about 4:00 p.m. Munoz went home, and Cristovol and Ricardo stayed in their room until they went to sleep.

Alvarez further testified that Cristovol told him he arose at about 5:45 a.m. the next morning and started to walk across the road to a friend's house. As he approached the house, he saw Octavio's car, a Ford Granada, drive up and park in a driveway. Sanchez, Octavio and a third "skinny" man got out of the car. **[*7]** Sanchez and Octavio both looked intoxicated. Sanchez told Cristovol he drank too much the night before, and he asked Cristovol to tell their boss Sanchez would not be at work that day. The three men got back in the car and left.

Cristovol said Ricardo[4] then walked to Sandoval's residence. When Ricardo returned, he told Cristovol he had found Sandoval, so Cristovol went over himself and saw Sandoval's body. Cristovol then walked across the road to where his friend Alberto lived and told Alberto that Sandoval was dead. Alberto went to tell the boss.

By stipulation, portions of Detective Ralph Price's report of his May 17, 1982 interview with Cristovol were read to the jurors. Among the notes Price took were the following: "At around 2:00 on Sunday, 5-16-82, . . . [Sanchez] had returned to the ranch from San Miguel." "The victim Sandoval came in for a break or something, and they had one beer, and then Sandoval had to go back to work." "[Cristovol] said that [Sanchez] then departed the ranch and he didn't see him again until approximately 6:00 [a.m.]."

Also by stipulation, portions of Price's report of his May 18, 1982 interview with Cristovol were read to the jurors. In this report, Price **[*8]** took the following notes: "Around 1400 hours on Sunday [Cristovol] and some friends had been in town in San Miguel. [¶] . . . [T]hey picked up [Sanchez] at the park and brought him home to the residence at [Rancho Lejos]"; "[W]hile they were there . . . Sandoval came in from work, and [Sanchez] invited Sandoval to have a beer, which he did"; "[A]round 1500 hours [Sanchez] departed the ranch for an unknown destination."

4. Ricardo's testimony

Ricardo testified he worked and lived at Rancho Lejos in May 1982, but would sometimes stay with his girlfriend in Paso Robles. Ricardo spent the Sunday night before Sandoval's murder with his girlfriend. On Monday morning, Ricardo was driving back to the ranch and passed a car going in the opposite direction. He saw Sanchez and two other people in that car. When Ricardo arrived at the ranch, Cristovol told him what had happened.

5. Adolfo Campoverde's testimony

In 1982, Adolfo Campoverde was living in a trailer near Rancho Lejos with his brother-in-law, Jose Contreras. Campoverde was close friends with Octavio, and was godfather to Octavio's daughter. Campoverde knew Octavio's brother, Sanchez, though not as well as Octavio.

On a Saturday or Sunday, Campoverde had been **[*9]** at Octavio's home from mid-afternoon until 8:00 or 9:00 that evening. He remembered that Sanchez was there as well. A couple of hours later, Octavio showed up at Campoverde's trailer. Sanchez was there as well, but did not come in. Campoverde talked with Octavio inside the trailer for five or 10 minutes, but did not think Contreras was present during this conversation. Octavio asked for the telephone number of Campoverde's brother-in-law, who lived in Washington State.

6. Contreras' testimony[5]

Contreras confirmed he and Campoverde were living in the same trailer in May 1982. At 1:00 or 2:00 a.m., one morning, Contreras was sleeping when someone knocked on the door. Campoverde opened the door and let Sanchez and Octavio inside. Contreras got up too and stood behind Campoverde. Octavio said, "This guy just killed a mother fucker." Sanchez did not say anything in response, though Contreras thought

[4] Alvarez testified he interviewed a man with no identification who identified himself as "Ricardo." Ricardo, who said Cristovol was his cousin, gave Alvarez a similar account as Cristovol, but said he had to tell Cristovol about the body twice.

[5] At the outset of his testimony, Contreras said he had suffered a stroke sometime in the past year.

"he looked like he was under the influence or something." Contreras saw him stumble at least once, though he could walk unassisted. Octavio asked for the telephone number of Contreras' brother "Chaquetas" who lived in Yakima, Washington.

After Octavio and Sanchez left the trailer, Contreras encouraged **[*10]** Campoverde to call the police, but he refused. Campoverde said they needed to "help our fellow country men. [*Sic*.]" When asked why he did not call the police himself, Contreras said he "never learned how to dial on a phone or make a phone call." Contreras also said he did not know how to write or how to drive a car so he could not get to the police station on his own.

On redirect, Contreras testified he did not report Sanchez to the police because he was afraid of him. Eight months before the night that Sanchez and Octavio came to his trailer, Contreras said Sanchez "tried to murder me." Sanchez had been playing cards with a group and had lost all his money. When the other players went inside, Sanchez pulled out a knife and told Contreras, "'You're going to give me all the money that you have, you mother fucker, or you're going to be fucked.'"

In 1985, Contreras married Sanchez' and Octavio's sister, Lidya. In 2008, Sanchez and Lidya were involved in litigation against each other. During the course of their dispute, Sanchez called Lidya a "witch," and showed up at the Contreras' house to threaten them, saying, "I'm going to kill you, you mother fuckers." After Sanchez physically "beat" **[*11]** Lidya, Contreras told the police about what happened that night in 1982 when Octavio and Sanchez came to his trailer.

7. Lidya's testimony

Lidya testified she loaned Sanchez $7,000 in 2007, and he became upset with her when she later asked him to repay it. Their dispute over the loan ended up in court in 2008. In the hallway of the courthouse, Sanchez accused Lidya of being a "witch," and she called him an "assassin" or "murderer." When Sanchez asked why she said that, Lidya replied that Octavio had told her. In a mocking tone of voice, Sanchez said he "hadn't done it, so what was it to [her]?"

8. Cynthia Lorenzi's testimony[6]

Cynthia Lorenzi testified that she married Sanchez' brother, Octavio, in the late 1970s, but they divorced approximately five years later. In 1982, she and Octavio lived at Shandon Star Nursery in Paso Robles. In May 1982, she knew that Sanchez worked at a ranch in San Miguel. Around that same time, she learned that a murder occurred at that ranch.

On the Sunday before the murder, Lorenzi went to a baptism at the San Miguel mission. Octavio and Sanchez were also there, though she was not sure if Sanchez went to the baptism or was simply at the park afterwards, drinking **[*12]** beer. At about 5:00 p.m., Sanchez and several others left the park and went to Lorenzi's house where they all continued to drink and talk. Sanchez was drunk, but he was able to stand and carry on a conversation.

Sanchez and Octavio left the house after dark, along with just about everyone else. Around midnight or 1:00 a.m., Lorenzi was in bed when she heard a car in the driveway. Octavio entered the bedroom and told her to go to the kitchen with him. When she entered the kitchen, Sanchez was sitting at the table. Octavio said they had to get Sanchez "out because . . . he had shot somebody." Octavio said, "'This son of a bitch just got through killing the boy out at the ranch.'" Lorenzi did not recall Sanchez responding to what Octavio said.

Octavio and Sanchez remained at the kitchen table for a couple of hours. Lorenzi acted as if she were going back to the bed, but instead stood behind the wall listening to them talk. She overheard Octavio ask Sanchez, "'Why did you shoot? Now we got to get you out of here. You were dumb. You got to go.'" Sanchez did not respond. She also heard Octavio tell Sanchez, "'You almost killed me, because you shot him, and I was right there hugging him.'"

[*13] Lorenzi returned to her bedroom. Sometime after the sun rose, Lorenzi heard the door close and she saw Octavio and Sanchez outside. They walked to Octavio's car, a gray or silver Ford Granada, and Sanchez took a shotgun out of the trunk. Octavio and Sanchez got shovels and buried the shotgun along the fence line of a nearby field.

Lorenzi went to work sometime after 7:00 a.m. that morning. When she returned home that afternoon, Octavio was holding a pistol and threatened to shoot her unless she drove Sanchez to Tijuana. Lorenzi drove Octavio and Sanchez, along with her two-year-old daughter to Tijuana. She recalled the drive took about eight hours and when they reached Tijuana, they dropped Sanchez off so he could take a bus to his parents' home. She, Octavio and her daughter drove straight back to Paso Robles.

Lorenzi recalled that Octavio took her out to the ranch at some point in time and showed her a tree, saying "'That's the

[6] At the beginning of her testimony, Lorenzi said her memory had been affected by three strokes she had suffered in the past five years.

tree, right there, where the body was laying against.'" She was not certain whether Sanchez was with them when this occurred.

9. Police interviews with Lorenzi

Detective Price interviewed Lorenzi at her residence on May 18, 1982 and, by stipulation, portions of **[*14]** Price's report documenting that interview were read to the jury. Lorenzi told Price there had been 12 or 13 people at her house dancing and celebrating the baptism. She went to sleep around 11:00 p.m. or possibly as late as midnight, and no one said anything about a shooting at any point in the evening. When she went to bed, Octavio, Sanchez and several other people, including "Rogelio," were still in the living room.

When she got up the next morning at 7:00 a.m., the three men were asleep in the living room. She left for work around 90 minutes later. When she returned home at about 9:30 or 10:00 a.m., no one was there and their car was gone. Octavio, Sanchez, and her children returned in the car a short time later along with two other men.

Price interviewed Lorenzi again on May 19, 1982. In this interview, she said she did not really remember whether Octavio and Sanchez left the house any time after the baptism and before she went to bed, but she was relatively sure they had not. She again said she did not "hear anyone mentioning shooting Sandoval."

Detective Shaheen Jorgensen interviewed Lorenzi on May 23, 2008. In this interview, Lorenzi said she observed Octavio and Sanchez bury a **[*15]** shotgun near her house in 1982. Afterwards, Octavio told her she was going to drive Sanchez to Tijuana, threatening her with a double-barreled shotgun. Lorenzi said she asked Octavio why he was threatening her, and he told her, "'One's for you and one's for me.'" When she responded, "'Who's going to give you yours?'" she saw him start to pull the trigger. Lorenzi threw up her arm, redirecting the shotgun, and the blast tore a hole in the roof of their car.

Lorenzi also told Jorgensen that Octavio showed her the tree where he and Sanchez had left the body. She first said this took place a couple of days after they took Sanchez to Tijuana. She subsequently clarified that the murder took place on a Sunday, and therefore Octavio must have driven her out to the ranch on Monday afternoon or evening. It was after that trip to the ranch that he threatened her with the shotgun and told her to drive Sanchez to Tijuana. That was also when she saw a .380-caliber handgun in the glove box. Lorenzi said she subsequently drove both Octavio and Sanchez to Tijuana but was able to return to Paso Robles in time for work the next day.

After Jorgensen asked Lorenzi to visualize a calendar in her head to orient **[*16]** herself on the day after the killing, Lorenzi told Jorgensen she recalled Octavio and Sanchez were actually *not* home when she got up at 7:00 a.m. on that particular Monday to go to work. When she came home to fix lunch, they were still not home. Octavio returned around 2:00 p.m., but she did not remember Sanchez being with him. She fed Octavio, then she returned to work until between 5:00 and 6:00 p.m.

When she got home that evening, Octavio and Sanchez were sitting at the kitchen table discussing the murder. Octavio told her to leave, but she went around the corner and stood behind the wall to the kitchen, eavesdropping. Lorenzi said she overheard Octavio telling Sanchez he would have Lorenzi drive them to Tijuana, and he would kill her if she refused. Octavio and Sanchez also talked about what to do with the gun and Octavio said they should bury it immediately. Lorenzi watched them from the window as they retrieved a shotgun from the car and took a shovel from the shed. Sanchez carried the gun to the tree line where they buried it.

Octavio and Sanchez returned to the house. Octavio asked Lorenzi if she would like to go for a ride, and she agreed. They drove out to the ranch where Sandoval **[*17]** had been killed and that is when Octavio showed her the tree where Sandoval's body was. Lorenzi asked Octavio how Sanchez did it, but he did not answer. Instead, he told her she was going to drive Sanchez to Tijuana. When she refused, Octavio pulled out the .380-caliber handgun and told her they were going. They returned to the house to pick up Sanchez, and left in the dark so no one would see them. They drove straight through to Tijuana and back. Lorenzi said she and Octavio got back home between 6:30 and 7:00 a.m. in time for her to go to work. She also said they might have arrived shortly before detectives came to her house that morning at 10:25 a.m.

Lorenzi told Jorgensen she did not remember talking to the detectives that morning but recalled only that they were looking for Octavio, who had just taken their daughter out to a restaurant. The detectives returned a day or two later and arrested Octavio. He was soon released, and Lorenzi said Octavio beat her badly when he got out of custody, because he thought she was the person who called the police.

Jorgensen testified she interviewed Lorenzi again in November 2011. In that interview, Lorenzi told her that she did not remember talking **[*18]** to Jorgensen in 2008.

10. Lawrence Mora's testimony

Lawrence Mora owned the ranch next to Rancho Lejos. Sanchez had worked for Mora for about seven months in

1982.

Early one morning, Sanchez showed up at Mora's house in a car with several other men, asking for his last paycheck. After Mora gave him his check, Sanchez climbed back into the car. Mora smelled alcohol and thought some of the men in the car were asleep or passed out. Sanchez "walked on his own okay. Maybe a little topsey-turvy."

At about 7:30 a.m. that same day, Mora saw Sanchez asleep in the front seat of the car, parked at another nearby ranch. Mora walked to the car and woke Sanchez up. Sanchez said he had lost his paycheck, so Mora helped him look for the check in the car. Mora opened the glove box and saw the butt of a pistol. Later that same day, Mora learned that Sandoval had been killed.

By stipulation, portions of a report prepared by Detective Price regarding his interview with Mora were read into the record. In that interview, Mora told Price that Sanchez arrived at his house on May 17, 1982, at about 6:00 a.m. in a gray Ford Granada. He was accompanied by Octavio and another man, Rogelio Legoretta. Mora said that **[*19]** both Sanchez and Octavio were "extremely drunk."

11. Isabel Madrid's testimony

In May 1982, Isabel Madrid lived with Legoretta on the ranch where they both worked. Madrid had known Octavio for about a year, but he had never met Sanchez. Madrid heard about Sandoval's murder the day after it happened.

Madrid overheard Octavio talking with Legoretta about midnight the night before the murder. Madrid first testified Octavio was alone at the time, but subsequently said there was another person there, who he assumed was Sanchez. Madrid could only hear their voices, since he was in bed, about 10 feet away, "covered."

Octavio and whoever else was with him stayed about 15 minutes. Legoretta left with them. On cross-examination, Madrid said he could not recall hearing Octavio tell Legoretta, "We're having a party at my house. Let's go get some beer," but admitted that if that statement was in the police officer's report, he probably said it at the time.

12. Forensic evidence

a. John Jardine's testimony

In 1982, John Jardine was employed as a coroner's investigator with the Monterey County Sheriff's Department. When he arrived at Rancho Lejos around 11:00 a.m. on May 17, 1982, Detective Price escorted **[*20]** him behind a building to where Sandoval's body lay.

Jardine observed blood in the doorway of Sandoval's residence along with some drops of blood on the steps and the door. A blood trail led from the door to where Sandoval's body was found.

Sandoval was six feet two inches tall. He had a gunshot wound to the upper right chest, but Jardine did not recall there being any black soot or powder burns on Sandoval's t-shirt. Inside the dwelling, police found a sawed-off 20-gauge shotgun. Jardine testified that if Sandoval's wound was caused by that particular shotgun, the shooter was anywhere from six to 10 feet away. Because investigators found no shotgun pellets in or around the entryway, Jardine opined Sandoval's body had probably taken the full impact of the blast.

Jardine estimated Sandoval most likely died about 12 hours prior, placing the time of death somewhere between 11:00 p.m. to midnight. Sandoval's body displayed full rigor mortis. As he turned the body over, Jardine looked to see if there were any changes to where the blood had settled inside Sandoval's body after his death or if it was coagulated and set. Based on his observations, Sandoval's blood was coagulated meaning he had **[*21]** died sometime between 10 and 12 hours beforehand. The blood trail from Sandoval's doorway to where his body was found was "extensive." The blood was dry, but not yet "crumbly."

b. Dr. John Hain's testimony

Dr. John Hain, a forensic pathologist, testified after reviewing the May 17, 1982 pathologist's report by Dr. E.E. Simard[7] and the accompanying autopsy photographs. In Dr. Hain's opinion, the shotgun which killed Sandoval was likely fired from a distance of a little less than six feet, due to the nearly circular nature of the wound, which indicated the pellets did not have time to spread before impact. In addition, the plastic wadding from the shell was lodged in the back of Sandoval's chest cavity.

According to Dr. Hain, the cause of death was the shotgun wound which lacerated Sandoval's lung, liver and heart, causing massive internal hemorrhaging. Despite the damage to his internal organs, Sandoval could have remained conscious for anywhere from 10 seconds to one minute after

[7] The parties do not explain why Dr. Simard did not testify, but his failure to testify is not raised as an issue on appeal.

being shot. From the blood trail, Dr. Hain could not determine whether Sandoval walked to where his body was found or if he had been dragged there.

Dr. Hain placed the time of Sandoval's death at about 12 hours **[*22]** before the body was found, or sometime between 11:00 p.m. and midnight. The body was "in full rigor mortis with posterior lividity that was fixed." Dr. Hain acknowledged both rigor mortis and lividity can be slowed by cooling, but in this case the outside temperature when the body was found was 70 degrees. Because rigor and fixed lividity can last anywhere from 24 to 30 hours, Dr. Hain conceded the time of death could be earlier. However, Dr. Hain found there was no evidence in the reports, such as insect or other scavenger activity on the body, to suggest Sandoval was killed earlier.

The trajectory of the wound was front to back and downwards. Although Sandoval was six feet two inches tall, Dr. Hain did not have enough information to offer an opinion on the location of the shotgun at the time it was fired. He testified that the impact of the shot would not necessarily send a person reeling or cause them to spin in the direction of the shot. It would depend on the initial position of the person's body and where the weight was on the person's feet at the time of impact. The angle of the wound trajectory would not be helpful in determining the position of the gun as it was fired unless **[*23]** one also knew how the victim's body was positioned at the time. According to Dr. Hain, a victim will sometimes lean forward or crouch in an attempt to avoid being shot. Without knowing how the victim and the shooter were positioned at the time of the killing, Dr. Hain could offer no opinion on the shooter's height.

c. Evidence collected/photographed at the scene

On May 17, 1982, Marvalee English, an identification technician from the Monterey County Sheriff's office photographed and collected evidence at the crime scene. English found an expended 20-gauge shotgun shell in the front yard near the west end of the driveway. There were numerous beer bottles, some unopened and others either empty or half-empty, in the garage and the house. English collected an envelope addressed to Sanchez that was lying on a mattress in the bedroom. One of the unopened beer bottles collected at the residence had a fingerprint that was matched to Octavio.

13. Sanchez's interviews with police

Detective Jorgensen, with the assistance of Spanish-speaking Detective Alfred Martinez, interviewed Sanchez on September 7, 2011. Over defense objection, a recording of the interview was played for the jury.

Sanchez told **[*24]** the detectives he came to the United States from Mexico in 1975 when he was 12 years old. At the time of the interview, he said he was 53 years old.[8]

Sanchez remembered working at a horse ranch for about three months in 1982. He returned to Mexico that same year because his father was sick. Sanchez told his brother Octavio he was leaving, and his brother told Sanchez's boss. He took a bus from Paso Robles to Mexico. Sanchez remained in Mexico for about five months, but when he returned another of his brothers was working at the horse ranch, so Sanchez continued north to Santa Rosa to find work.

After further questioning by the detectives, Sanchez discussed the period of time leading up to Sandoval's death. He said on "that day we were drunk. . . . The honest truth we ended wrong. . . . We fought like 5 times." He said "out of rage well I did that, yes, it happened." Martinez asked Sanchez where he got the shotgun, but Sanchez could not remember, saying "I don't remember who it came from. I don't . . . know where—I just it seems we were both drinking, yes, and I don't remember if it was in his car, in my car . . . . All that I know is that I lost my marble. [*Sic*.]"

Sanchez did not know **[*25]** he had killed Sandoval until other people told him he had and he did not "imagine that serious. [*Sic*.]" Sanchez admitted he went to Mexico because "I was afraid of the law." Asked how he felt, Sanchez said it was "a great mistake" but he could not bring Sandoval back. Sanchez did not know what happened to the shotgun afterwards.

Detective Martinez later asked Sanchez directly: "[Y]ou do k[n]ow that . . . you shot [Sandoval] with a shotgun?" and Sanchez replied "Yes." However, Sanchez again said he only thought he had injured Sandoval, and it was not until the next day, when Octavio "scolded" him about the killing, that he learned Sandoval had died.

Sanchez did not leave for Mexico until about three days later, and then he stayed in Mexico for about 10 to 15 years. During that time, he got married and had children. Detective Jorgensen told Sanchez she knew he did not take a bus to Mexico, but Sanchez said he did not remember.

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[8] If Sanchez was 12 years old when he arrived in the United States in 1975, he would have been 48 years old in 2011. The age discrepancy, intentional or not, is not relevant to this appeal, but we would be remiss if we neglected to point it out.

Later in the interview, Sanchez provided additional details of the events leading up to the shooting. He stated that he was with a man from Jalisco[9] and with Sandoval drinking at a bar in Avenal. When Jalisco was driving them back, Sanchez and Sandoval got in several fights over **[*26]** a woman, and Sandoval made Sanchez bleed. When they returned to Sandoval's residence, they continued drinking. They drank a lot that day—beer, whiskey, tequila, and champagne. At some point Octavio showed up, but Sanchez could not remember how or when Octavio got there.

Sanchez participated in a second interview with police on October 19, 2011. In this interview, Jorgensen was assisted by Spanish-speaking Detective Alex Aguayo. Sanchez told the detectives he was drunk during his first interview in September and did not recall what he had told them. He insisted the real reason he went to Mexico after the murder was because his parents were sick. Sanchez denied being involved in the shooting and denied previously admitting to Sandoval's murder.

Sanchez said he could not take the blame for something he did not remember doing, and on several occasions, said he could not give the detectives an account of what had happened because he did not recall. He told Aguayo and Jorgensen: "'His brother Octavio had told him he had to leave, and for him[10] to take responsibility for the death.'" Sanchez said he had fought with Sandoval a few times that night, and Sandoval broke his nose at some point.

*14. **[*27]** Search for the murder weapon*

On May 28, 2008, Detective Jorgensen and other law enforcement officers went with Lorenzi to try to find the shotgun she saw Octavio and Sanchez bury in 1982. Sometime between 1982 and 2008, the property had been converted to a vineyard. Lorenzi directed the searchers to the area where she believed the shotgun had been buried. Using metal detectors, the officers found multiple bottle caps and pieces of wire, but not a shotgun, despite an expansive search.

B. Defense case

Sanchez testified in his own behalf. He said he could remember parts, but not all, of the events around the time of Sandoval's[11] death in 1982.

In 1982, Sanchez worked for Mora for about five or six months, then left that job to work at Rancho Lejos. He worked at Rancho Lejos for one or two weeks.

In May 1982, Jalisco picked up Sanchez and Sandoval at Rancho Lejos and drove to a bar in Avenal. They left the ranch sometime after 2:00 p.m., and it took about an hour and a half to get there. Along the way they stopped at a bar in "Park Field"[12] and bought an 18 pack of beer, drinking about 12 of those along the way to Avenal. They arrived at the bar in Avenal sometime around 4:00 p.m. or after, but **[*28]** the bar was mostly empty. The three men left and bought a 30 pack of beer at a store in town. They drank the remainder of the 18 pack, and Sanchez drank about five more beers from the 30 pack in the store's parking lot.

When they returned to the bar, it was crowded, and Sanchez invited a girl to have some drinks with him. She accepted, and they sat down at a table. Sanchez switched to hard liquor and had maybe five or six more drinks with the girl.

Sandoval came up to their table and asked the girl to dance with him, but she refused. Sanchez told Sandoval the girl was with him and they began arguing. They stepped out of the bar to fight and traded a few blows before they were separated. They went back inside, and Sanchez began drinking again. At some point, when "[i]t was quite late," Jalisco came up and said it was time to go.

On the drive back, Sandoval was in the front passenger seat and Sanchez was behind him. They continued to argue about what happened in the bar. Jalisco saw that they were going to fight so he pulled over and they got out. The two men, both of whom were drunk, started fighting until Jalisco broke them up. They all got back in the car and resumed driving back to the **[*29]** ranch. Sanchez and Sandoval continued to argue in the car, and fought three or four more times before reaching their destination. In the last fight, Sandoval broke Sanchez's nose. Sanchez said he was upset by this, but not very angry.

Sometime later, Jalisco dropped Sanchez off at a friend's house in San Miguel. Sanchez washed his face and changed into a clean shirt his friend gave him, then went to sleep. He woke up the next day sometime after 11:00 a.m., and went to the baptism party in San Miguel.

Octavio and his wife were also at the party. Sanchez began drinking beer again, but did not know how much he drank. After leaving the park, Sanchez went to Octavio's house

[9] Sanchez testified at trial he did not know this man's true name, but everyone called him "Jalisco," apparently because of his origin.

[10] Presumably Sanchez.

[11] Sanchez said he knew Sandoval by the name "Manuel Pesqueira."

[12] We presume Sanchez was referring to the town of Parkfield in Monterey County and this was mistranscribed.

where the party continued. He drank more beer, though he did not keep track of how much, and suddenly "just fell asleep."

Sanchez did not leave the house that night. The next morning, around 6:00 a.m., Octavio drove Sanchez to the ranch where he used to work to get his paycheck from Mora. Sanchez said he was still drunk at the time. After he picked up his check, he and Octavio, along with some of Octavio's friends who were in the car, went to Rancho Lejos.

When they got to Rancho Lejos, they stopped in front of Sandoval's **[*30]** house. Sanchez said he wanted to tell Sandoval to tell his boss he was not going to work that day because he was drunk. Sanchez and Octavio got out of the car. Cristovol walked up to them and asked Octavio where Sandoval was. Because he did not see Sandoval, Sanchez told Cristovol to relay the message to his boss. Sanchez said he got back in Octavio's car and they drove to San Miguel. At no time did Sanchez or Octavio enter anyone's residence at Rancho Lejos, nor did Sanchez see anyone walk around behind the houses.

They bought more beer in San Miguel, and then returned to Octavio's house. Lorenzi was not there when they arrived. They continued drinking. Sanchez did not return to work the next day because he was still drunk. By the second or third day he felt sober enough to go back to work, but could not recall if he did so.

At some point, Octavio told Sanchez that he had to go to Mexico, but did not tell him why. Because Octavio was so insistent, Sanchez was "convinced" he had to do as his brother said. Lorenzi was not present during their discussion about going to Mexico.

Sanchez did not own any guns,[13] but he knew that Octavio had a .380-caliber handgun as well as a breech-loader rifle. **[*31]** Sanchez did not know whether Octavio also owned a shotgun. He denied burying a shotgun with Octavio on or around Octavio's house.

Either Octavio or Filipe Morales took Sanchez to the bus station in Paso Robles, where he bought a ticket to Tijuana. After arriving in Tijuana, Sanchez purchased another bus ticket to San Juan Nuevo where his father lived.

About five or six months later Octavio, Lorenzi, and their children visited San Juan Nuevo. Octavio asked their father for forgiveness for sending Sanchez to Mexico and for falsely "saying that [Sanchez] had killed [Sandoval]." Octavio said Sanchez did not "owe anything" and he, Octavio, was responsible for "what had happened." Sanchez returned to the United States once Octavio paid a "coyote" to smuggle him across the border. He lived with Octavio and Lorenzi for about three days, then started working in Atascadero.

When Sanchez was asked about his September interview with the police, he said he admitted shooting Sandoval because the detectives "didn't tell me what they really wanted to know. . . . And I'd get all confused." He was "very tired mentally" so "I just told them 'yes.'" He acknowledged, however, the atmosphere at his initial **[*32]** interview was "relaxed" and he told the detective that he felt fine during the interview. Sanchez clarified it had been "so many years," his "mind wasn't functioning properly[, although] [p]erhaps I didn't tell her that." Part of his confusion stemmed from Jorgensen's questions, which were not focused on one thing at a time.

By the time of the second interrogation a month later, Sanchez testified his mind had "opened up a bit" and he had been "able to focus more." After his first interview, his attorney showed him "evidence of this, evidence of that, that has helped me have a clear mind and remember things clearer."

Sanchez acknowledged he told Jorgensen in his interview that he was in Mexico for 10 to 15 years, but at trial testified he was only there for eight to 10 months. He explained he "wasn't thinking normally" when he spoke with Jorgensen.

Sanchez also admitted that he never told police, in either interview, that he and Sandoval were arguing about a girl at a bar or that he first began fighting with Sandoval at the bar. Sanchez said he did not know of any problems Octavio had with Sandoval that might have led Octavio to murder him.

C. Jury verdict and sentencing

The jury found Sanchez guilty **[*33]** of first degree murder (*§ 187, subd. (a)*) and also found that Sanchez personally used a shotgun, in the commission of that crime. (*§ 12022.5, subd. (a)*.)

After denying Sanchez's motion to set aside the verdict and motion for a new trial, the court sentenced Sanchez to a total term of 27 years to life consisting of 25 years to life for the murder, plus a consecutive two year term for the firearm enhancement. The trial court imposed a restitution fine of $4,000 under *section 1202.4, subdivision (b)*, and victim

[13] Exhibit No. 42 was a letter from Sanchez's father to Sanchez, in which Sanchez's father referred to Sanchez having a .380-caliber handgun and cautioned him not to handle the weapon when he was drunk. When asked about this letter, Sanchez said his father mistakenly believed this gun belonged to him, but it was actually Octavio's.

restitution in an amount to be determined by the probation department under *section 1202.4, subdivision (f)*. The court imposed an additional restitution fine of $4,000 under *section 1202.45* but ordered that fine suspended pending successful completion of parole, if any.

Sanchez timely appealed.

II. DISCUSSION

A. Adoptive admissions

1. Relevant procedural background

Before trial, the prosecutor filed a motion in limine to admit various hearsay statements at trial, including Octavio's statements reported by Lorenzi as well as the statements Octavio made in the presence of Contreras. The prosecutor argued these statements, though hearsay, were admissible as adoptive admissions under *Evidence Code section 1221*.

The defense objected. As to Lorenzi's testimony, defense counsel argued the statements were inadmissible because they **[*34]** lacked foundation, Lorenzi was biased, and Octavio was not present in court to be cross-examined. The trial court ruled that, so long as the prosecution laid a sufficient foundation for the statements, the testimony would come in as adoptive admissions.

Turning to the statements Octavio made in the trailer, defense counsel argued there could be no adoptive admission of them by Sanchez since Campoverde would testify that Sanchez never entered the trailer and thus was not present when Octavio spoke. The prosecution countered that Contreras would testify Sanchez did, in fact, come into the trailer and was present when Octavio was talking. The trial court deferred ruling until further information was developed. At trial, Campoverde and Contreras testified essentially as counsel indicated they would.

The trial court instructed the jury on this issue (*CALCRIM No. 357*) as follows: "If you conclude that someone made a statement outside of court that accused the defendant of the crime or tended to connect the defendant with the commission of the crime and the defendant did not deny it, you must decide whether each of the following is true: [¶] 1. The statement was made to the defendant or made in his presence; **[*35]** [¶] 2. The defendant heard and understood the statement; [¶] 3. The defendant would, under all the circumstances, naturally have denied the statement if he thought it was not true; [¶] AND [¶] 4. The defendant could have denied it but did not. [¶] If you decide that all of these requirements have been met, you may conclude that the defendant admitted the statement was true. [¶] If you decide that any of these requirements has not been met, you must not consider either the statement or the defendant's response for any purpose."

2. Standard of review and applicable legal principles

"Broadly speaking, an appellate court applies the abuse of discretion standard of review to any ruling by a trial court on the admissibility of evidence." (*People v. Waidla (2000) 22 Cal.4th 690, 717, 94 Cal. Rptr. 2d 396, 996 P.2d 46*.)

Hearsay is "evidence of a statement that was made other than by a witness while testifying at the hearing and that is offered to prove the truth of the matter stated." (*Evid. Code, § 1200, subd. (a)*.) Hearsay is inadmissible unless it qualifies under one of the exceptions to the hearsay rule, such as the adoptive admissions exception set forth in *Evidence Code section 1221*. "A statement by someone other than the defendant is admissible as an adoptive admission if the defendant 'with knowledge of the content **[*36]** thereof, has by words or other conduct manifested his adoption [of] or his belief in its truth.' (*Evid. Code, § 1221*; see *People v. Preston (1973) 9 Cal.3d 308, 314, 107 Cal. Rptr. 300, 508 P.2d 300* & fn. 3.)" (*People v. Davis (2005) 36 Cal.4th 510, 535, 31 Cal. Rptr. 3d 96, 115 P.3d 417* (*Davis*).) A trial court determining whether a statement is admissible as an adoptive admission must first decide whether there is sufficient evidence that: "(a) the defendant heard and understood the statement under circumstances that normally would call for a response; and (b) by words or conduct, the defendant adopted the statement as true." (*Ibid.*)

"'[I]f a person is accused of having committed a crime, *under circumstances which fairly afford him an opportunity to hear, understand, and to reply*, and which do not lend themselves to an inference that he was relying on the right of silence guaranteed by the *Fifth Amendment to the United States Constitution*, and he fails to speak, or he makes an evasive or equivocal reply, both the accusatory statement and the fact of silence or equivocation may be offered as an implied or adoptive admission of guilt.'" (*People v. Jennings (2010) 50 Cal.4th 616, 661, 114 Cal. Rptr. 3d 133, 237 P.3d 474*, italics added.)

"'"[O]nce the defendant has expressly or impliedly adopted the statements of another, the statements become *his own admissions*, and are admissible on that basis as a well-recognized exception to the hearsay rule."'" (*People v. Cruz*

(2008) 44 Cal.4th 636, 672, 80 Cal. Rptr. 3d 126, 187 P.3d 970.) "'To warrant admissibility, it is sufficient **[*37]** that the evidence supports a reasonable inference that an accusatory statement was made under circumstances affording a fair opportunity to deny the accusation; *whether defendant's conduct actually constituted an adoptive admission becomes a question for the jury to decide*.'" (*People v. Riel (2000) 22 Cal.4th 1153, 1189-1190, 96 Cal. Rptr. 2d 1, 998 P.2d 969*, italics added.)

3. Analysis

Sanchez argues that, given the evidence of his extreme intoxication and the ambiguity of the circumstances surrounding the statements purportedly made by Octavio, his silence lacked sufficient probative value to show consciousness of guilt, and those statements should have been excluded. We agree.

In support of his argument, Sanchez cites *People v. Simmons (1946) 28 Cal.2d 699, 172 P.2d 18* (*Simmons) and People v. Bracamonte (1961) 197 Cal.App.2d 385, 17 Cal. Rptr. 62* (*Bracamonte*) both of which stand for the proposition that, under certain circumstances, an accused's silence in the face of an accusatory statement should not be considered an adoptive admission of that accusation. The *Simmons* court listed a number of such situations, e.g., where the accused is under arrest, in fear for his or her safety or the safety of others, in severe physical or emotional pain. (*Simmons, supra, at pp. 715-716*.) *Bracamonte* suggested that being under the influence of drugs or alcohol may also explain an accused's failure to refute an accusatory statement. **[*38]** (*Bracamonte, supra, at p. 390*.) In this case, no foundation was laid by the prosecution to meet the test of these cases.

In this case, there was no dispute that Sanchez was intoxicated both *before* and *after* he murdered Sandoval. Every witness who came into contact with him during that time period testified Sanchez was drunk. Consequently, the issue was not whether he *was* drunk; rather, it was whether he was *too* drunk to be able to hear and understand Octavio's statements incriminating him in the murder and, if not, whether by his silence or inaction he adopted the statements as true. (*Davis, supra, 36 Cal.4th at p. 535*.)

However, even though the trial court erred in admitting the statements at issue, Sanchez cannot show prejudice as a result. It is not "reasonably probable that a result more favorable to defendant[s] would have [resulted]" had the testimony been excluded. (*People v. Watson (1956) 46 Cal.2d 818, 837, 299 P.2d 243*.) "[T]he admission of evidence, even if erroneous under state law, results in a due process violation only if it makes the trial *fundamentally unfair*." (*People v. Partida (2005) 37 Cal.4th 428, 439, 35 Cal. Rptr. 3d 644, 122 P.3d 765*.)

Had these particular statements not been admitted, the jury still heard Sanchez's admission to police that he shot Sandoval. Multiple witnesses confirmed that Sanchez was with Sandoval the day before he was killed, that he and Sandoval fought **[*39]** several times that day with Sanchez getting the worst of those encounters, that Sanchez left Lorenzi's house late that night, that Sanchez was at the ranch trying to collect his paycheck early the next morning, and that Sanchez soon afterward went to Mexico. Octavio's statements were undeniably strong evidence of Sanchez's guilt, but it is simply not reasonably probable the jury would have acquitted Sanchez without them.

B. Testimony about prior threats by Sanchez

Sanchez next argues the trial court erred by permitting testimony about an incident in which Sanchez threatened Contreras with a knife and demanded money from him. Testimony about this same incident was elicited during the prosecutor's redirect examination of Contreras as well as during his cross-examination of Sanchez. Finally, Sanchez argues the trial court erred by permitting Contreras to testify that Sanchez had come to his home during the time Sanchez and Lidya were involved in a civil lawsuit and threatened to kill him and Lidya.

1. Relevant factual background

a. Contreras' testimony about being robbed at knifepoint

In cross-examination, defense counsel asked Contreras about the reasons he did not contact police after learning **[*40]** Sanchez had killed someone. Before redirect, the prosecutor asked for a sidebar conference and sought permission to introduce testimony that Contreras did not contact police because he was afraid of Sanchez. The trial court allowed the prosecutor to ask Contreras again why he did not contact police, but without suggesting or leading Contreras into citing fear as a motivation since he did not offer this as a reason during cross-examination.

On redirect, Contreras at first said he could not recall the reasons he gave on cross-examination for not calling the police. The prosecutor reminded Contreras of the various reasons he had given before asking if there "was . . . another reason you didn't contact police?" Contreras replied, "Because

he's quite a traitor. And I said I don't want the same thing to happen to me as to the person that he murdered." When asked to elaborate, Contreras explained that, "[a]bout eight months before he committed the murder," Sanchez pulled a knife on him after losing all his money playing cards. Sanchez threatened to kill Contreras if he did not give him his money. The trial court immediately instructed the jury that Contreras' testimony was admitted for the limited **[*41]** purpose of explaining why Contreras did not contact police, not for the truth of the matter asserted.

b. Sanchez's cross-examination about the robbery

Subsequently, when Sanchez took the stand, the prosecutor asked him on cross-examination if he recalled Contreras testifying about the knife incident. When Sanchez said he did, the prosecutor asked Sanchez if it would be a crime to "hold[] a knife to somebody and threaten[] them with it[?]" Sanchez responded, "If I had done it, yes. But if I hadn't—"

Outside the presence of the jury, the trial court memorialized a side-bar discussion that took place prior to this line of questioning. During that conference, the prosecutor argued Sanchez had opened the door by stating in his direct examination that he had "no criminal history against anybody." Defense counsel responded that Sanchez's statement was referring to his being able to return to the United States with a clean conscience about Sandoval's death. It was not, according to defense counsel, a more blanket statement that Sanchez had never committed a crime against another person. The trial court ruled that, although defense counsel's question to Sanchez was narrowly tailored, Sanchez gave **[*42]** a broad answer and defense counsel did not move to strike that answer. Under *Evidence Code section 352*, the trial court ruled it would be unfair for Sanchez to "paint himself in a false light" and overruled defense counsel's objection.

c. Contreras' testimony about Sanchez's threats

Lidya testified when she and Sanchez were in court in 2008 on an unrelated civil matter relating to an unpaid loan, Sanchez called Lidya a "witch." Lidya further said she had gone to police more than once to complain about Sanchez.

During Contreras' cross-examination, defense counsel asked if he was aware that Lidya was upset by her brother, Sanchez, calling her a "witch." Contreras did not respond to that question, but said, "And many times he came to our house threatening us and yelling and saying 'I'm going to kill you, you mother fuckers.'"

Defense counsel objected to the answer as nonresponsive, but following a bench conference, the trial court overruled the objection. At the bench, the trial court noted defense counsel had objected to Contreras' answer as "either nonresponsive or otherwise objectionable." The trial court observed that defense counsel, who also spoke Spanish, was objecting before the answer could be translated **[*43]** by the interpreter. As a result, the court could not gauge whether the objection was well-taken if it did not hear the translation. Defense counsel said that if his question called for a "yes" or "no" response, sometimes the answer would go beyond that. To prevent the jury hearing inadmissible evidence, defense counsel would object before the response was translated. The trial court replied that Contreras' answers were appropriate as they were responsive and explained the "yes" or "no" answers, even if defense counsel was unhappy with those explanations.

2. Standard of review and legal principles

Under *Evidence Code section 352*, "[t]he court in its discretion may exclude evidence if its probative value is substantially outweighed by the probability that its admission will (a) necessitate undue consumption of time or (b) create substantial danger of undue prejudice, of confusing the issues, or of misleading the jury."

It is the exclusive province of the trial court to determine whether the probative value of evidence outweighs its possible prejudicial effect. (*People v. Sassounian (1986) 182 Cal.App.3d 361, 402, 226 Cal. Rptr. 880.*) Accordingly, the trial court's exercise of discretion on this issue will not be disturbed on appeal absent a clear showing of abuse. (*Ibid.*)

"The prejudice **[*44]** which exclusion of evidence under *Evidence Code section 352* is designed to avoid is not the prejudice or damage to a defense that naturally flows from relevant, highly probative evidence. '[A]ll evidence which tends to prove guilt is prejudicial or damaging to the defendant's case. The stronger the evidence, the more it is "prejudicial." The "prejudice" referred to in *Evidence Code section 352* applies to evidence which uniquely tends to evoke an emotional bias against the defendant as an individual and which has very little effect on the issues. In applying *section 352*, "prejudicial" is not synonymous with "damaging."'" (*People v. Karis (1988) 46 Cal.3d 612, 638, 250 Cal. Rptr. 659, 758 P.2d 1189.*) "'In other words, evidence should be excluded as unduly prejudicial when it is of such nature as to inflame the emotions of the jury, motivating them to use the information, not to logically evaluate the point upon which it is relevant, but to reward or punish one side because of the jurors' emotional reaction. In such a circumstance, the

evidence is unduly prejudicial because of the substantial likelihood the jury will use it for an illegitimate purpose.'" (*People v. Branch (2001) 91 Cal.App.4th 274, 286, 109 Cal. Rptr. 2d 870*.)

3. Analysis

a. Sanchez forfeited his objection to Contreras' testimony about Sanchez threatening him and Lidya

Sanchez forfeited his claims that the trial court's rulings **[*45]** on this evidence violated *Evidence Code section 352*, as well as his right to due process, by failing to obtain a ruling on his objections at trial and further by failing to move that Contreras's answer to his question be stricken.[14] "'In the absence of an erroneous ruling on an objection or request that a nonresponsive answer be stricken and the jury instructed to disregard it, there is no error.'" (*People v. Jackson (1996) 13 Cal.4th 1164, 1214, 56 Cal. Rptr. 2d 49, 920 P.2d 1254*.) An objection that the answer was nonresponsive is insufficient to preserve a claim of error for appeal. "'A nonresponsive answer is properly the subject of a motion to strike (*Evid. Code, § 766*), not an objection.'" (*People v. Virgil (2011) 51 Cal.4th 1210, 1249, 126 Cal. Rptr. 3d 465, 253 P.3d 553*.)

b. The evidence of Sanchez robbing Contreras at knifepoint was more probative than prejudicial

In this case, the trial court properly found that Contreras's testimony about Sanchez threatening him with a knife was relevant since Contreras, without being prompted by the prosecutor, testified that his fear of Sanchez was a reason for not contacting police. The evidence, while somewhat prejudicial to Sanchez, was more probative in that it provided the jury with an additional reason for Contreras not contacting police, as opposed to his other explanations of not knowing how to drive a car or operate a telephone.

Furthermore, **[*46]** the potential prejudice of this testimony was diminished by the trial court instructing the jury, immediately after the testimony came out, that it was not to consider it as evidence that Sanchez did in fact threaten Contreras with a knife but only to explain why he did not contact police. In general, such a limiting instruction eliminates "any danger 'of confusing the issues, or of misleading the jury.' (*Evid. Code, § 352*.)" (*People v. Lindberg (2008) 45 Cal.4th 1, 26, 82 Cal. Rptr. 3d 323, 190 P.3d 664*.) We presume the jury followed the instructions it was given. (*People v. Cain (1995) 10 Cal.4th 1, 34, 40 Cal. Rptr. 2d 481, 892 P.2d 1224*.)

Likewise, Sanchez's testimony on cross-examination about this incident was elicited to counter his self-serving declaration on direct that he had "no criminal history against anybody." The jury had previously heard Contreras's testimony about this incident, so there was little additional prejudice to Sanchez's defense in asking a single question about whether he considered threatening someone with a knife to be a "crime against a person."

c. Any error was harmless

Even assuming the trial court abused its discretion in admitting Contreras's testimony or allowing Sanchez to be asked about the incident on cross-examination, those errors were harmless. Generally, the admission of evidence in violation of state law is **[*47]** reversible only upon a showing that it is "reasonably probable that a result more favorable to the appealing party would have been reached in the absence of the error." (*People v. Watson, supra, 46 Cal.2d at p. 836*.) A *due process clause* violation, requiring review under the more stringent federal standard set forth in *Chapman v. California (1967) 386 U.S. 18, 87 S. Ct. 824, 17 L. Ed. 2d 705*, occurs where the admission of the evidence "makes the trial *fundamentally unfair*." (*People v. Partida, supra, 37 Cal.4th at p. 439*.) The admission of the testimony at issue here was not "'so prejudicial as to render the defendant's trial fundamentally unfair.'" (*People v. Jablonski (2006) 37 Cal.4th 774, 805, 38 Cal. Rptr. 3d 98, 126 P.3d 938*.) Accordingly, we apply the *Watson* harmless error standard.

As discussed above, there was ample evidence that Sanchez murdered Sandoval, not the least of which was Sanchez's confession to the crime in his September 2011 interview with police. In addition, Lorenzi and Contreras testified that Octavio made statements—in Sanchez's presence—implicating him in the killing, and Sanchez did not refute those statements. Several witnesses, and Sanchez himself, testified that Sanchez had physically fought several times with Sandoval the day of the murder. The evidence of the knife incident was admitted to bolster Contreras's credibility in his testimony that Octavio said that Sanchez had killed Sandoval, notwithstanding the **[*48]** fact that Contreras did not tell anyone about it at the time.

Sanchez argues, as he did below, that it was possible Octavio was the one who killed Sandoval and he implicated Sanchez

[14] We address below Sanchez's claim that his trial counsel was ineffective for failing to object to Contreras's testimony under *Evidence Code section 352*.

in order to deflect suspicion. This explanation is highly implausible. There was no evidence presented at trial that Octavio knew Sandoval, much less had any reason to harm him. It is not reasonably likely that the jury would have acquitted Sanchez even if it had not heard any testimony about Sanchez threatening Contreras with a knife.

C. No ineffective assistance of counsel

Sanchez also argues that his trial counsel was ineffective for failing to raise an appropriate objection to Contreras's testimony about him threatening to kill Contreras and Lidya.

A cognizable claim of ineffective assistance of counsel requires a showing "counsel made errors so serious that counsel was not functioning as the 'counsel' guaranteed . . . by the *Sixth Amendment*." (*Strickland v. Washington (1984) 466 U.S. 668, 687, 104 S. Ct. 2052, 80 L. Ed. 2d 674*.) "[T]he performance inquiry must be whether counsel's assistance was reasonable considering all the circumstances." (*Id. at p. 688*.) To prevail on an ineffective assistance of counsel claim, a defendant must also establish counsel's performance prejudiced his defense. (*Id. at p. 687*.) To establish prejudice, **[*49]** a defendant must demonstrate "there is a reasonable probability that, but for counsel's unprofessional errors, the result of the proceeding would have been different. A reasonable probability is a probability sufficient to undermine confidence in the outcome." (*Id. at p. 694*.)

Sanchez has not met his burden here to prove either prong of the *Strickland* test, i.e., he has not shown his trial counsel's performance was deficient, nor has he shown a reasonable probability the result of the trial would have been different had the objection been raised.

During cross-examination, defense counsel was seeking to undermine Contreras's credibility by showing he was biased against Sanchez because of the acrimonious relationship Sanchez had with Lidya (Contreras's wife). Contreras's response to defense counsel's questioning was unexpected, to say the least, and certainly tangential. However, a trial attorney, in deciding whether to object, must engage in a rapid mental cost-benefit analysis, and this analysis is among "'the minute to minute and second to second strategic and tactical decisions which must be made by the trial lawyer during the heat of battle.'" (*People v. Riel, supra, 22 Cal.4th at p. 1202*.) Having elicited this surprising response from **[*50]** Contreras, trial counsel could reasonably have concluded—as a tactical matter—that it was better not to move to strike the answer and thereby risk highlighting for the jury what they might otherwise have discounted.

D. Sanchez's statements to police were not involuntary

Renewing an argument raised in the trial court, Sanchez claims his confession was involuntary because it was given in response to an offer of leniency. On appeal, Sanchez highlights three statements made by detectives during his interview which he contends amounted to improper promises of leniency. First, "he was told that 'consequences' would not be 'as severe if, if we admit to what we have done.'" Second, he "was told that things 'are always worse' if one did not accept responsibility 'beforehand.'" Third, he "was told that 'the hole' would get 'deeper' if he did not admit responsibility."

1. Relevant legal standards

"A confession or admission is involuntary, and thus subject to exclusion at trial, only if it is the product of coercive police activity." (*People v. Williams (1997) 16 Cal.4th 635, 659, 66 Cal. Rptr. 2d 573, 941 P.2d 752* (*Williams*).) In other words, "involuntariness requires coercive activity on the part of the state or its agents[] and [that] such activity [was] the 'proximate cause' **[*51]** of the statement in question, and not merely a cause in fact." (*People v. Mickey (1991) 54 Cal.3d 612, 647, 286 Cal. Rptr. 801, 818 P.2d 84*.) In deciding the question of voluntariness, we apply a "'totality of [the] circumstances'" test. (*Williams, supra, at p. 660*.) Among the relevant circumstances are "the characteristics of the accused" (e.g., age and education) and "the details of the interrogation" (e.g., "the length of detention," "the repeated and prolonged nature of the questioning," and "the use of physical punishment such as the deprivation of food or sleep"). (*Schneckloth v. Bustamonte (1973) 412 U.S. 218, 226, 93 S. Ct. 2041, 36 L. Ed. 2d 854*.)

"[A] statement is involuntary and inadmissible when the motivating cause of the decision to speak was an express or clearly implied promise of leniency or advantage." (*People v. McCurdy (2014) 59 Cal.4th 1063, 1088, 176 Cal. Rptr. 3d 103, 331 P.3d 265*.) "'Mere advice or exhortation by the police that it would be better for the accused to tell the truth, when unaccompanied by either a threat or a promise . . . does not . . . make a subsequent confession involuntary.'" (*People v. Dowdell (2014) 227 Cal.App.4th 1388, 1401, 174 Cal. Rptr. 3d 547*.) The police may point out benefits that "flow[] naturally from a truthful and honest course of conduct," but if they suggest that the defendant "might reasonably expect benefits in the nature of more lenient treatment at the hands of the police, prosecution or court in consideration of making a statement, even a truthful one, such **[*52]** motivation is deemed to render the statement involuntary and

inadmissible." (*People v. Hill (1967) 66 Cal.2d 536, 549, 58 Cal. Rptr. 340, 426 P.2d 908*.)

"On appeal, we uphold the trial court's findings of historical fact, but we independently review its determination that defendant's statements were voluntary." (*People v. Leonard (2007) 40 Cal.4th 1370, 1402-1403, 58 Cal. Rptr. 3d 368, 157 P.3d 973*.)

Examining the totality of the circumstances, we agree with the trial court's conclusion that Sanchez's confession was not made as a consequence of, nor was it influenced by, false promises of leniency. In the context of the interview, each of the comments which Sanchez has identified are, in essence, nothing more than platitudes about the merits of taking responsibility for one's actions. There were no promises, implied or express, of leniency from prosecutors or the court if he confessed to killing Sandoval. At no point in their interrogation did Martinez or Jorgenson suggest they would intervene with the district attorney on Sanchez's behalf if he confessed. Calling on Sanchez's experience as a parent and reflecting how parents want their children to take responsibility for their misconduct was not tantamount to a promise that the criminal justice system would treat Sanchez more leniently in any particularized way, e.g., a lesser charge or lighter **[*53]** sentence if convicted. The context surrounding each of these comments reveals that the detectives were referring only to the "peace of mind defendant and others would have after he did the right thing and gave his side of the story. That is not coercion." (*People v. Vance (2010) 188 Cal.App.4th 1182, 1212, 116 Cal. Rptr. 3d 98*.)

"[W]hen law enforcement officers describe the moral or psychological advantages to the accused of telling the truth, no implication of leniency or favorable treatment at the hands of the authorities arises." (*People v. Carrington (2009) 47 Cal.4th 145, 172, 97 Cal. Rptr. 3d 117, 211 P.3d 617* (*Carrington*).) In *People v. Jackson (1980) 28 Cal.3d 264, 299, 168 Cal. Rptr. 603, 618 P.2d 149*, disapproved on another ground in *People v. Cromer (2001) 24 Cal.4th 889, 901, footnote 3, 103 Cal. Rptr. 2d 23, 15 P.3d 243*, the California Supreme Court determined that an officer's "statement that defendant would 'feel better' if he confessed" did not constitute "any promise of benefit other than the psychological benefit which 'flows naturally from a truthful and honest course of conduct.'" (*People v. Jackson, supra, at p. 299*.)

As the California Supreme Court has recognized, "'[t]he compulsion to confess wrong has deep psychological roots, and while confession may bring legal disabilities it also brings great psychological relief.' (*People v. Andersen (1980) 101 Cal.App.3d 563, 583-584, 161 Cal. Rptr. 707*, fn. omitted.)" (*Carrington, supra, 47 Cal.4th at p. 176* [detective's comments that sought to "evoke defendant's better nature by persuading her that 'purg[ing] it all' was morally the right thing to do and would provide her with psychological relief" **[*54]** was not coercive].) As in *Carrington*, the detectives here did not suggest to Sanchez they could influence the prosecution or the court, but "simply informed defendant that full cooperation might be beneficial in an unspecified way." (*Id. at p. 174*.)

Sanchez further argues, citing *People v. Johnson (1969) 70 Cal.2d 469, 74 Cal. Rptr. 889, 450 P.2d 265*, that he construed Martinez's comments as promises of leniency because he was "unskilled and uncounseled in the law." (*Id. at p. 479*.) In *Johnson*, the interrogating officer told the defendant that he should be truthful because otherwise a jury would be more likely to send him to the gas chamber. (*Id. at p. 478*.) The California Supreme Court agreed with the defendant that the officer's statements were "more than merely pointing out to a suspect that which flows naturally from a truthful and honest course of conduct." (*Id. at p. 479*.) "To someone unskilled and uncounseled in the law it might have offered a hope that since no money was taken in the robbery and if, as he claimed he did not do the shooting, that he might be cleared of any serious charges. Because of the felony-murder rule his statements amounted to a confession of first degree murder (see *Pen. Code, § 189*). It stretches the imagination to believe that he knowingly and intelligently waived his right to be free from **[*55]** self-incrimination." (*Ibid.*)

However, *Johnson* is readily distinguishable, as the result in that case did not turn merely on the officer's statements during the interrogation, but also on defective *Miranda*[15] warnings, the defendant's youth and lack of criminal history. Sanchez does not suggest he was not effectively *Mirandized* and, while he may have been a young man at the time of Sandoval's murder, he was not at the time he confessed to the detectives.

Furthermore, Sanchez's own testimony at trial regarding his confession made no mention of offers of leniency or his lack of education or knowledge of the legal system. Rather, he testified he was drunk and confused during the interview, and the officers "didn't tell me what they really wanted to know." According to Sanchez, it was his intoxication, coupled with the confusing and shifting line of inquiry posed by detectives that brought about his confession. We agree with the trial court that Sanchez's confession was voluntary.

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[15] *Miranda v. Arizona (1966) 384 U.S. 436, 86 S. Ct. 1602, 16 L. Ed. 2d 694*.

E. Johnson's opinion on time of death

Sanchez argues the trial court abused its discretion when it ruled that Jardine was qualified to offer an opinion on the time of Sandoval's death. We disagree.

1. Relevant factual ***[*56]*** *background*

During Jardine's direct examination, the trial court sustained defense counsel's objection that no foundation had been laid for him to proffer an opinion on time of death. The prosecutor subsequently inquired into Jardine's qualifications, eliciting testimony that he had taken two homicide investigation courses through the Department of Justice and attended various seminars. Jardine also testified he had discussed the issue with Dr. Simard and another pathologist with whom he worked. In estimating time of death, Jardine testified he looked for lividity and rigor mortis in the corpse, and explained how those physical processes inform that estimate.

During defense counsel's voir dire, Jardine acknowledged that one of two Department of Justice homicide investigation courses he took consisted of a two-week class which covered many topics besides rigor mortis. Over renewed objection, the trial court recognized Jardine "as an expert in determining time of death."

2. Applicable legal standards

In order to testify as an expert, a witness must have special knowledge, skill, experience, training or education in the subject area of his proposed testimony. (*Evid. Code, § 720, subd. (a)*.) "Against the objection of **[*57]** a party, such special knowledge, skill, experience, training, or education must be shown before the witness may testify as an expert." (*Ibid.*) In considering whether a person qualifies as an expert, the field of expertise must be carefully distinguished and limited. (*People v. King (1968) 266 Cal.App.2d 437, 445, 72 Cal. Rptr. 478*.) It is left to the trial judge's discretion to determine if that standard has been met. (*People v. Ramos (1997) 15 Cal.4th 1133, 1175, 64 Cal. Rptr. 2d 892, 938 P.2d 950*.)

A trial court has broad discretion in deciding whether to admit or exclude expert testimony, and its decision will not be reversed on appeal unless a manifest abuse of discretion is shown. (*People v. McDowell (2012) 54 Cal.4th 395, 426, 143 Cal. Rptr. 3d 215, 279 P.3d 547*; *People v. McAlpin (1991) 53 Cal.3d 1289, 1299, 283 Cal. Rptr. 382, 812 P.2d 563*; *People v. Sandoval (2008) 164 Cal.App.4th 994, 1001, 79 Cal. Rptr. 3d 634*.) Expert testimony is admissible on any subject sufficiently beyond common experience such that the opinion of an expert would assist the trier of fact. (*Evid. Code, § 801, subd. (a)*; *People v. Brown (2004) 33 Cal.4th 892, 905, 16 Cal. Rptr. 3d 447, 94 P.3d 574*.)

3. Analysis

In this case, Jardine's expert qualifications were arguably minimal, but the topic on which he was asked to testify did not require more training and experience than he possessed. Jardine testified that lividity is the settling and coagulation of blood which occurs after death. Rigor mortis is a process in which the corpse's muscles contract, rendering the body stiff. According to Jardine, lividity and rigor mortis become set about 12 hours after death, with some variation **[*58]** due to ambient temperature. Sanchez offered no contrary evidence to show that Jardine's understanding of the physical processes of lividity and rigor mortis were incorrect. In fact, Dr. Hain testified in accordance with Jardine, i.e., full rigor mortis with fixed lividity is typically seen about 12 hours after death.

Thus, Jardine possessed the necessary qualifications to render an opinion on time of death, and the trial court did not abuse its discretion in qualifying him as an expert on that topic. His comparative lack of qualifications as a forensic pathologist would go to weight of the evidence, not its admissibility.

Assuming arguendo the trial court erred in permitting Jardine to opine on time of death, this was an error of state law, and we apply the *Watson* test for harmless error. Under that test, it is clear that, even if all the evidence regarding time of death were somehow to be tainted by Jardine's testimony, it is not reasonably likely the jury would have reached a different verdict. The forensic evidence in this case, including evidence regarding the time of death, was not essential. Sanchez admitted shooting Sandoval, and there was ample evidence that Sanchez acquiesced **[*59]** when Octavio implicated him in Sandoval's murder. Multiple witnesses, including Sanchez, testified that Sanchez drank a great deal the day and evening of the murder, and that he and Sandoval fought multiple times that day, with Sandoval even breaking Sanchez's nose.

G. No cumulative error

Sanchez's argument that the cumulative effect of the purported errors discussed above warrants reversal. A claim of cumulative error "is in essence a due process claim." (*People v. Rivas (2013) 214 Cal.App.4th 1410, 1436, 155 Cal. Rptr. 3d 403*.) "The 'litmus test' for cumulative error 'is whether defendant received due process and a fair trial.'" (*People v. Cuccia (2002) 97 Cal.App.4th 785, 795, 118 Cal.*

Rptr. 2d 668.) Here, we are satisfied that Sanchez received due process and a fair trial. As explained above, Sanchez has failed to show any prejudicial error that infringed his due process rights. Sanchez "was entitled to a fair trial but not a perfect one." (*People v. Cunningham (2001) 25 Cal.4th 926, 1009, 108 Cal. Rptr. 2d 291, 25 P.3d 519*.) Sanchez's trial was fair, and his claim of cumulative error fails.

H. There was no Brady *error*

Sanchez's final argument related to his conviction is that the trial court erred in denying his postverdict motions based on a purported violation of *Brady v. Maryland (1963) 373 U.S. 83, 83 S. Ct. 1194, 10 L. Ed. 2d 215* (*Brady*).

1. Relevant factual and procedural background

The day after the jury returned its verdict, the district attorney's office informed **[*60]** defense counsel and the court it had recently discovered that Jardine had suffered two misdemeanor convictions in 1988 under *section 647.6* for "annoy[ing] or molest[ing]" a child. Sanchez brought a motion to set aside the verdict and a motion for a new trial based on the failure to disclose Jardine's convictions. Both motions were denied.

The trial court denied Sanchez's motions for the following reasons: (1) had the convictions been disclosed prior to Jardine's testimony, it would not have permitted impeachment with those convictions under *Evidence Code section 352*; and (2) even if it had permitted the impeachment, Jardine's testimony had only "minimal relevance."

2. Applicable legal standards

Under *Brady, supra, 373 U.S. 83*, "the suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or to punishment, irrespective of the good faith or bad faith of the prosecution." (*Id. at p. 87*.) Accordingly, the state has a duty to disclose any favorable and material evidence even without a request. (*Ibid.; United States v. Bagley (1985) 473 U.S. 667, 678, 105 S. Ct. 3375, 87 L. Ed. 2d 481*; *In re Sassounian (1995) 9 Cal.4th 535, 543, 37 Cal. Rptr. 2d 446, 887 P.2d 527*.)

There are three elements to a *Brady* violation. First, evidence must be suppressed, either willfully or inadvertently. (*People v. Salazar (2005) 35 Cal.4th 1031, 1035, 29 Cal. Rptr. 3d 16, 112 P.3d 14*.) Second, the suppressed evidence must be favorable to the prosecution, **[*61]** meaning it "either helps the defendant or hurts the prosecution" (*In re Sassounian, supra, 9 Cal.4th at p. 544*) in that it is exculpatory or has impeachment value. (*Strickler v. Greene (1999) 527 U.S. 263, 282, 119 S. Ct. 1936, 144 L. Ed. 2d 286* (*Strickler*).) Third, the suppressed evidence must be material, meaning there is "a reasonable probability that, had the evidence been disclosed to the defense, the result of the proceeding would have been different. A 'reasonable probability' is a probability sufficient to undermine confidence in the outcome." (*United States v. Bagley, supra, 473 U.S. at p. 682*.)

On appeal, a defendant has the burden to establish the elements of a *Brady* violation. (*Strickler, supra, 527 U.S. at pp. 289, 291*.) "Conclusions of law or of mixed questions of law and fact, such as the elements of a *Brady* claim [citation], are subject to independent review. [Citation.] Because the [trier of fact] can observe the demeanor of the witnesses and their manner of testifying, findings of fact, though not binding, are entitled to great weight when supported by substantial evidence." (*People v. Salazar, supra, 35 Cal.4th at p. 1042*.)

There is no dispute the first element of a *Brady* violation—suppression of evidence—is satisfied here. Although there is no suggestion the prosecution willfully withheld evidence from the defense, even an inadvertent failure to disclose is sufficient to establish this first element. (*People v. Salazar, supra, 35 Cal.4th at p. 1035*.)

The other two elements **[*62]** of a *Brady* violation, i.e., whether the evidence was favorable to the defense and whether it was material to the verdict, require more in-depth analyses.

Sanchez argues the evidence was favorable, because it would have impeached Jardine's testimony about the time of Sandoval's death. (*Strickler, supra, 527 U.S. at p. 282*.) Generally, misconduct that does not result in a felony conviction can be admissible to impeach a witnesses' credibility if it involves moral turpitude, because it has ""'some tendency in reason" [citation] to shake one's confidence in [the witness'] honesty.'" (*People v. Wheeler (1992) 4 Cal.4th 284, 295, 14 Cal. Rptr. 2d 418, 841 P.2d 938*.) ""'Moral turpitude" means a general "'readiness to do evil'" [citation], i.e., "an act of baseness, vileness or depravity in the private and social duties which a man owes to his fellowmen, or to society in general, contrary to the accepted and customary rule of right and duty between man and man."'"" (*People v. Sanders (1992) 10 Cal.App.4th 1268, 1272, 13 Cal. Rptr. 2d 205*.) Evidence of past misconduct amounting to a misdemeanor and involving moral turpitude is admissible to impeach a witness in a criminal case, subject to

exclusion under *Evidence Code section 352*. (*People v. Wheeler, supra, at pp. 295-296*.)

Jardine's convictions fall into the category of impeachment evidence arising from acts of moral turpitude. Annoying or molesting a child under the age of 18, a violation **[*63]** of *section 647.6*, and any charge involving child molestation is a crime of moral turpitude. (*People v. Massey (1987) 192 Cal.App.3d 819, 823, 237 Cal. Rptr. 734*.) As a result, the evidence was arguably "favorable" to Sanchez's defense in that it conceivably could impeach Jardine's testimony. However, it is the last element of a *Brady* violation—materiality—that Sanchez cannot establish.

"Materiality . . . requires more than a showing that the suppressed evidence would have been admissible [citation], that the absence of the suppressed evidence made conviction 'more likely' [citation], or that using the suppressed evidence to discredit a witness's testimony 'might have changed the outcome of the trial' [citation]. A defendant instead 'must show a "reasonable probability of a different result."'" (*People v. Salazar, supra, 35 Cal.4th at p. 1043*.) "'In general, impeachment evidence has been found to be material where the witness at issue "supplied the only evidence linking the defendant(s) to the crime," [citations], or where the likely impact on the witness's credibility would have undermined a critical element of the prosecution's case, [citations]. In contrast, a new trial is generally not required when the testimony of the witness is "corroborated by other testimony."'" (*Id. at p. 1050*.)

In *People v. Letner and Tobin (2010) 50 Cal.4th 99, 112 Cal. Rptr. 3d 746, 235 P.3d 62* (*Letner*), the California Supreme **[*64]** Court determined that the prosecution's failure to turn over evidence of a witness' outstanding warrant for a misdemeanor petty theft charge and two pending criminal matters for writing bad checks and theft of clothing were not material under *Brady*. (*Id. at pp. 174-175, 177-178*.) In *Letner*, the witness at issue did not provide the only evidence linking the defendant to the crime. (*Id. at pp. 176-177*.) However, the *Letner* court determined that even if it were to conclude the witness' testimony constituted a critical element of the prosecution's case, it "would agree with the trial court's assessment that the undisclosed information concerning [the witness'] pending criminal matters would not have undermined her credibility to any significant degree." (*Id. at p. 177*.)

The *Letner* court observed that "none of the charges against [the witness] was particularly serious, and therefore the jury might not have found compelling the theory that [the witness] perjured herself at defendants' capital trial in order to obtain some relatively minor benefit in her own pending matters. In addition, the possibility that the charges would have had material impeachment value is contradicted by [the witness'] declaration submitted with the opposition to defendants' **[*65]** motions for new trials, in which she stated she did not speak with the prosecutor about the pending charges, did not expect or receive any benefits for testifying, did not alter her testimony as a result of the pending matters, and had requested (and the court had ordered) that her jail sentence be suspended so she would not be in jail while defendants also were incarcerated there." (*Letner, supra, 50 Cal.4th at p. 177*.)

Moreover, the *Letner* court noted that "misdemeanor *convictions* are inadmissible under the hearsay rule and furthermore, with reference to the underlying *facts* of misdemeanor offenses, that trial courts retain the authority to exclude such evidence under *section 352 of the Evidence Code* if presentation of those facts would create undue prejudice, delay, or confusion, substantially outweighing their probative value." (*Letner, supra, 50 Cal.4th at p. 178*.)

Similarly, the only evidence of Jardine's misconduct that could have been disclosed to the defense prior to Sanchez's trial was his 1988 misdemeanor convictions for annoying or molesting a minor. As previously noted, evidence of conduct involving moral turpitude may be admissible for impeachment purposes. However, it is equally true that such evidence may be subject to exclusion under *Evidence Code section 352*. Evidence of misdemeanor conduct **[*66]** in particular may be *more* subject to exclusion, because "a misdemeanor—or any other conduct not amounting to a felony—is a less forceful indicator of immoral character or dishonesty than is a felony" (*People v. Wheeler, supra, 4 Cal.4th at p. 296*), and its use at trial "entails problems of proof, unfair surprise, and moral turpitude evaluation which felony convictions do not present." (*Ibid.*)

In this case, the evidence had little probative value. Jardine's misconduct involved an entirely collateral incident that had no apparent relation either to his investigation of a homicide scene or his work as a coroner's investigator. Therefore, the trial court would have acted well within its discretion in excluding the evidence of his convictions for impeachment purposes.

Additionally, Sanchez has not shown there is a reasonable possibility disclosure of the suppressed evidence would have produced a different verdict. (*Strickler, supra, 527 U.S. at p. 289*.) Sanchez claims the probative value of this evidence bore on Jardine's qualifications and training to render expert opinion" and apparently these convictions would have led the trial court to not qualify Jardine as an expert on the time of death and would have led the jury to question his credibility

on that subject. However, **[*67]** this is not a situation where Jardine's offenses, which took place many years before the trial, could somehow cast doubt on his ability to estimate time of death based on the condition of Sandoval's body when he examined it. Nor is this a situation where the impeachment material contradicts a crucial part of Jardine's testimony. Jardine's criminal case was concluded long before Sanchez's trial so it is inconceivable that he testified in way that implicated Sanchez in exchange for any leniency in that case. Jardine's misdemeanors were stale, unrelated to his testimony in any way and therefore had minimal, if any, impeachment value.

Moreover, Jardine's testimony was corroborated by other evidence. Contreras testified Sandoval's body was stiff when he tried to turn him over a few hours before Jardine arrived at the scene. Dr. Hain independently established the time of death. Moreover, the issue of time of death was not determinative because there was ample independent evidence implicating Sanchez in Sandoval's death.

In short, we are unconvinced that if this evidence was disclosed prior to or during trial, it is reasonably probable Sanchez would have received a different result. (*People v. Salazar, supra, 35 Cal.4th at p. 1043*.) We **[*68]** therefore reject Sanchez's claim of *Brady* error.

I. Restitution fines

At sentencing, the trial court imposed a "restitution fund fine of $4000" pursuant to *section 1202.4, subdivision (b)*. In addition, the court imposed an "additional restitution fund fine in that same amount" though this fine was suspended "pending successful completion of parole." Finally, the court ordered direct victim restitution "in an amount to be determined by the probation officer" under *section 1202.4, subdivision (f)*. The record does not reflect the amount of victim restitution, if any, Sanchez was ultimately ordered to pay.

Sanchez argues that, because *sections 1202.4* and *1202.45* were not in effect at the time of the commitment offense, the three fines imposed under those sections are barred by the prohibition against ex post facto laws. The People expressly concede that the trial court erred in imposing fines under *section 1202.4*,[16] but argue that the matter should be remanded to the trial court for consideration under the restitution statute in effect at the time of the offense, namely former *Government Code section 13967, subdivision (a)*. (Stats. 1981, ch. 102, § 54, p. 710.)

The parties agree *section 1202.4* was only enacted in 1983 and thus was not operational when Sanchez murdered Sandoval in 1982. (Stats. 1983, ch. 1092, § 320.1.) "A restitution fine qualifies as punishment **[*69]** for the purposes of the prohibition against ex post facto laws." (*People v. Saelee (1995) 35 Cal.App.4th 27, 30, 40 Cal. Rptr. 2d 790*; *People v. Souza (2012) 54 Cal.4th 90, 143, 141 Cal. Rptr. 3d 419, 277 P.3d 118*.) Sanchez's failure to object to imposition of these fines does not preclude him from raising them for the first time on appeal. (*People v. Zito (1992) 8 Cal.App.4th 736, 741-742, 10 Cal. Rptr. 2d 491*.) Accordingly, the fines imposed under *section 1202.4, subdivisions (b)* and *(f)* must be stricken *unless* there was a statute in effect at the time of the commitment offense that would support them. As shown below, there was a statute supporting imposition of a restitution fine but no statute providing for direct victim restitution.

Former *Government Code section 13967, subdivision (a)* was the law in effect at the time of the offense. That statute provided, as follows: "Upon a person being convicted of a crime of violence committed in the State of California resulting in the injury or death of another person, if the court finds that the defendant has the present ability to pay a fine and finds that the economic impact of the fine upon the defendant's dependents will not cause such dependents to be dependent on public welfare the court shall, in addition to any other penalty, order the defendant to pay a fine commensurate with the offense committed, and with the probable economic impact upon the victim, of at least ten dollars ($10), but not to exceed ten thousand dollars **[*70]** ($10,000)." (Stats. 1981, ch. 102, § 54, p. 710.) This statute provides for a means of imposing a restitution fine, and therefore supports an order of restitution assuming the trial court makes the necessary findings relating to Sanchez's ability to pay and the potential economic hardship of a fine on his dependents. Accordingly, the matter is remanded to the trial court to make the necessary findings. (See *People v. Barker (1986) 182 Cal.App.3d 921, 943-944, 227 Cal. Rptr. 578*.)

However, former *Government Code section 13967* makes no provision for ordering direct victim restitution. Accordingly, the trial court's imposition of victim restitution under *section 1202.4, subdivision (f)*, has no statutory antecedent and that fine must be stricken.

[16] The People did not address the fine imposed but suspended under *section 1202.45*, first enacted in 2004. (Stats. 2004, ch. 223, *§ 3*.) As there appears to have been no similar statute in effect in 1982 when Sandoval was murdered, we will direct the trial court to strike that fine upon remand.

III. DISPOSITION

The judgment is reversed and the matter is remanded to the trial court for the limited purpose of deciding whether to impose a restitution fine under the law in effect at the time of the offense, specifically former *Government Code section 13967, subdivision (a)*. The trial court is further directed to strike the fines imposed under *Penal Code sections 1202.4, subdivision (f)* and *1202.45*.

Premo, J.

WE CONCUR:

Rushing, P. J.

Elia, J.

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Sargon Enterprises, Inc. v. University of Southern California

Supreme Court of California

November 26, 2012, Filed

S191550

Reporter
55 Cal. 4th 747 *; 288 P.3d 1237 **; 149 Cal. Rptr. 3d 614 ***; 2012 Cal. LEXIS 10713 ****

SARGON ENTERPRISES, INC., Plaintiff and Appellant, v. UNIVERSITY OF SOUTHERN CALIFORNIA et al., Defendants and Appellants.

Subsequent History: Reported at *Sargon Enterprises, Inc. v. University of Southern California, 2012 Cal. LEXIS 11472 (Cal., Nov. 26, 2012)*

On remand at *Sargon Enterprises, Inc. v. University of Southern California, 215 Cal. App. 4th 1495, 156 Cal. Rptr. 3d 372, 2013 Cal. App. LEXIS 352 (Cal. App. 2d Dist., May 2, 2013)*

Related proceeding at *Sargon Enters. v. Browne George Ross Llp, 2017 Cal. App. LEXIS 830 (Cal. App. 2d Dist., Sept. 26, 2017)*

Prior History: [**1]** Superior Court of Los Angeles County, No. BC209992, Terry A. Green, Judge. Court of Appeal, Second Appellate District, Division One, No. 202789, No. 205034.

Sargon Enterprises, Inc. v. University of Southern California, 2012 Cal. LEXIS 10285 (Cal., Oct. 1, 2012)

Core Terms

innovative, implant, lost profits, market share, companies, trial court, speculative, Big, damages, profits, leaders, dental, expert testimony, comparable, products, smaller, gatekeeping, projections, sales, expert opinion, calculated, estimates, excluding, driver, cases, clinical study, reasons, load, rank, reasonable certainty

Case Summary

Procedural Posture
Defendants, a university and others, challenged a judgment from the Court of Appeal, Second Appellate District, Division One (California), which ruled that the trial court erred in excluding expert testimony to prove plaintiff company's lost profits from the university's breach of contract and remanded for a new trial on lost profits.

Overview

The university entered into a contract with the company to perform clinical testing of the company's new product. After initial success in the clinical trials, the university failed to present the reports required by the contract. The trial court excluded as speculative the proffered opinion testimony of one of the company's experts, who calculated future profits based on large anticipated market share gains. The court held that the trial court properly acted as a gatekeeper in excluding the testimony. Pursuant to *Civ. Code, § 3301*, lost profits had to be reasonably certain. To the extent that the expert relied on data from larger companies that were not comparable and thus not relevant to the measure of lost profit damages, the trial court acted within its discretion to exclude the testimony because it was not based on matter of a type reasonably relied upon under *Evid. Code, § 801, subd. (b)*. Circularity in the expert's reasoning with regard to innovation and success was another reason to exclude the testimony under *Evid. Code, § 802*. The expert's testimony provided no logical basis to infer that the company would have achieved the market share the expert projected.

Outcome
The court reversed the judgment of the court of appeal and remanded to that court for further proceedings.

LexisNexis® Headnotes

Evidence > Admissibility > Expert Witnesses

HN1[] **Admissibility, Expert Witnesses**

There is no bright line that divides evidence worthy of consideration by a jury, although subject to heavy counterattack, from evidence that is not. Especially because of the guaranty of the Seventh *Amendment, U.S. Const., 7th* Amend., a federal court must be exceedingly careful not to set the threshold to the jury room too high. Yet it is the jury system itself that requires the common law judge, in his efforts to prevent the jury from being satisfied by matters of slight value, capable of being exaggerated by prejudice and hasty reasoning to exclude matter which does not rise to a clearly sufficient degree of value; something more than a minimum of probative value is required. These comments are especially pertinent to an array of figures conveying a delusive impression of exactness in an area where a jury's common sense is less available than usual to protect it. Although discussing federal law and federal courts, these comments, both in their cautionary note that, due to the jury trial right, courts should not set the admission bar too high, and in their stressing the need to exclude unreliable evidence, could just as well have described California law and California courts. Under California law, trial courts have a substantial gatekeeping responsibility.

Evidence > Admissibility > Expert Witnesses

HN2[] **Admissibility, Expert Witnesses**

See *Evid. Code, § 801*.

Evidence > Admissibility > Expert Witnesses

HN3[] **Admissibility, Expert Witnesses**

Evid. Code, § 801, subd. (b), clearly permits a court to determine whether the matter is of a type on which an expert may reasonably rely. An expert opinion has no value if its basis is unsound. Matter that provides a reasonable basis for one opinion does not necessarily provide a reasonable basis for another opinion. *Section 801, subd. (b)*, states that a court must determine whether the matter that the expert relies on is of a type that an expert reasonably can rely on in forming an opinion upon the subject to which his testimony relates. This means that the matter relied on must provide a reasonable basis for the particular opinion offered, and that an expert opinion based on speculation or conjecture is inadmissible. The California Law Revision Commission comments to *§ 801* have explained that under existing law, irrelevant or speculative matters are not a proper basis for an expert's opinion.

Governments > Legislation > Interpretation

HN4[] **Legislation, Interpretation**

Comments of a commission that proposed a statute are entitled to substantial weight in construing the statute, especially when the Legislature adopted the statute without change.

Evidence > Admissibility > Expert Witnesses

HN5[] **Admissibility, Expert Witnesses**

Under *Evid. Code, § 801*, a trial court acts as a gatekeeper to exclude speculative or irrelevant expert opinion. An expert's opinion may not be based on assumptions of fact without evidentiary support, or on speculative or conjectural factors. Exclusion of expert opinions that rest on guess, surmise or conjecture is an inherent corollary to the foundational predicate for admission of the expert testimony: will the testimony assist the trier of fact to evaluate the issues it must decide?

Evidence > Admissibility > Expert Witnesses

HN6[] **Admissibility, Expert Witnesses**

See *Evid. Code, § 802*.

Evidence > Admissibility > Expert Witnesses

HN7[] **Admissibility, Expert Witnesses**

Evid. Code, § 802, indicates that a court may inquire into an expert's reasons for an opinion. It expressly permits the court to examine experts concerning the matter on which they base their opinion before admitting their testimony. The reasons for the experts' opinions are part of the matter on which they are based just as is the type of matter. *Evid. Code, § 801*, governs judicial review of the type of matter; *§ 802* governs

judicial review of the reasons for the opinion. The stark contrast between the wording of the two statutes strongly suggests that although under *§ 801, subd. (b)*, the judge may consider only the acceptability of the generic type of information the expert relies on, the judge is not so limited under *§ 802*.

Evidence > Admissibility > Expert Witnesses

HN8 **Admissibility, Expert Witnesses**

Evid. Code, § 802, permits a trial court to find that an expert is precluded by law from using the reasons or matter as a basis for the opinion. Law includes constitutional, statutory, and decisional law. *Evid. Code, § 160*. Thus, construed in the context of *§ 160*, *§ 802* authorizes a court to promulgate case law restrictions on an expert's reasons. This means that a court may inquire into, not only the type of material on which an expert relies, but also whether that material actually supports the expert's reasoning. A court may conclude that there is simply too great an analytical gap between the data and the opinion proffered.

Evidence > Admissibility > Expert Witnesses

HN9 **Admissibility, Expert Witnesses**

Under *Evid. Code, §§ 801, subd. (b)*, *802*, the trial court acts as a gatekeeper to exclude expert opinion testimony that is (1) based on matter of a type on which an expert may not reasonably rely, (2) based on reasons unsupported by the material on which the expert relies, or (3) speculative. Other provisions of law, including decisional law, may also provide reasons for excluding expert opinion testimony.

Evidence > Admissibility > Expert Witnesses > Daubert Standard

Evidence > Admissibility > Expert Witnesses

HN10 **Expert Witnesses, Daubert Standard**

Courts must be cautious in excluding expert testimony. The trial court's gatekeeping role does not involve choosing between competing expert opinions. The gatekeeper's focus must be solely on principles and methodology, not on the conclusions that they generate. In the context of the Daubert rule, the trial court's task is not to choose the most reliable of the offered opinions and exclude the others. When a trial court rules that an expert's testimony is reliable, this does not necessarily mean that contradictory expert testimony is unreliable. Testimony that is the product of competing principles or methods in the same field of expertise is permissible.

Evidence > Admissibility > Expert Witnesses

HN11 **Admissibility, Expert Witnesses**

A trial court's preliminary determination whether an expert opinion is founded on sound logic is not a decision on its persuasiveness. The court must not weigh an opinion's probative value or substitute its own opinion for the expert's opinion. Rather, the court must simply determine whether the matter relied on can provide a reasonable basis for the opinion or whether that opinion is based on a leap of logic or conjecture. The court does not resolve scientific controversies. Rather, it conducts a circumscribed inquiry to determine whether, as a matter of logic, the studies and other information cited by experts adequately support the conclusion that the expert's general theory or technique is valid. The goal of trial court gatekeeping is simply to exclude clearly invalid and unreliable expert opinion. In short, the gatekeeper's role is to make certain that an expert, whether basing testimony upon professional studies or personal experience, employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field.

Civil Procedure > Appeals > Standards of Review > Abuse of Discretion

Evidence > Admissibility > Expert Witnesses

HN12 **Standards of Review, Abuse of Discretion**

Except to the extent a trial court bases its ruling on a conclusion of law (which is reviewed de novo), its ruling excluding or admitting expert testimony is reviewed for abuse of discretion. A ruling that constitutes an abuse of discretion has been described as one that is so irrational or arbitrary that no reasonable person could agree with it. But the court's discretion is not unlimited, especially when ts exercise implicates a party's ability to present its case. Rather, it must be exercised within the confines of the applicable legal principles.

Civil Procedure > Appeals > Standards of Review > Abuse of Discretion

HN13[] **Standards of Review, Abuse of Discretion**

The discretion of a trial judge is not a whimsical, uncontrolled power, but a legal discretion, which is subject to the limitations of legal principles governing the subject of its action, and to reversal on appeal where no reasonable basis for the action is shown. The scope of discretion always resides in the particular law being applied, i.e., in the legal principles governing the subject of the action. Action that transgresses the confines of the applicable principles of law is outside the scope of discretion and such action is called an abuse of discretion. The legal principles that govern the subject of discretionary action vary greatly with context. They are derived from the common law or statutes under which discretion is conferred. To determine if a court abused its discretion, a reviewing court must thus consider the legal principles and policies that should have guided the court's actions.

Contracts Law > ... > Damages > Foreseeable Damages > Lost Profits

HN14[] **Foreseeable Damages, Lost Profits**

Lost profits may be recoverable as damages for breach of a contract. The general principle is that damages for the loss of prospective profits are recoverable where the evidence makes reasonably certain their occurrence and extent. Such damages must be proven to be certain both as to their occurrence and their extent, albeit not with mathematical precision. The rule that lost profits must be reasonably certain is a specific application of a more general statutory rule.

Contracts Law > ... > Damages > Foreseeable Damages > General Overview

HN15[] **Measurement of Damages, Foreseeable Damages**

See *Civ. Code, § 3301*.

Contracts Law > ... > Damages > Foreseeable Damages > Lost Profits

HN16[] **Foreseeable Damages, Lost Profits**

Regarding lost business profits, the cases have generally distinguished between established and unestablished businesses. Where the operation of an established business is prevented or interrupted, as by a breach of contract, damages for the loss of prospective profits that otherwise might have been made from its operation are generally recoverable for the reason that their occurrence and extent may be ascertained with reasonable certainty from the past volume of business and other provable data relevant to the probable future sales. Lost profits to an established business may be recovered if their extent and occurrence can be ascertained with reasonable certainty; once their existence has been so established, recovery will not be denied because the amount cannot be shown with mathematical precision. Historical data, such as past business volume, supply an acceptable basis for ascertaining lost future profits. In some instances, lost profits may be recovered where the plaintiff introduces evidence of the profits lost by similar businesses operating under similar conditions. On the other hand, where the operation of an unestablished business is prevented or interrupted, damages for prospective profits that might otherwise have been made from its operation are not recoverable for the reason that their occurrence is uncertain, contingent and speculative.

Contracts Law > ... > Damages > Foreseeable Damages > Lost Profits

HN17[] **Foreseeable Damages, Lost Profits**

Although generally objectionable for the reason that their estimation is conjectural and speculative, anticipated profits dependent upon future events are allowed where their nature and occurrence can be shown by evidence of reasonable reliability. Where the fact of damages is certain, the amount of damages need not be calculated with absolute certainty. The law requires only that some reasonable basis of computation of damages be used, and the damages may be computed even of the result reached is an approximation. This is especially true where it is the wrongful acts of the defendant that have created the difficulty in proving the amount of loss of profits or where it is the wrongful acts of the defendant that have caused the other party to not realize a profit to which that party is entitled.

Contracts Law > ... > Damages > Foreseeable Damages > Lost Profits

Evidence > Admissibility > Expert Witnesses

HN18[] **Foreseeable Damages, Lost Profits**

The lost profit inquiry is always speculative to some degree. Inevitably, there will always be an element of uncertainty. Courts must not be too quick to exclude expert evidence as speculative merely because the expert cannot say with absolute certainty what the profits would have been. Courts must not eviscerate the possibility of recovering lost profits by too broadly defining what is too speculative. A reasonable certainty only is required, not absolute certainty.

Evidence > Admissibility > Expert Witnesses

HN19[] **Admissibility, Expert Witnesses**

Because it is inherently difficult to accurately predict the future or to accurately reconstruct a counterfactual past, it is appropriate that trial courts vigilantly exercise their gatekeeping function when deciding whether to admit testimony that purports to prove such claims.

Headnotes/Syllabus

Summary

CALIFORNIA OFFICIAL REPORTS SUMMARY

The trial court excluded expert testimony to prove a company's lost profits. A university had entered into a contract with the company to perform clinical testing of the company's new product. After initial success in the clinical trials, the university failed to present the reports required by the contract. The trial court excluded as speculative the proffered opinion testimony of one of the company's experts, who calculated future profits based on large anticipated market share gains. (Superior Court of Los Angeles County, No. BC209992, Terry A. Green, Judge.) The Court of Appeal, Second Dist., Div. One, Nos. B202789 and B205034, reversed.

The Supreme Court reversed the judgment of the Court of Appeal and remanded to that court for further proceedings. The court held that the trial court properly acted as a gatekeeper in excluding the testimony. Lost profits must be reasonably certain (*Civ. Code, § 3301*). To the extent that the expert relied on data from larger companies that were not comparable and thus not relevant to the measure of lost profit damages, the trial court acted within its discretion to exclude the testimony because it was not based on matter of a type reasonably relied upon (*Evid. Code, § 801, subd. (b)*). Circularity in the expert's reasoning with regard to innovation and success was another reason to exclude the testimony (*Evid. Code, § 802*). The expert's testimony provided no logical basis to infer that the company would have achieved the market share the expert projected. (Opinion by Chin, J., expressing the unanimous view of the court.)

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

CA(1)[] **(1)**

Evidence § 81—Opinion Evidence—Expert Witnesses—Reliability.

There is no bright line that divides evidence worthy of consideration by a jury, although subject to heavy counterattack, from evidence that is **[*748]** not. Especially because of the guaranty of the *Seventh Amendment* (*U.S. Const., 7th Amend.*), a federal court must be exceedingly careful not to set the threshold to the jury room too high. Yet it is the jury system itself that requires the common law judge, in his or her efforts to prevent the jury from being satisfied by matters of slight value, capable of being exaggerated by prejudice and hasty reasoning to exclude matter which does not rise to a clearly sufficient degree of value; something more than a minimum of probative value is required. These comments are especially pertinent to an array of figures conveying a delusive impression of exactness in an area where a jury's common sense is less available than usual to protect it. Although discussing federal law and federal courts, these comments, both in their cautionary note that, due to the jury trial right, courts should not set the admission bar too high, and in their stressing the need to exclude unreliable evidence, could just as well have described California law and California courts. Under California law, trial courts have a substantial gatekeeping responsibility.

CA(2)[] **(2)**

Evidence § 81—Opinion Evidence—Expert Witnesses—Reliability—Type of Matter Relied On.

Evid. Code, § 801, subd. (b), clearly permits a court to determine whether the matter is of a type on which an expert may reasonably rely. An expert opinion has no value if its basis is unsound. Matter that provides a reasonable basis for one opinion does not necessarily provide a reasonable basis for another opinion. *Section 801, subd. (b)*, states that a court must determine whether the matter that the expert relies on is of a type that an expert reasonably can rely on in forming an opinion upon the subject to which his testimony relates. This

means that the matter relied on must provide a reasonable basis for the particular opinion offered, and that an expert opinion based on speculation or conjecture is inadmissible.

CA(3)[] (3)

Statutes § 42—Construction—Aids—Commission Comments.

Comments of a commission that proposed a statute are entitled to substantial weight in construing the statute, especially when the Legislature adopted the statute without change.

CA(4)[] (4)

Evidence § 81—Opinion Evidence—Expert Witnesses—Reliability—Exclusion of Speculative or Irrelevant Testimony.

Under Evid. Code, § 801, a trial court acts as a gatekeeper to exclude speculative or irrelevant expert opinion. An expert's opinion may not be based on **[*749]** assumptions of fact without evidentiary support, or on speculative or conjectural factors. Exclusion of expert opinions that rest on guess, surmise or conjecture is an inherent corollary to the foundational predicate for admission of the expert testimony: will the testimony assist the trier of fact to evaluate the issues it must decide?

CA(5)[] (5)

Evidence § 81—Opinion Evidence—Expert Witnesses—Reliability—Reasons for Opinion.

Evid. Code, § 802, indicates that a court may inquire into an expert's reasons for an opinion. It expressly permits the court to examine experts concerning the matter on which they base their opinion before admitting their testimony. The reasons for the experts' opinions are part of the matter on which they are based just as is the type of matter. Evid. Code, § 801, governs judicial review of the type of matter; § 802 governs judicial review of the reasons for the opinion. The stark contrast between the wording of the two statutes strongly suggests that although under § 801, subd. (b), the judge may consider only the acceptability of the generic type of information the expert relies on, the judge is not so limited under § 802.

CA(6)[] (6)

Evidence § 81—Opinion Evidence—Expert Witnesses—Reliability—Reasons for Opinion—Case Law Restrictions.

Evid. Code, § 802, permits a trial court to find that an expert is precluded by law from using the reasons or matter as a basis for the opinion. Law includes constitutional, statutory, and decisional law (Evid. Code, § 160). Thus, construed in the context of § 160, § 802 authorizes a court to promulgate case law restrictions on an expert's reasons. This means that a court may inquire into, not only the type of material on which an expert relies, but also whether that material actually supports the expert's reasoning. A court may conclude that there is simply too great an analytical gap between the data and the opinion proffered.

CA(7)[] (7)

Evidence § 81—Opinion Evidence—Expert Witnesses—Reliability—Reasons for Excluding Testimony.

Under Evid. Code, §§ 801, subd. (b), 802, the trial court acts as a gatekeeper to exclude expert opinion testimony that is (1) based on matter of a type on which an expert may not reasonably rely, (2) based on reasons unsupported by the material on which the expert relies, or (3) speculative. Other provisions of law, including decisional law, may also provide reasons for excluding expert opinion testimony.

CA(8)[] (8)

Evidence § 81—Opinion Evidence—Expert Witnesses—Reliability—Gatekeeping Role of Trial Court.

Courts must be cautious in excluding expert testimony. The trial court's gatekeeping role does not involve **[*750]** choosing between competing expert opinions. The gatekeeper's focus must be solely on principles and methodology, not on the conclusions that they generate. In the context of the *Daubert* rule, the trial court's task is not to choose the most reliable of the offered opinions and exclude the others. When a trial court rules that an expert's testimony is reliable, this does not necessarily mean that contradictory expert testimony is unreliable. Testimony that is the product of competing principles or methods in the same field of expertise is permissible.

CA(9)[] (9)

Evidence § 81—Opinion Evidence—Expert Witnesses—Reliability—Gatekeeping Role of Trial Court.

A trial court's preliminary determination whether an expert opinion is founded on sound logic is not a decision on its persuasiveness. The court must not weigh an opinion's probative value or substitute its own opinion for the expert's opinion. Rather, the court must simply determine whether the matter relied on can provide a reasonable basis for the opinion or whether that opinion is based on a leap of logic or conjecture. The court does not resolve scientific controversies. Rather, it conducts a circumscribed inquiry to determine whether, as a matter of logic, the studies and other information cited by experts adequately support the conclusion that the expert's general theory or technique is valid. The goal of trial court gatekeeping is simply to exclude clearly invalid and unreliable expert opinion. In short, the gatekeeper's role is to make certain that an expert, whether basing testimony upon professional studies or personal experience, employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field.

CA(10)[] **(10)**

Damages § 15—Measure of Damages—For Breach of Contract—Lost Profits—Reasonable Certainty.

Lost profits may be recoverable as damages for breach of a contract. The general principle is that damages for the loss of prospective profits are recoverable where the evidence makes reasonably certain their occurrence and extent. Such damages must be proven to be certain both as to their occurrence and their extent, albeit not with mathematical precision. The rule that lost profits must be reasonably certain is a specific application of a more general statutory rule.

CA(11)[] **(11)**

Damages § 15—Measure of Damages—For Breach of Contract—Lost Profits—Established and Unestablished Businesses.

Regarding lost business profits, the cases have generally distinguished between established and unestablished businesses. Where the operation of an established business is prevented or interrupted, as by a breach of contract, damages for the loss of prospective profits that otherwise might **[*751]** have been made from its operation are generally recoverable for the reason that their occurrence and extent may be ascertained with reasonable certainty from the past volume of business and other provable data relevant to the probable future sales. Lost profits to an established business may be recovered if their extent and occurrence can be ascertained with reasonable certainty; once their existence has been so established, recovery will not be denied because the amount cannot be shown with mathematical precision. Historical data, such as past business volume, supply an acceptable basis for ascertaining lost future profits. In some instances, lost profits may be recovered where the plaintiff introduces evidence of the profits lost by similar businesses operating under similar conditions.

CA(12)[] **(12)**

Damages § 15—Measure of Damages—For Breach of Contract—Lost Profits—Reasonable Certainty.

Although generally objectionable for the reason that their estimation is conjectural and speculative, anticipated profits dependent upon future events are allowed where their nature and occurrence can be shown by evidence of reasonable reliability. Where the fact of damages is certain, the amount of damages need not be calculated with absolute certainty. The law requires only that some reasonable basis of computation of damages be used, and the damages may be computed even of the result reached is an approximation. This is especially true where it is the wrongful acts of the defendant that have created the difficulty in proving the amount of loss of profits or where it is the wrongful acts of the defendant that have caused the other party to not realize a profit to which that party is entitled.

CA(13)[] **(13)**

Damages § 15—Measure of Damages—For Breach of Contract—Lost Profits—Reasonable Certainty.

The lost profit inquiry is always speculative to some degree. Inevitably, there will always be an element of uncertainty. Courts must not be too quick to exclude expert evidence as speculative merely because the expert cannot say with absolute certainty what the profits would have been. Courts must not eviscerate the possibility of recovering lost profits by too broadly defining what is too speculative. A reasonable certainty only is required, not absolute certainty.

CA(14)[] **(14)**

Evidence § 81—Opinion Evidence—Expert Witnesses—Reliability—Predictions.

Because it is inherently difficult to accurately predict the future or to accurately reconstruct a counterfactual past, it is

appropriate **[*752]** that trial courts vigilantly exercise their gatekeeping function when deciding whether to admit testimony that purports to prove such claims.

CA(15)[] **(15)**

Evidence § 87—Opinion Evidence—Subjects of Expert Testimony—Lost Profits—Exclusion of Speculative Testimony.

Many avenues exist to show lost profits. An expert can use a company's actual profits, a comparison to the profits of similar companies, or other objective evidence to project lost profits. In a case involving a university's breach of a contract to perform clinical testing of a company's new product, the record contained evidence of specific lost sales and canceled contracts due to the university's failure to complete the study. Evidence of this kind might support reasonably certain lost profit estimates. The trial court's ruling excluding an expert's calculation of future profits based on anticipated market share gains merely meant the company could not obtain a massive verdict based on speculative projections of future spectacular success. The trial court properly acted as a gatekeeper to exclude speculative expert testimony. Its ruling came within its discretion.

[Cal. Forms of Pleading and Practice (2012) ch. 177, Damages, § 177.79; 1 Crompton et al., Matthew Bender Practice Guide: Cal. Contract Litigation (2012) § 7.09; 1 Witkin, Cal. Evidence (5th ed. 2012) Opinion Evidence, § 32.]

Counsel: Browne George Ross, Brown Woods George, Allan Browne, Eric M. George, Benjamin D. Scheibe, Ira Bibbero; Glaser Weil Fink Jacobs Howard Avchen & Shapiro, Patricia L. Glaser, Elizabeth G. Chilton and Andrew Baum for Plaintiff and Appellant.

Quinn Emmanuel Urquhart & Sullivan, Quinn Emmanuel Urquhart Oliver & Hedges, Kathleen M. Sullivan, Daniel H. Bromberg, John B. Quinn, Michael E. Williams and Michael T. Lifrak for Defendants and Appellants.

Cole Pedroza, Curtis A. Cole and Cassidy E. Cole for California Medical Association, California Hospital Association and California Dental Association as Amici Curiae on behalf of Defendants and Appellants.

Daniel J. Popeo, Richard A. Samp; Bergeson and Mark E. Foster for Washington Legal Foundation and Allied Educational Foundation as Amici Curiae on behalf of Defendants and Appellants.

[*753] Mayer Brown and Donald M. Falk for Actelion Pharmaceuticals U.S. as Amicus Curiae on behalf of Defendants and Appellants.

Ada Meloy; Hogan Lovells US, Michael Shepard, Martin Michaelson, Alexander Dreier and David **[****2]** Ginn for American Council on Education and other Higher Education Associations and Institutions as Amici Curiae on behalf of Defendants and Appellants.

Morgan, Lewis & Bockius. Thomas M. Peterson and Benjamin P. Smith for Asahi Kasei Pharma Corporation as Amicus Curiae on behalf of Defendants and Appellants.

Judges: Opinion by Chin, J., with Cantil-Sakauye, C. J., Kennard, Baxter, Werdegar, Corrigan, and Liu, JJ., concurring.

Opinion by: Chin

Opinion

[*617] [**1239]** **CHIN, J.**—A small dental implant company that had net profits of $ 101,000 in 1998 has sued a university for breach of a contract for the **[**1240]** university to clinically test a new implant the company had patented. The company seeks damages for lost profits beginning in 1998, ranging from $ 200 million to over $ 1 billion. It claims that, but for the university's breach of the contract, the company would have become a worldwide leader in the dental implant industry and made many millions of dollars a year in profit. Following an evidentiary hearing, the trial court excluded as speculative the proffered testimony of an expert to this effect. We must determine whether the court erred in doing so.

We conclude that the trial court has the duty to act as a "gatekeeper" to exclude **[****3]** speculative expert testimony. Lost profits need not be proven with mathematical precision, but they must also not be unduly speculative. Here, the court acted within its discretion when it excluded opinion testimony that the company would have become extraordinarily successful had the university completed the clinical testing.

We reverse the judgment of the Court of Appeal, which had held the trial court erred in excluding the testimony.

I. Factual and Procedural History

Because neither party petitioned the Court of Appeal for rehearing, much of this summary of the factual and procedural

history is taken from that court's majority opinion. (See *Richmond v. Shasta Community Services Dist. (2004) 32 Cal.4th 409, 415 [9 Cal. Rptr. 3d 121, 83 P.3d 518]*; *Cal. Rules of Court, rule 8.500(c)(2)*.)
[*754]

A. *The Lawsuit and First Appeal*

In 1991, plaintiff Sargon Enterprises, Inc. (Sargon), patented a dental implant **[***618]** that its president and chief executive officer, Dr. Sargon Lazarof, had developed. The United States Food and Drug Administration approved the implant, which meant it could be sold and used in the United States. As the Court of Appeal opinion described it, Sargon's implant "could be implanted immediately following an extraction **[****4]** and contained both the implant and full restoration. [¶] In the 1980's, the standard implant was the Branemark implant developed at the University of Gothenburg in Sweden. The Branemark implant required several steps. First, surgery would place the implant in a healed extraction socket in the patient's mouth; a second surgery would inspect the implant to see if it had properly integrated with the bone (a process known as 'osseointegration'); last, a crown would be placed on the implant. Sargon's implant was a one stage implant: it expanded immediately into the bone socket with an expanding screw; this mechanism permitted the implant to be 'loaded' with a crown the same day."

In 1996, Sargon contracted with defendant University of Southern California (USC) for the USC School of Dentistry to conduct a five-year clinical study of the implant. In May 1999, Sargon sued USC and faculty members of its dental school involved in the study, alleging breach of contract and other causes of action. USC cross-claimed for breach of contract. All of Sargon's claims except the breach of contract claim against USC were eliminated by demurrer or summary judgment. In 2003, the contract action was tried **[****5]** before a jury. Before trial, at an in limine hearing, the trial court excluded evidence of Sargon's lost profits on the ground USC could not have foreseen them.

The evidence presented at trial showed that after initial success in the clinical trials, USC failed to present proper reports as its contract with Sargon required. The jury found that USC had breached the contract and awarded Sargon $ 433,000 in compensatory damages. It also found in Sargon's favor on USC's cross-complaint for breach of contract.

Sargon appealed. The Court of Appeal reversed the judgment, holding that the trial court had erred in excluding evidence of Sargon's lost profits on the ground of foreseeability. [1] It also stated, "Given that the in limine hearings focused on foreseeability and not the amount of lost profit damages, it is premature to determine whether such damages can be calculated with reasonable certainty." (*Sargon Enterprises, Inc. v. University of Southern California* (Feb. 25, 2005, B163707) [nonpub. opn.].)
[*755]

[1241]** On remand, the case proceeded to retrial on the breach of contract claim. USC moved to exclude as **[****6]** speculative the proffered opinion testimony of one of Sargon's experts, James Skorheim. The court presided over an eight-day evidentiary hearing at which Skorheim was the primary witness.

B. *The Evidentiary Hearing*

Skorheim testified that he was a certified public accountant and an attorney. He had been an accountant for 25 years and "work[ed] as a business and industry analyst and forensic accountant." As the Court of Appeal summarized, he testified that Sargon's lost profits "ranged from $ 220 million to $ 1.18 billion. In preparing his opinion, Skorheim reviewed litigation materials (including deposition transcripts and reports of USC's damages experts), financial information from Sargon and its competitors (including annual reports), and market analyses of the global dental im **[***619]** plant market prepared by Millennium Research Group …" (Millennium). Skorheim based his opinion on a "market share" approach, by which he determined what share of the worldwide dental implant market Sargon would have gained had USC completed a favorable clinical study, and he calculated future profits based on that market share. "Skorheim used the market share approach to lost profit damages because the methodology **[****7]** had been used in complicated patent cases, antitrust cases, and unfair competition cases."

The Court of Appeal summarized Skorheim's testimony about the dental implant industry: "Nobel Biocare's Branemark implant was the pioneer implant developed in the 1960's and 1970's and required two surgeries. Straumann developed the second generation implant, which was placed in the bone without being submerged in the gum. In the early 1990's, there was very little penetration into the potential dental implant market. Out of millions of potential patients, only about 1 percent of this potential market was receiving product, presenting an opportunity for tremendous growth. In the late 1990's, the market began to grow dramatically. Industry reports demonstrated the global market was expected

[1] We express no opinion on the correctness of this ruling, which is not before us on review.

to grow during the period 1998 to 2009 at an annualized rate of 18.5 percent. At the time, the market craved technological innovation aimed at shortening healing time, cost, and treatment time. [Millennium] predicted that sales of immediate load implants would grow at compound annual rates of 56.3 percent during 2002 to 2006, and 32.8 percent from 2005 to 2009. Further, [Millennium] reported in 2004, immediate **[****8]** loading implants represented only a 'niche' market because demand was limited by industry acceptance. By 2009, immediate load implants would account for 14.9 percent of the United States market, up from 0.4 percent in 2000.

"Sargon's innovation lay in the use of an 'immediate load implant,' the ' "holy grail of dental implantology," ' which was directed at the market's **[*756]** need for ease of use, shortened healing times, and overall cost. Given the state of the implant market at the time, in Skorheim's opinion an innovator such as Sargon would have rapidly commanded a significant market share; with the exception of Nobel Biocare, all of the other major implant makers are recent arrivals on the scene."

In Skorheim's opinion, three key "market drivers" operate in the dental implant industry: (1) innovation, (2) clinical studies, and (3) outreach to general practitioners. A company must have all three to be successful. Skorheim had testified, the Court of Appeal stated, that "[t]he value of a clinical study to an implant maker is two-fold: It establishes the efficacy of the device and permits entry into the universities where students can be taught to use the device, with the expectation that, **[****9]** upon graduation, they will use the product in their practices." He believed that clinical success of the Sargon implant would likely lead to commercial success. Skorheim also had testified that because virtually every dental implant company employed clinical studies and general practitioner outreach, innovation really determined market success and what market share a company would achieve. He had explained, "The greater the technological achievement in the product mix, the greater the likelihood for revenues." In Skorheim's opinion, innovation was a necessary prerequisite to achieving market success. "[F]irst and foremost, you have to have the technological innovation and the efficacy."

[1242]** As the Court of Appeal observed, "Skorheim's 'market share' approach was based **[***620]** upon a comparison of Sargon to six other large, multinational dental implant companies that were the dominant market leaders in the industry, and which controlled in excess of 80 percent of global sales (Big Six): Nobel Biocare, Straumann, [Biomet 3i], Zimmer, Dentsply, and Astra Tech. Although there are approximately 96 companies worldwide that make dental implants, Skorheim believed the Big Six were the top innovators based **[****10]** upon his analysis of the [Millennium] report and market intelligence." Skorheim had described the smaller companies as "copycats" and "price cutters" that competed on the basis of price and were not innovative; he believed that "the top six are innovators and the rest are copycats." The Court of Appeal stated: "On cross-examination, Skorheim acknowledged that [Millennium's] report did not state the Big Six were the most innovative; rather, it was an inference he drew from reviewing the report and the size and success of the companies in comparison to other, smaller companies."

Skorheim had acknowledged that many of the smaller companies claimed to be innovative, but he believed in fact they were not. When the trial court noted that the Millennium report mentioned other companies that claimed to be innovative, Skorheim had responded, "And I would say that the proof is in the pudding. And the proof is their ability to track the market share and they **[*757]** haven't been able to do that." When asked whether he agreed "that the company with the largest market share is not necessarily the most innovative," Skorheim had answered, "I don't think I can agree with that. I mean, ultimately, the markets **[****11]** determine what's innovative and what's not innovative. These markets reward innovativeness. … And so the market really makes a determination of which of these companies is more innovative than not by the extent to which they reward them with purchasing their products, and so forth." Skorheim had acknowledged that the Millennium report did not specifically indicate that some of the smaller companies were not innovative, but explained that this was because "those companies are not big enough to be even addressed in the global market, so there's nothing specific."

Skorheim believed that Sargon was innovative, like the "Big Six," and not a "copycat" or "price cutter," like the other small companies. He acknowledged that Sargon was a very small company whose annual profits peaked in 1998 at around $ 101,000 and, unlike the big companies, it had no meaningful marketing or research and development organization and no parent company to assist it. But he believed these factors were merely "incidental" to innovation and played little role in achieving market share. Accordingly, and because innovation is the key factor driving market success, Skorheim had compared Sargon to the "Big Six" rather **[****12]** than to the smaller companies in computing lost profits. He considered the "Big Six" and Sargon to be "comparable companies."

Skorheim had testified that "assuming the jury finds [the new implant] was a superior innovative revolutionary product and based upon everything else I see in the materials here, I think that Sargon had a very good chance of becoming the market

leader over a period of time. I estimated maybe a 10-year period of time." Indeed, he believed to a "reasonable certainty" that within 10 years or so Sargon would have become a market leader. He also believed it likely that one of the "Big Six" would have dropped out of the leadership, and that Sargon would have replaced that company as a world leader.

When the trial court asked whether it mattered that some of the big companies **[***621]** had many different products, Skorheim had responded that Sargon "would have to remain competitive by investing significant amounts of money in [research and development] like … the other major manufacturers. Each of them are investing tens of millions of dollars a year into research and development to remain strong and technologically sound." He was confident that a company like Sargon would have **[****13]** been able to expend the necessary resources to "develop other products over time, that they would be able to use **[*758]** their patented expandable root process with other types of coatings, let's say, or shapes or sizes." He thought Sargon's ability to do so distinguished it from the other small companies.

[1243]** The Court of Appeal stated: "Skorheim outlined similarities and differences between the Big Six and Sargon: First, they all manufactured titanium implants, and the implants were one-stage, two-stage, or immediate load (Sargon only); second, all used clinical studies; third, all used outreach to general practitioners; fourth, pricing was substantially the same; fifth, their qualitative and quantitative cost structures were the same; and the implants were manufactured either in-house or pursuant to a contract with a third party. Qualitative cost structure consisted of cost of goods sold, research and development costs (R & D), sales and marketing costs, and general administrative costs. Sargon did not have a meaningful R & D organization or a sales and marketing department. In all other respects, Sargon's costs were similar to the Big Six." Skorheim had acknowledged, however, that he could **[****14]** not think of any objective "business metric"—"whether it's sales, number of employees, number of distributers, anything"—by which Sargon was comparable to, for example, Astra Tech, the member of the "Big Six" with the smallest market share.

The Court of Appeal opinion provided a chart summarizing Skorheim's testimony regarding Sargon and its competitors for the "relevant time period, approximately 1998." We reproduce it here:

Go to table1

The dental implant business was only part of AstraZeneca's company. Skorheim testified that Astra Tech, its dental implant division, had sales in 1999 of $ 111 million. **[*759]**

[*622]** For the reasons he gave, Skorheim believed that Sargon, unlike any of the other smaller companies, would, over time, have become a market leader, one of the "Big Six." In calculating Sargon's lost profits, he had not considered profits Sargon had ever actually realized, but instead considered the market leaders' profits. He believed that Sargon's profits would have increased over time until they reached the level of one of the market leaders. He testified, however, that in one respect he had taken into account Sargon's actual income. [4] He had started with Sargon's gross revenues (not net income) in 1998, the year USC should have produced an interim report, which were around $ 1.7 million to $ 1.8 million and constituted approximately one-half of 1 percent of the total global market. He then doubled that number based on his belief that, had **[****16]** the initial report from the clinical study been favorable and had other potentially favorable publicity followed, Sargon would have sold approximately 20 implants each to approximately 200 additional dentists. This would have brought Sargon's market share for that **[**1244]** year to about 1 percent. Skorheim believed that beginning in 1998, Sargon's market share would have "ramp[ed] up" over the years from this 1 percent to a share that a comparable member of the "Big Six" enjoyed. He had calculated the lost profits based on sales in 1998 of over $ 3 million and a subsequent increase each year until Sargon reached the level of one of the "Big Six."

Skorheim claimed no expertise regarding how innovative Sargon's dental implant was, although he had testified that "the immediate loading of implants is kind of the so-called holy grail of dental **[****17]** implantology." He said the jury would have to "wrestle" with the question of how innovative Sargon was. Because of this lack of expertise, Skorheim could not give a single sum of lost profits. Rather, in Skorheim's opinion, the amount would depend on how innovative the jury found Sargon to be, compared to the market leaders.

As the Court of Appeal explained, "Skorheim's damages model created four alternative damage scenarios based upon the jury's determination of the innovativeness of the implant. As a predicate, Skorheim had ranked the innovativeness of the comparator companies and established a hierarchy. If the jury concluded Sargon's level of innovation was equal to the least

[4] The trial court had initially sustained USC's objection to this testimony on the basis that it was inconsistent with Skorheim's deposition, and Sargon had failed to provide notice of this testimony, thus depriving USC of the opportunity to cross-examine Skorheim meaningfully on the point. But it permitted Skorheim to present this testimony "to make a record."

innovative of the benchmark companies, Astra Tech, Sargon would have attained a 3.75 percent share; if the jury concluded Sargon's level of innovation was equal to one of the lesser innovators of the benchmark companies, like Dentsply, Sargon would have attained a 5 percent market share; if the jury concluded Sargon's level of innovation was equal to a middle-level innovator, like [Biomet 3i], Sargon would have attained a 10 **[*760]** percent share; and if the jury concluded Sargon's level of innovation was that of the **[****18]** most innovative companies, Nobel Biocare and Straumann, Sargon would have attained a 20 percent market share." In establishing this hierarchy, Skorheim had assumed that the higher the market share a company had obtained, the more innovative it was. He also agreed, however, that it was possible, for example, that Astra Tech, with its smaller market share, was more innovative than Biomet 3i, which had a greater market share.

[*623]** For each of these four scenarios, Skorheim had calculated lost profits from 1998 to 2009, then added what he calculated to be post-2009 lost profits. Skorheim believed that Sargon's net profits, which in actuality peaked at $ 101,000 in 1998, would have grown to $ 26 million per year in 2009 under the least profitable of the scenarios, and to $ 142 million per year in 2009 under the most profitable of the scenarios.

The Court of Appeal opinion provided a chart summarizing Skorheim's lost profits calculations. We reproduce it here:

Go to table2

Thus, **[****19]** Skorheim had projected total lost profits of $ 220 million if the jury found Sargon's innovation was comparable to that of the least innovative market leaders, making what he described as a "meaningful contribution to innovation"; of $ 315 million if the jury found Sargon's innovation was somewhat greater; of $ 600 million if the jury found Sargon's innovation was somewhat greater yet; and of $ 1.2 billion if the jury found Sargon's innovation was comparable to that of the market leaders, making what he described as "revolutionary industry changing technology."

The Court of Appeal summarized the testimony of the other witnesses at the evidentiary hearing. "Dr. Lazarof confirmed Skorheim's conclusion that innovation coupled with clinical studies was the driver of market share. Sargon also presented the testimony of Steven Hanson, president from 1992 to 2004 of Calcitek, a successful implant company, who testified Sargon could have commanded a 15 to 20 percent share of the **[**1245]** market if the USC study had been completed, although he had not done a market study or considered the probability of all of the other steps necessary to get Sargon a 15 to 20 percent market share. Robert Pendry was **[****20]** at Straumann from 1992 to 2001 and at Thommen Medical from 2002 to 2006, and testified that in his **[*761]** opinion the Sargon implant was 'absolutely revolutionary' and 'world changing' when introduced in 1997 to 1998. In Pendry's words, the Sargon implant 'was the most exciting thing I'd heard in the implant business ever.' "

C. *The Trial Court's Ruling*

Following the evidentiary hearing, the court issued a 33-page written ruling on USC's motion to exclude Skorheim's testimony.

The court began by quoting an opinion by Judge Friendly of the Second Circuit Court of Appeals stressing the need to protect juries from "an array of figures conveying a delusive impression of exactness in an area where a jury's common sense is less available than usual to protect it." (*Herman Schwabe, Inc. v. United Shoe Machinery Corp. (2d Cir. 1962) 297 F.2d 906, 912*.) The court found it unreasonable for Skorheim, "or any such expert, to rely on much of the data which forms the basis of his opinions, because no data bears any resemblance to Plaintiff's historical profits or to those of any similar business." "Mr. Skorheim's opinion leaves the determination of up to a billion dollars of lost profit damages to pure speculation."

The **[****21]** court assumed for purposes of its ruling "that a 'market share' analysis is appropriate and warranted under California **[***624]** law," but it found that Skorheim's "market share opinion is not based on any actual historical financial results or comparisons to similar companies and, therefore, is not based on matter of a type [on which] an expert may reasonably rely." "The fatal flaw in Mr. Skorheim's reasoning is that it starts off assuming, without foundation, its conclusion. The fatal flaw in his analysis is that he relies on data that in no way is analogous to Plaintiff. Mr. Skorheim deems Plaintiff's historical data, such as past business volume, 'not relevant' to his lost profits projections." (Fn. omitted.)

[1246]** The court noted that at the evidentiary hearing, Skorheim had "offered a new opinion that would have been grounded in some historical performance." It explained that it had sustained USC's objection to this new opinion "on grounds it was never disclosed in discovery. This court notes that this new methodology is directly inconsistent with Mr. Skorheim's declaration, depositions testimony and the position Plaintiff has taken throughout this litigation. … Regardless, the methodology **[****22]** of the new opinion is unreasonable." Later in the evidentiary hearing, "Plaintiff again attempted to show some historical grounding for the damage projections. Mr. Skorheim testified that his damage

projections started with Sargon's gross revenues of $ 1,700,000 in 1997. Mr. Skorheim then doubled those revenues in 1998 … . To accomplish this, Mr. Skorheim assumed a favorable USC study and resultant publicity would cause 200 more dentists to buy at least 20 more implants each. The **[*762]** Court can find no factual basis for this assumption. [¶] … [¶] This Court specifically finds that Sargon's historical performance played no role in determining Mr. Skorheim's market projections, except to the extent that Sargon's data showed it had some sales."

The court found that Skorheim's "projections are wildly beyond, by degrees of magnitude, anything Sargon had ever experienced in the past. Under the 20% market share scenario, for example, Plaintiff would see its profits climb by 534.4% the first year, and by over 157,000% by 2009." Instead, the court found, Skorheim "starts his analysis with a comparison to industry leaders, all multi-million or multi-billion international corporations, or subsidiaries **[****23]** of such. This, of course, is unavoidable if one only looks to industry 'drivers' to ascertain who most successfully employs those 'drivers.' [¶] The only thing these established companies have in common with Plaintiff is that they all sell or make dental implants. In all other respects, in areas the [Millennium] report deems relevant, such as size, history, product line, sales force, access to financing, among others, they are worlds apart from Sargon." (Fn. omitted.)

The court noted that Skorheim had testified "that of all the 98 dental implant manufacturers, he could not identify one that did not pursue clinical studies or target general practitioners, rendering these two 'drivers' meaningless for comparison purposes. [¶] Moreover, many implant companies who touted 'innovative' products, yet had smaller revenues, were omitted for comparison purposes." In his testimony, "Mr. Skorheim grouped the companies that he deemed had 'innovative' products. He omitted certain smaller companies who, according to the [Millennium] report, also claimed to have innovations. When asked in court to explain this omission, he testified, 'The proof is in the pudding.' The small market share of these companies **[****24]** showed the market disagreed. Apparently, a product is 'innovative' if the market embraces it and it sells. [¶] The summary exclusion of other companies from his analysis, along with the fact that it should not be a **[***625]** startling revelation that biotechnology companies that have innovative products, all other things being equal, do better than those who do not, render this 'driver' equally meaningless for comparison purposes." The court found this argument to be "entirely circular."

The court continued: "At the hearing, Plaintiff changed its theory and attempted to show that it was similar to the industry leaders in ways other than possession of the three 'drivers.' The characteristics that Mr. Skorheim contended made Plaintiff 'similar' to the industry leaders, however, were characteristics common to most, if not all, implant companies. Obviously, if most share these 'common traits,' the traits are meaningless for comparison purposes. If, based upon these common characteristics, the very smallest is **[*763]** considered 'similar' to the very biggest, all cases that have required objective similarity would be effectively overruled, and the rule requiring 'similarity' would cease to exist. This Court **[****25]** finds that Sargon is not similar to the industry leaders by any relevant, objective business measure."

The court found that the dissimilarity between Sargon and the industry leaders "is sufficient, itself, to grant Defendant's motion" to exclude Skorheim's testimony, but "this court has other problems with Mr. Skorheim's opinion that give further grounds, by themselves, to grant Defendant's motion." It found that "[c]omparing 'degrees of innovation' with other products fails to give the jury standards from which it can make a rational decision, is inherently speculative and subjective, and thus fails to assist the jury in its fact-finding function. [¶] The relevance of Mr. Skorheim's testimony, if any, is that it provides the jury with an evidentiary basis to make market share choices and thus assess damages. The jury can choose from four market shares ranging from 3.75% to 20%, depending upon its finding of relative 'innovativeness.' The highest rating gets Nobel Biocare's share, with the lesser market share percentages awarded depending upon whether the innovativeness of the Plaintiff's implant is more on a par with products from Zimmer, 3i, and Straumann. The lowest percentage finding **[****26]** the jury can make is that the innovativeness of the Sargon implant is comparable to Astra Tech's or Dentsply's products. The fatal problem with this is that there is little rational basis for this choice, and no rational standards for how the jury is to choose.

"Implicit in this choice is that there is an evidentiary basis for this ranking; an 'innovativeness' pecking order where, in fact, Nobel Biocare is on top, others follow, with Astra Tech and Dentsply on the bottom. Likewise, there must be an evidentiary basis for degree of difference; evidence that shows not only that Nobel Biocare is more innovative, but, with 20% of the market, it must be twice as 'innovative' as 3i, in the 10% group, and so on. Otherwise, 'innovativeness' would not track the percentage market share for the findings he proposes the jury make. Yet, the only factual basis for such a pecking order comes from Dr. Lazarof's opinion of such, and there is no evidence or reason to believe one company is more innovative than another, in the percentage difference, other than the fact the companies have different market shares. [¶] … [¶] The only possible evidentiary support for the percentage difference in the pecking **[****27]** order comes from Mr. Skorheim's oft repeated observations of the

marketplace. Certain smaller companies, who claimed to have innovative products, were excluded from his 'industry leader' market share list because 'the market' disagreed **[**1247]** with their claim of 'innovativeness.' 'The proof is in the pudding,' Mr. Skorheim explained. If their products were truly innovative, they **[***626]** would sell more and thus have larger market shares. [¶] … [¶] To the extent that this ranking of 'innovativeness,' with Nobel Biocare on top with 20%, and Astra Tech on the bottom with 3.75%, rests on **[*764]** the fact that some have larger market shares, it rests on nothing more than a tautology. As there is no evidentiary basis that equates the degree of innovativeness with the degree of difference in market share, the question posed to the jury—to rank innovativeness and assign a market share, the *sine qua non* of Mr. Skorheim's opinion—has no rational basis."

Additionally, the court continued, "[t]he only rational answer to the question Mr. Skorheim seeks to have the jury answer comparing 'innovativeness' is 'it depends.' What is 'most innovative' about any implant depends upon what the practitioner and patient think **[****28]** is important. [¶] What is good, better or best is inherently subjective, and depends upon the need, the patient, the price, and the situation. [¶] … [¶] It is not that the jury, given the time confines of a trial, will not have enough information to decide relative 'innovativeness,' it is that no jury, given an infinite amount of time, will ever have enough information. Such is the nature of purely subjective determinations. Which is the most innovative implant? The Court expects there to be experts giving their views, but do we have any standards or guidelines to help us in the determination?"

The court explained that in the Millennium reports "there are many different types of implants. The market leaders have product lines of implants to serve the diverse needs of patients and practitioners. Some implants have different coating and/or screws. Some are immediate loading, some are two-stage loading, others have internal or external connections. Astra Tech markets an implant that it claims 'has amassed significant documentation that confirms the increased bone retention right up to the top of the implant compared to competitive products.' Another Astra Tech implant is touted as **[****29]** 'simple and easier to use.' [Citation.] Others are more 'affordable' such as INNOVA Life Sciences and IMTEC. [Citation.] Each company offers a line of implant products it claims are excellent for various uses." "Is the Sargon implant as good or better than those offered by competitors? Plaintiff will advocate for the Sargon implant. Who will advocate for all the rest?"

The court explained why, in its view, Skorheim's opinion was speculative. "A jury can determine if a Ford was defective, because there are objective facts, such as industry standards and standards for safety, as well as a body of case law on the subject of products liability. A jury cannot say if a Ford is a better car than a Chevrolet, because that is subjective and depends upon what the driver wants and what he can afford, among other things.

"By way of example, assume that Miss Oklahoma entered into a contract to transport her to the 'Miss America' contest. Assume further that the carrier breached the contract and Miss Oklahoma missed the chance to compete. A jury could decide if she was damaged by the breach, to the extent damages **[*765]** could be ascertained. Could the jury go further and, based upon testimony of experts, **[****30]** decide that, had she been allowed to compete, she would have defeated Miss Colorado for the title of Miss America, or decide that she would have been second, behind Miss Colorado and ahead of Miss Montana? [¶] It is not a situation … that juries can and do decide complex issues. Of course they do. But in all cases, including cases where jurors are asked to 'rank,' as in comparative fault, there are standards in the form of jury instructions and a body of case law **[***627]** to refer to if needed for special instructions."

The court believed that asking a jury to rank innovativeness "is no different than deciding whether Miss Oklahoma or Miss Colorado should wear the Miss America crown. [¶] Mr. Skorheim's question calls for nothing but a subjective and speculative response. Whether an implant is good, better or best can only be answered in the market place, not the jury room. The market place has rendered its verdict: 'It depends.' That is why all the various implant companies, even the very biggest, and their implants have their own market niche with corresponding **[**1248]** minority market shares. [¶] … [¶] Because there are no standards or guidelines to determine 'degrees of innovation,' it relegates **[****31]** the question of determining potentially more than a billion dollars in damages to pure speculation. Accordingly, the court finds that there are two independent grounds to rule this evidence inadmissible: No damage award can be based on speculation; and evidence that cannot assist the trier of fact in the resolution of an issue is not relevant."

The court continued: "Mr. Skorheim has no qualifications to opine that but for Defendant's breach, Plaintiff would have a program of targeting general practitioners on a par with any of the companies he singled out for comparison. [¶] The [Millennium] report sets forth sales and marketing strategies for the industry leaders. For example, Nobel Biocare in the 2001–2003 timeframe had 80 field representatives in the United States alone. What makes Mr. Skorheim think that Plaintiff would equal or surpass these numbers, or done so with equal or greater success? The only information he can

offer is the uncritical acceptance of Dr. Lazarof's hoped-for marketing plans. Whether these plans would ever have been implemented as anticipated, or succeeded, is pure speculation."

"Mr. Skorheim testified that, in the perfect world where there had been no breach, **[****32]** by 2007 Sargon would have made the seamless transition from a three-person operation to sharing industry leadership with Nobel Biocare, a multi-million dollar international corporation. Nobel Biocare touts, according to the annual reports he relied upon, many different product lines, including different types of implants. When asked how Sargon could be an industry leader with only one implant (he later testified that Sargon had developed **[*766]** seven) Mr. Skorheim testified that 'he would expect' Sargon to have invested in 'R and D' in the intervening years and also, by 2007, to have invented new products and coatings. Mr. Skorheim thus opined that not only would Sargon have invested in 'R and D' by 2007, but has also opined on what the results of that 'R and D' would be. [¶] It is not reasonable for any expert to make such a faith-based prediction so absolutely devoid of any factual basis about an industry where he has no expertise."

Additionally, "nowhere in [Skorheim's] success scenario is any mention of how competitors will react to having their market share taken by Plaintiff. … We do not know if these million or billion dollar corporations, or their shareholders, would just go quietly, **[****33]** because it is not discussed or considered. We are forced to assume they would do nothing." "This 'Field of Dreams' 'trust me' analysis forces us to assume, speculate and believe too much. It is no different than our Miss Oklahoma asking the jury to vote her Miss America and arguing that her damages include the inevitable movie deals and product endorsements that 'common sense' dictates every Miss America receives and were lost because her transportation breached the **[***628]** contract to take her to the contest." (Fn. omitted.)

In its concluding portion, the court stated that "case law demands that to establish such lost profits through expert testimony, the expert must base his/her opinion on either historical performance of the company or a comparison to the profits of companies similar in terms of size, locality, sales, products, number of employees and other relevant financial factors. A party is not permitted to 'make up' its own factors as a basis for comparison and invite the jury to decide whether the corporations are similar. To allow this is to invite proceedings where there are no objective standards as there will always be some way to argue that companies are 'similar,' no matter **[****34]** how superficial or irrelevant. Here, for example, the factors Mr. Skorheim uses would lead to the absurd result that Sargon, one of the industry's smallest companies, was 'similar' to the largest. In assessing lost profit damages in this context, there is a meaningful difference between biggest and smallest. [¶] Mr. Skorheim admittedly shunned historical performance and comparison to companies of similar size and financial situation, choosing instead to compare Plaintiff to multi-national industry giants based upon his own criteria of 'similar.' His criteria, even assuming he has the qualifications to decide them, which he does not, are nebulous and legally irrelevant under case law. Accordingly, there is no issue of similarity to give to the jury to compare and decide."

[1249]** The court concluded "that Mr. Skorheim's opinions are not based upon matters upon which a reasonable expert would rely, and do not show the nature and occurrence of lost profits with evidence of reasonable reliability, **[*767]** because his opinion is not based on any historical data from Plaintiff or a comparison to similar businesses. The court also finds his 'market drivers' meaningless for comparison purposes. Additionally, **[****35]** his opinion rests on speculation and unreasonable assumptions."

Accordingly, the court granted USC's motion to exclude Skorheim's testimony.

D. *The Second Appeal*

After the court excluded Skorheim's testimony, the parties stipulated to entry of judgment for $ 433,000 on Sargon's breach of contract claim. Sargon appealed for the second time.

By a two-to-one vote, the Court of Appeal reversed the judgment and remanded the matter for a new trial on lost profits. It concluded the trial court erred in excluding Skorheim's testimony.

After reviewing in detail the facts, the parties' arguments, and the relevant law, the court found that "Sargon has the better argument here. … In 1998, Sargon had about $ 1.8 million in revenues, roughly one-half of 1 percent of the global market for dental implants. Astra Tech, one of the companies relied on by Skorheim, had around $ 18.5 million in revenues, for a 4.8 percent market share. The other companies had greater revenues and market shares. At the very least, the jury was entitled to hear about Astra Tech because it was sufficiently similar to Sargon, and a damages award based on a comparison to that company would have been supported by substantial **[****36]** evidence, not speculation.

"We acknowledge the difficulty in determining lost profits when an established business is built upon the sale of an innovative, revolutionary, or world-changing product. The factor of innovation—what the trial court described as a

'beauty contest'—is not easily converted into dollars and cents. But exactitude is not required. None of Sargon's competitors used its implant, **[***629]** and, to that extent, they were different. But lost profits may be based on a comparison of similar companies; they need not be identical in all respects. Skorheim's expert opinion was based on 'economic and financial data, market surveys and analyses, business records of similar enterprises, and the like.' (*Kids' Universe v. In2Labs[(2002) 95 Cal.App.4th 870, 884 [116 Cal. Rptr. 2d 158]]*.) He also considered Sargon's historical financial data. The trial court's ruling is tantamount to a flat prohibition on lost profits in any case involving a revolutionary breakthrough in an industry.

"If USC had not sabotaged the clinical study of the Sargon implant, Sargon would have had a successful clinical trial to its credit and a prominent **[*768]** university using the implant at its dental school. But it was denied. Through its **[****37]** wrongful conduct, USC allegedly caused the loss of profits and has made the proof of lost profits all the more difficult, thereby rendering its evidentiary attack unconvincing. (*GHK Associates v. Mayer Group, Inc.[(1990) 224 Cal. App. 3d 856, 874 [274 Cal. Rptr. 168]]*.) We have carefully reviewed the trial court's criticisms of Skorheim's proffered testimony and conclude they were better left for the jury's assessment."

Justice Johnson dissented. He argued that "[w]here, as here, the law does not offer precise parameters to the quantum of proof required to establish lost profit damages, a trial court must be permitted to draw the line in the sand, either letting the evidence in as meeting the certainty threshold, or excluding it as below that threshold. The placement of that threshold is left to the trial court so long as it is within the bounds of the law." He found the trial court's decision to be "founded on a detailed, methodical and well-reasoned examination of the law of contracts and the limits on lost profits damages. … [¶] … [T]he task of determining the threshold measure of certainty to permit Skorheim's opinion to go to the jury should be left to the gatekeeping function of the trial **[****38]** court, in the context of its evidentiary rulings after an evaluation of all of the facts, evidence, and arguments. Here, the trial court drew a very reasonable line in the sand with its ruling excluding Sargon's evidence of lost profit damages. I see no justification for this court to overturn that decision."

[1250]** The dissent argued that "Sargon was not similar to the Big Six under any relevant, objective business measure" and found "nothing in this ruling that indicates the trial court acted in an arbitrary, capricious fashion, was guided by whim rather than the rule of law, or exceeded the bounds of reason." Justice Johnson added that "while I admittedly share with the trial court a healthy dose of skepticism over Skorheim's unyieldingly optimistic projections for Sargon's market share growth and while I struggle to see a nexus between those projections and business and economic reality, this dissent nonetheless does not stem from the havoc that Skorheim's methodology may wreak upon reasonable damage calculations but from the damage done to the trial judge's reasonable and prudently exercised judgment on an evidentiary issue over which he and he alone should have decisional authority, **[****39]** absent arbitrariness and capriciousness. Nothing in the trial judge's reasonable, straightforward and clearly articulated evidentiary ruling bears even a smidgeon of arbitrariness or capriciousness." Accordingly, Justice Johnson would have affirmed the trial court's ruling excluding Skorheim's testimony.

We granted USC's petition for review to decide whether the trial court erred in excluding Skorheim's testimony.
[*769]

[*630]** II. Discussion

This case stands at the intersection of two legal principles: (1) Expert testimony must not be speculative, and (2) lost profit damages must not be speculative. We will discuss both principles, then apply them to this case.

A. *Expert Testimony*

CA(1)[↑] **(1)** As did the trial court, we begin our consideration of expert testimony with words that Judge Friendly wrote half a century ago: *HN1*[↑] "There is no bright line that divides evidence worthy of consideration by a jury, although subject to heavy counter-attack, from evidence that is not. Especially because of the guaranty of the *Seventh Amendment*, a federal court must be exceedingly careful not to set the threshold to the jury room too high. Yet it is the jury system itself that requires the common law 'judge, in his efforts to prevent **[****40]** the jury from being satisfied by matters of slight value, capable of being exaggerated by prejudice and hasty reasoning … to exclude matter which does not rise to a clearly sufficient degree of value'; 'something more than a minimum of probative value' is required. 1 Wigmore, Evidence (3d ed. 1940), pp. 409–410. These comments are especially pertinent to an array of figures conveying a delusive impression of exactness in an area where a jury's common sense is less available than usual to protect it." (*Herman Schwabe, Inc. v. United Shoe Machinery Corp., supra, 297 F.2d at p. 912*.)

Although Judge Friendly was discussing federal law and federal courts, his comments, both in their cautionary note that, due to the jury trial right, courts should not set the

admission bar too high, and in their stressing the need to exclude unreliable evidence, could just as well have described California law and California courts. Under California law, trial courts have a substantial "gatekeeping" responsibility. [5]

CA(2)[↑] **(2)** Evidence Code section 801 provides: HN2[↑] "If a witness is testifying as an expert, his testimony in the form of an opinion is limited to such an opinion as is: [¶] (a) Related to a subject that is sufficiently beyond common experience that the opinion of an expert would assist the trier of fact; and [¶] (b) Based on matter … that is *of a type* that reasonably may be relied upon by an expert in forming an opinion upon the subject to which his testimony relates, unless an expert is precluded by law from using such matter as a basis **[*770]** for his opinion." (Italics added.) HN3[↑] Subdivision (b) clearly permits a court to determine whether the matter is of a *type* on which an expert may reasonably rely.

In *Lockheed Litigation Cases (2004) 115 Cal.App.4th 558, 563 [10 Cal. Rptr. 3d 34]*, the plaintiffs argued that under Evidence Code section 801, subdivision (b), **[**1251]** "a court should determine only whether the type of matter that an expert relies on in forming his or her opinion is the type of matter that an expert reasonably can rely on in forming an opinion, without **[****42]** regard to whether the matter relied on reasonably does support the particular opinion offered." The Court of Appeal disagreed. "An expert opinion has no value if its basis is unsound. [Citations.] Matter that provides a reasonable basis for **[***631]** one opinion does not necessarily provide a reasonable basis for another opinion. Evidence Code section 801, subdivision (b), states that a court must determine whether the matter that the expert relies on is of a type that an expert reasonably can rely on 'in forming an opinion *upon the subject to which his testimony relates*.' (Italics added.) We construe this to mean that the matter relied on must provide a reasonable basis for the particular opinion offered, and that an expert opinion based on speculation or conjecture is inadmissible." (*Lockheed Litigation Cases, supra, at p. 564*.)

CA(3)[↑] **(3)** We agree with this analysis. Indeed, as the Court of Appeal in that case also noted (*Lockheed Litigation Cases, supra, 115 Cal.App.4th at p. 564*), the California Law Revision Commission comments to Evidence Code section 801 explained that "under existing law, irrelevant or speculative matters are not a proper basis for an expert's opinion. See *Roscoe Moss Co. v. Jenkins [(1942) 55 Cal. App. 2d 369 [130 P.2d 477]]* **[****43]** (expert may not base opinion upon a comparison if the matters compared are not reasonably comparable) … ." (Cal. Law Revision Com. com., 29B pt. 3A West's Ann. Evid. Code (2009 ed.) foll. § 801, p. 25.) HN4[↑] Comments of a commission that proposed a statute are entitled to substantial weight in construing the statute, especially when, as here, the Legislature adopted the statute without change. (*Jevne v. Superior Court (2005) 35 Cal.4th 935, 947 [28 Cal. Rptr. 3d 685, 111 P.3d 954]*.) CA(4)[↑] **(4)** Thus, HN5[↑] under Evidence Code section 801, the trial court acts as a gatekeeper to exclude speculative or irrelevant expert opinion. As we recently explained, "[T]he expert's opinion may not be based 'on assumptions of fact without evidentiary support [citation], or on speculative or conjectural factors … . [¶] Exclusion of expert opinions that rest on guess, surmise or conjecture [citation] is an inherent corollary to the foundational predicate for admission of the expert testimony: will the testimony assist the trier of fact to evaluate the issues it must decide?' (Jennings v. Palomar Pomerado Health Systems, Inc. (2003) 114 Cal.App.4th 1108, 1117 [8 Cal. Rptr. 3d 363].)" (People v. Richardson (2008) 43 Cal.4th 959, 1008 [77 Cal. Rptr. 3d 163, 183 P.3d 1146]; accord, *People v. Moore (2011) 51 Cal.4th 386, 405 [121 Cal. Rptr. 3d 280, 247 P.3d 515]*.)

[*771]

Additionally, **[****44]** as a recent law review article explains, Evidence Code section 801 is not the only statute that governs the trial court's gatekeeping role. We must also consider Evidence Code section 802. (See Imwinkelried & Faigman, Evidence Code Section 802: The Neglected Key to Rationalizing the California Law of Expert Testimony (2009) 42 Loyola L.A. L.Rev. 427 (hereafter Imwinkelried & Faigman).)

CA(5)[↑] **(5)** Evidence Code section 802 provides: HN6[↑] "A witness testifying in the form of an opinion may state … the *reasons* for his opinion and the matter … upon which it is based, unless he is precluded by law from using such reasons or matter as a basis for his opinion. The court in its discretion may require that a witness before testifying in the form of an opinion be first examined concerning the matter upon which his opinion is based." (Italics added.) HN7[↑] This section indicates the court may inquire into the expert's reasons for an opinion. It expressly permits the court to examine experts concerning the matter on which they base their opinion before admitting their testimony. The *reasons* for the experts' opinions are part of the matter on which they are based just as is the *type* of matter. Evidence Code section 801

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[5] Recent United States Supreme Court decisions have referred to the trial judge's " 'gatekeeper' role" (General Electric Co. v. Joiner (1997) 522 U.S. 136, 142 [139 L. Ed. 2d 508, 118 S. Ct. 512]) or " 'gatekeeping' obligation" **[****41]** (Kumho Tire Co. v. Carmichael (1999) 526 U.S. 137, 141 [143 L. Ed. 2d 238, 119 S. Ct. 1167]). We have used the term "gatekeeping responsibility." (People v. Prince (2007) 40 Cal.4th 1179, 1225, fn. 8 [57 Cal. Rptr. 3d 543, 156 P.3d 1015].)

[**45]** governs judicial review of the *type* of matter; *Evidence Code section 802* governs judicial review of the *reasons* for the opinion. "The stark contrast between the wording **[***632]** of the two statutes strongly suggests that although under *section 801(b)* the judge may consider only the acceptability of the generic type of information the expert relies on, the judge is not so limited under *section 802*." (Imwinkelried & Faigman, *supra, 42 Loyola L.A. L.Rev. at p. 441*.)

[1252]** ***HN8***[↑] ***CA(6)***[↑] **(6)** *Evidence Code section 802* also permits the trial court to find the expert is precluded "by law" from using the reasons or matter as a basis for the opinion. " 'Law' includes constitutional, statutory, and decisional law." (*Evid. Code, § 160*.) Thus, "construed in the context of *section 160*, *section 802* authorizes a court to promulgate case law restrictions on an expert's 'reasons' … ." (Imwinkelried & Faigman, *supra, 42 Loyola L.A. L.Rev, at p. 442*.) This means that a court may inquire into, not only the type of material on which an expert relies, but also whether that material actually supports the expert's reasoning. "A court may conclude that there is simply too great an analytical gap between the data and the opinion proffered." **[****46]** (*General Electric Co. v. Joiner, supra, 522 U.S. at p. 146*, and quoted in Imwinkelried & Faigman, *supra, 42 Loyola L.A. L.Rev., at p. 448*.)

CA(7)[↑] **(7)** Thus, ***HN9***[↑] under *Evidence Code sections 801, subdivision (b)*, and *802*, the trial court acts as a gatekeeper to exclude expert opinion testimony that is (1) based on matter of a type on which an expert may not reasonably rely, (2) based on reasons unsupported by the material on which the expert relies, or **[*772]** (3) speculative. Other provisions of law, including decisional law, may also provide reasons for excluding expert opinion testimony. [6]

CA(8)[↑] **(8)** But ***HN10***[↑] courts must also be cautious in excluding expert testimony. The trial court's gatekeeping role does not involve choosing between **[****47]** competing expert opinions. The high court warned that the gatekeeper's focus "must be solely on principles and methodology, not on the conclusions that they generate." (*Daubert v. Merrell Dow Pharmaceuticals, Inc., supra, 509 U.S. at p. 595*.) The advisory committee on the 2000 amendments to *Federal Rules of Evidence, rule 702* (28 U.S.C.), which codified the rule established in *Daubert*, noted that the trial court's task is not to choose the most reliable of the offered opinions and exclude the others: "When a trial court, applying this amendment, rules that an expert's testimony is reliable, this does not necessarily mean that contradictory expert testimony is unreliable. The amendment is broad enough to permit testimony that is the product of competing principles or methods in the same field of expertise." (Advisory Com. Notes to *Fed. Rules Evid., rule 702*, 28 U.S.C.)

HN11[↑] ***CA(9)***[↑] **(9)** The trial court's preliminary determination whether the expert opinion is founded on sound logic is not a decision on its persuasiveness. The court must not weigh an opinion's probative value or substitute its own opinion for the expert's opinion. Rather, the court must simply determine whether the matter relied on can provide **[****48]** a reasonable basis for the opinion or whether that opinion is based on a leap of logic or conjecture. The court does not resolve scientific controversies. **[***633]** Rather, it conducts a "circumscribed inquiry" to "determine whether, as a matter of logic, the studies and other information cited by experts adequately support the conclusion that the expert's general theory or technique is valid." (Imwinkelried & Faigman, *supra, 42 Loyola L.A. L.Rev. at p. 449*.) The goal of trial court gatekeeping is simply to exclude "clearly invalid and unreliable" expert opinion. (Black et al., *Science and the Law in the Wake of Daubert: A New Search for Scientific Knowledge (1994) 72 Tex. L.Rev. 715, 788*.) In short, the gatekeeper's role "is to make certain that an expert, whether basing testimony upon professional studies or personal experience, employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field." (*Kumho Tire Co. v. Carmichael, supra, 526 U.S. at p. 152*.)
[*773]

HN12[↑] Except to the extent the trial court bases its ruling on a conclusion of law (which we review de novo), we review its ruling excluding or admitting expert testimony for abuse of **[****49]** discretion. (*People v. McWhorter* ***[**1253]*** *(2009) 47 Cal.4th 318, 362 [97 Cal. Rptr. 3d 412, 212 P.3d 692]*; *People v. Gardeley (1996) 14 Cal.4th 605, 619 [59 Cal. Rptr. 2d 356, 927 P.2d 713]*; *People v. Mickey (1991) 54 Cal.3d 612, 687–688 [286 Cal. Rptr. 801, 818 P.2d 84]*; *Lockheed Litigation Cases, supra, 115 Cal.App.4th at p. 564*.) A ruling that constitutes an abuse of discretion has been described as one that is "so irrational or arbitrary that no reasonable person could agree with it." (*People v. Carmony (2004) 33 Cal.4th 367, 377 [14 Cal. Rptr. 3d 880, 92 P.3d 369*].) But the court's

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[6] In ***People v. Leahy (1994) 8 Cal.4th 587, 604 [34 Cal. Rptr. 2d 663, 882 P.2d 321]***, this court held that the "general acceptance" test for admissibility of expert testimony based on new scientific techniques (see ***People v. Kelly (1976) 17 Cal.3d 24 [130 Cal. Rptr. 144, 549 P.2d 1240]***) still applies in California courts despite the United States Supreme Court's rejection, in *Daubert v. Merrell Dow Pharmaceuticals, Inc. (1993) 509 U.S. 579 [125 L. Ed. 2d 469, 113 S. Ct. 2786]*, of a similar test in federal courts. Nothing we say in this case affects our holding in *Leahy* regarding new scientific techniques.

discretion is not unlimited, especially when, as here, its exercise implicates a party's ability to present its case. Rather, it must be exercised within the confines of the applicable legal principles.

HN13[↑] "The discretion of a trial judge is not a whimsical, uncontrolled power, but a legal discretion, which is subject to the limitations of legal principles governing the subject of its action, and to reversal on appeal where no reasonable basis for the action is shown." (9 Witkin, Cal. Procedure (5th ed. 2008) Appeal, § 364, p. 420; see *Westside Community for Independent Living, Inc. v. Obledo (1983) 33 Cal.3d 348, 355 [188 Cal. Rptr. 873, 657 P.2d 365]* [quoting this language].) "The scope of discretion always resides in the particular law being applied, i.e., in the 'legal principles governing **[****50]** the subject of [the] action … .' Action that transgresses the confines of the applicable principles of law is outside the scope of discretion and we call such action an 'abuse' of discretion. [Citation.] … [¶] The legal principles that govern the subject of discretionary action vary greatly with context. [Citation.] They are derived from the common law or statutes under which discretion is conferred." (*City of Sacramento v. Drew (1989) 207 Cal. App. 3d 1287, 1297–1298 [255 Cal. Rptr. 704]*.) To determine if a court abused its discretion, we must thus consider "the legal principles and policies that should have guided the court's actions." (*People v. Carmony, supra, 33 Cal.4th at p. 377*.)

In this case, we consider whether the trial court properly exercised its discretion to exclude expert opinion testimony. As we have explained, the trial court's discretion in this regard is circumscribed; it must be exercised within the limits the law permits. Accordingly, we must review the record to ensure that the ruling comes within the scope of that discretion.

B. *Lost Profits*

HN14[↑] *CA(10)*[↑] **(10)** Lost profits may be recoverable as damages for breach of a contract. "[T]he general principle [is] that damages **[***634]** for the loss of prospective **[****51]** profits are recoverable where the evidence makes reasonably certain their occurrence **[*774]** and extent." (*Grupe v. Glick (1945) 26 Cal.2d 680, 693 [160 P.2d 832]*.) Such damages must "be proven to be certain both as to their occurrence and their extent, albeit not with 'mathematical precision.'" (*Lewis Jorge Construction Management, Inc. v. Pomona Unified School Dist. (2004) 34 Cal.4th 960, 975 [22 Cal. Rptr. 3d 340, 102 P.3d 257]*.) The rule that lost profits must be reasonably certain is a specific application of a more general statutory rule. *HN15*[↑] "No damages can be recovered for a breach of contract which are not clearly ascertainable in both their nature and origin." (*Civ. Code, § 3301*; see *Greenwich S.F., LLC v. Wong (2010) 190 Cal.App.4th 739, 760 [118 Cal. Rptr. 3d 531]*.)

HN16[↑] *CA(11)*[↑] **(11)** Regarding lost business profits, the cases have generally distinguished between established and unestablished businesses. "[W]here the operation of an established business is prevented or interrupted, as by a … breach of contract … , damages for the loss of prospective profits that otherwise might have been made from its operation are generally recoverable for the reason that their occurrence and extent may be ascertained with reasonable certainty from the past volume of business and other **[****52]** provable data relevant to the probable future sales." (*Grupe v. Glick, supra, 26 Cal.2d at p. 692*.) "Lost profits to an established business may be recovered if their extent and occurrence can be ascertained with reasonable certainty; once their existence has been so established, recovery will not be denied because the amount cannot be shown with mathematical precision. [Citations.] Historical data, such as past business volume, supply an acceptable basis for ascertaining lost future profits. [Citations.] In **[**1254]** some instances, lost profits may be recovered where plaintiff introduces evidence of the profits lost by similar businesses operating under similar conditions. [Citations.]" (*Berge v. International Harvester Co. (1983) 142 Cal. App. 3d 152, 161–162 [190 Cal. Rptr. 815]*.)

CA(12)[↑] **(12)** "On the other hand, where the operation of an unestablished business is prevented or interrupted, damages for prospective profits that might otherwise have been made from its operation are not recoverable for the reason that their occurrence is uncertain, contingent and speculative. [Citations.] … But *HN17*[↑] although generally objectionable for the reason that their estimation is conjectural and speculative, anticipated profits dependent upon future **[****53]** events are allowed where their nature and occurrence can be shown by evidence of reasonable reliability." (*Grupe v Glick, supra, 26 Cal.2d at pp. 692–693*.)

"Where the *fact* of damages is certain, the amount of damages need not be calculated with absolute certainty. [Citations.] The law requires only that some reasonable basis of computation of damages be used, and the damages may be computed even if the result reached is an approximation. [Citation.] **[*775]** This is especially true where … it is the wrongful acts of the defendant that have created the difficulty in proving the amount of loss of profits [citation] or where it is the wrongful acts of the defendant that have caused the other party to not realize a profit to which that party is entitled." (*GHK Associates v. Mayer Group, Inc. (1990) 224 Cal. App. 3d 856, 873–874 [274 Cal. Rptr. 168]* [permitting an award of profits calculated from a project's "*actual* income"].)

A recent case provides an example of claimed lost profits that were found to be "uncertain, hypothetical and entirely speculative." (*Greenwich S.F., LLC v. Wong, **[***635]** supra, 190 Cal.App.4th at p. 743*.) There the plaintiffs sought lost profits for breach of a real property sales agreement. They "presented **[****54]** evidence of lost profits through the testimony of [a] real estate appraiser," who testified about what the property would have been worth had it been developed according to the intended plans and specifications. (*Id. at p. 749*.) The appellate court found the resulting award of $ 600,000 in lost profits to be unsupported. "[T]he occurrence and extent of the projected lost profits were not proven with the requisite *reasonable certainty* in this case." (*Id. at p. 760*.) "The evidence in this case was insufficient to show that [either plaintiff] was an established business or had a track record of successfully developing or redeveloping properties. … [¶] … The existence of plans for a development does not supply substantial evidence that the development is reasonably certain to be built, much less that it is reasonably certain to produce profits." (*Id. at p. 763*.) "The lost profits claim was based on the assumption that [plaintiffs] would have constructed the residence according to the plans and specifications without changes and that the venture would have been profitable. These assumptions were inherently uncertain, contingent, unforeseeable and speculative. The proposed real estate **[****55]** development project here involved numerous variables that made any calculation of lost profits inherently uncertain." (*Id. at p. 766*.)

CA(13)[↑] **(13)** Once again, we add a cautionary note. *HN18*[↑] The lost profit inquiry is always speculative to some degree. Inevitably, there will always be an element of uncertainty. Courts must not be too quick to exclude expert evidence as speculative merely because the expert cannot say with absolute certainty what the profits would have been. Courts must not eviscerate the possibility of recovering lost profits by too broadly defining what is too speculative. A reasonable certainty only is required, not absolute certainty.

C. *Application to This Case*

We now apply these principles to this case. The issue before us is whether the court abused its discretion in excluding the expert testimony, not whether substantial evidence supports a lost profits award. But the substantive law regarding lost profits is relevant to help define the type of matter on which an **[*776]** expert may reasonably rely. For example, as the trial court explained, "While lost profits can be established with the aid of expert testimony, economic and financial data, market surveys and analysis, business records **[****56]** of similar enterprises and the like, the underlying **[**1255]** requirement for each is ' "a substantial similarity between the facts forming the basis of the profit projections and the business opportunity that was destroyed." ' " (Quoting *Kids' Universe v. In2Labs, supra, 95 Cal.App.4th at p. 886*.) But, as the trial court further found, Skorheim's analysis relied "on data that in no way is analogous to Plaintiff."

To the extent that the expert relied on data that is not relevant to the measure of lost profit damages, the trial court acted within its discretion to exclude the testimony because it was not "[b]ased on matter … that is of a type that reasonably may be relied upon by an expert in forming an opinion upon the subject to which his testimony relates … ." (*Evid. Code, § 801, subd. (b)*; see *Westrec Marina Management, Inc. v. Jardine Ins. Brokers Orange County, Inc. (2000) 85 Cal.App.4th 1042, 1050–1051 [102 Cal. Rptr. 2d 673]* [upholding the exclusion of expert testimony due in part to substantive law of **[***636]** lost profits].) Accordingly, although the issue is the admissibility of expert testimony, we will also consider the law of lost profits to the extent it is relevant to that issue.

The trial court did not abuse **[****57]** its discretion in the sense of making a ruling that was irrational or arbitrary. It presided over a lengthy evidentiary hearing and provided a detailed ruling. The Court of Appeal majority identified no specific error in that ruling. As the dissenter in the Court of Appeal stated, "Nothing in the trial judge's reasonable, straightforward and clearly articulated evidentiary ruling bears even a smidgeon of arbitrariness or capriciousness." Indeed, the court could hardly have exercised its discretion more carefully.

The trial court also excluded the expert testimony for proper reasons. It properly found the expert's methodology was too speculative for the evidence to be admissible. The court assumed that Skorheim's market share approach would be appropriate in a proper case. We will do so also. An expert might be able to make reasonably certain lost profit estimates based on a company's share of the overall market. But Skorheim did not base his lost profit estimates on a market share Sargon had ever actually achieved. Instead, he opined that Sargon's market share would have increased spectacularly over time to levels far above anything it had ever reached. He based his lost profit estimates **[****58]** on that hypothetical increased share.

[*777]

Skorheim considered Sargon to be comparable to the "Big Six" dental implant companies rather than the smaller ones that appear to have far more closely resembled it. He admitted that by no objective business metric, such as sales or number of employees, was Sargon in fact comparable to the "Big Six." Instead, he based his comparison solely on his belief that Sargon, like the "Big Six," and unlike the rest, was

innovative, and that innovation was the prime market driver. (He also testified that clinical studies and outreach to general practitioners were market drivers, but he recognized that all dental implant companies used them, thus making them essentially irrelevant for comparison purposes.) But, as the trial court noted, Skorheim's reasoning was circular. He concluded that the "Big Six" were innovative because they were successful, and that the smaller companies (excluding Sargon) were not innovative because they were less successful. In essence, he said that the smaller companies were smaller because they were not innovative. The trial court properly considered this circularity in the reasoning as a basis to exclude the testimony under *Evidence Code section 802*.

Skorheim **[****59]** based his estimates on the belief that the more innovative a company was, the larger the market share it would achieve. Thus, he testified, if Sargon had a level of innovation equal to that of the smallest of the "Big Six," it would have gained only its level of market share. He then testified to gradations of innovation, with each increase in innovation equaling a step up in market share and thus in future profits. However, as the trial court explained, "Implicit in this choice is that there is an evidentiary basis for this ranking; an 'innovativeness' pecking order where, in fact, Nobel Biocare is on top, others follow, with Astra Tech and Dentsply on the bottom. Likewise, there must be an evidentiary basis for degree of difference; evidence that shows not only that Nobel Biocare is more innovative, but, with 20% of the market, it must be twice as 'innovative' as 3i, **[**1256]** in the 10% group, and so on. Otherwise, 'innovativeness' would not track the percentage market share for the findings he proposes the jury make." But **[***637]** Skorheim also agreed that a company with a smaller market share could, in fact, be more innovative than a company with a larger share.

As the trial court further explained, **[****60]** "The only possible evidentiary support for the percentage difference in the pecking order comes from Mr. Skorheim's oft repeated observations of the marketplace. Certain smaller companies, who claimed to have innovative products, were excluded from his 'industry leader' market share list because 'the market' disagreed with their claim of 'innovativeness.' 'The proof is in the pudding,' Mr. Skorheim explained. If their products were truly innovative, they would sell more and thus have larger market shares. [¶] … [¶] To the extent that this ranking of **[*778]** 'innovativeness,' with Nobel Biocare on top with 20%, and Astra Tech on the bottom with 3.75%, rests on the fact that some have larger market shares, it rests on nothing more than a tautology. As there is no evidentiary basis that equates the degree of innovativeness with the degree of difference in market share, the question posed to the jury—to rank innovativeness and assign a market share, the *sine qua non* of Mr. Skorheim's opinion—has no rational basis."

Sargon argues that the cases concerning an *unestablished* company do not apply here because it was an *established* company with a track record of having made a profit. It had, for **[****61]** example, a net profit of $ 101,000 in 1998. But Sargon had no track record of being a global leader, one of the "Big Six." An established company may base its claim to future profits on evidence of its past profits, but Skorheim did not do so. He tried to compare Sargon to the "Big Six," but the companies were not comparable. In *Parlour Enterprises, Inc. v. Kirin Group, Inc. (2007) 152 Cal.App.4th 281 [61 Cal. Rptr. 3d 243]* (*Parlour Enterprises*), a jury gave a small restaurant business called Farrell's a multimillion-dollar lost profit award. The Court of Appeal reversed the award, finding the claim of lost profits was improperly based on speculative expert testimony. The expert in that case had compared the company to "a publicly traded restaurant chain called Friendly's, which he claimed was 'relatively similar to the Farrell's concept.' " (*Id. at p. 290*.) But the Court of Appeal found the two companies not comparable. "Although one way to prove prospective profits is through the experience of comparable businesses, [the expert's] cursory description of Friendly's business model failed to establish its profit-and-loss experience is sufficiently similar to Farrell's to be relevant to the question of plaintiffs' **[****62]** alleged lost profits." (*Ibid*.) The court explained that "[b]efore evidence of similar businesses may be used to prove loss of prospective profits, there must be ' "a substantial similarity between the facts forming the basis of the profit projections and the business opportunity that was destroyed." '" (*Id. at p. 291*.)

This case is like *Parlour Enterprises, supra, 152 Cal.App.4th 281*. Except for Skorheim's belief that, like the "Big Six" and unlike the rest of the smaller companies, Sargon was innovative, Sargon was dissimilar to all of the "Big Six." As the trial court noted, "Sargon is not similar to the industry leaders by any relevant, objective business measure." Skorheim did not base his lost profits estimates on any objective evidence of "past volume of business" or any "other provable data relevant to the probable future sales." (*Grupe v. Glick, supra, 26 Cal.2d at p. 692*.) Instead, as the trial court further **[*779]** noted, Skorheim's lost profit projections were "wildly beyond, by degrees of magnitude, anything Sargon had ever experienced in the past."

[*638]** In finding that the trial court should have admitted Skorheim's testimony, the majority below observed that "exactitude is not required." **[****63]** The observation is correct. If lost profits can be estimated with reasonable certainty, a court may not deny recovery merely because one cannot determine precisely what they would have been. But exactitude is not the problem here. Whether the actual profits

could logically be estimated in the manner Skorheim claimed is the problem. As the trial court noted, a lost profit award of up to $ 1 billion may not be based on pure speculation.

[1257]** The Court of Appeal majority found that the case of *Palm Medical Group, Inc. v. State Comp. Ins. Fund (2008) 161 Cal.App.4th 206 [74 Cal. Rptr. 3d 266]* "is more on point" than *Parlour Enterprises, supra, 152 Cal.App.4th 281*. In *Palm Medical*, a medical clinic sued, claiming it was wrongly denied admission into a preferred provider network. The Court of Appeal upheld a lost profits award. But there the plaintiff's expert based his lost profits estimate on the plaintiff's own profit margin and a comparison to the profits of other clinics that had participated in the preferred provider network from which the plaintiff had been excluded. (*Id. at p. 227*.) As far as the opinion indicates, the plaintiff and the other clinics were, in fact, comparable. The opinion gives no indication **[****64]** the defendant claimed otherwise. Nothing in *Palm Medical* suggests the trial court here abused its discretion in finding Sargon *not* to be comparable to the "Big Six."

Sargon also relies on *Sanchez-Corea v. Bank of America (1985) 38 Cal.3d 892 [215 Cal. Rptr. 679, 701 P.2d 826]*. The trial court considered and aptly distinguished that case: "In *Sanchez-Corea*, the earnings of plaintiff's small company were compared to the earnings of 'other companies, including Honeywell, which occupied the market after [plaintiff's] departure … .' (*Id. at p. 907*.) On appeal, the defendant complained, as does USC, that the comparison was unfair because plaintiff had 'far smaller financial resources.' (*Id. at p. 908*.) [¶] Sargon's reliance is misplaced. The Supreme Court held the evidence supported a $ 1,000,000 compensatory damage award because the damage award was based on Plaintiff's historical growth, as Plaintiff had experienced a 'tenfold growth in contracts (sales) from $ 180,000 in 1970 to $ 1.5 million in 1973.' (*Id. at p. 907*.) In that case, the Plaintiff's expert's projections were based on pre-litigation estimates, which underestimated Plaintiff's actual growth in the year before Defendant's wrongful act and the subsequent lawsuit. **[****65]** The court never discussed the comparison to Honeywell, **[*780]** and this case has never been cited as authority for comparing businesses of any size."

As the trial court also noted, Skorheim's testimony was speculative in other ways as well. He assumed Sargon, which had virtually no marketing or research and development departments, would have developed such departments to permit it to compete with the "Big Six," all of which had large ones. He assumed one of the "Big Six" would fall out of that group, and Sargon would replace it. He assumed the "Big Six" would have taken no steps to contend with their new competitor, Sargon. All of these factors also support the trial court's exclusion of Skorheim's testimony.

Skorheim gave the opinion that, to a "reasonable certainty," Sargon would have become a market leader within 10 years. The quoted term derives from the law of lost profits. We stated in *Grupe v. Glick, **[***639]** supra, 26 Cal.2d at page 693*, that lost profits must be "reasonably certain" to be recoverable. But, as the trial court found, this testimony was inherently speculative. It "involved numerous variables that made any calculation of lost profits inherently uncertain." (*Greenwich S.F., LLC v. Wong, supra, 190 Cal.App.4th at p. 766*.) **[****66]** Skorheim's attempt to predict the future was in no way grounded in the past.

If a professional football team claims lost profits because a certain defensive lineman did not play for it the previous season, could an expert testify that in his opinion the key driver for success in the National Football League is quarterback sacks and, because the player was the best in the league in sacking the quarterback, the team would have won the Super Bowl had he played? Could another expert counter that testimony by expressing her opinion that the key to success is turnovers, and, because the player was not particularly adept at forcing turnovers, the team would not even have made the playoffs with that player? Should the court ask the jury to choose between the two experts? Or could the jury choose something in between and conclude the team would have reached, but lost, the Super Bowl? Or lost in the conference title game?

Similarly, if a first-time author sues a publisher for breach of a contract to publish a **[**1258]** novel, could a witness who was an expert on the publishing business, literature, and popular culture testify that the novel, if published, would have become a national bestseller, won the **[****67]** Pulitzer Prize, and spawned a megahit movie with several blockbuster sequels? Could a jury award lost profits based on that scenario? Or could it compromise by finding the book would have been a bestseller but would not have won the Pulitzer Prize, and would have spawned a moderately successful movie but no sequel?

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CA(14)[↑] **(14)** World history is replete with fascinating "what ifs." What if Alexander the Great had been killed early in his career at the Battle of the Granicus River, as he nearly was? What if the Saxon King Harold had prevailed at Hastings, and William, later called the Conqueror, had died in that battle rather than Harold? What if the series of Chinese overseas discovery expeditions that two Ming Dynasty emperors sponsored, and that reached at least the east coast of Africa by 1432, had continued rather than stopped? Many serious, and not-so-serious, historians have enjoyed

speculating about these what ifs. But few, if any, claim they are considering what *would* have happened rather than what *might* have happened. *HN19*[↑] Because it is inherently difficult to accurately predict the future or to accurately reconstruct a counterfactual past, it is appropriate that trial courts vigilantly exercise **[****68]** their gatekeeping function when deciding whether to admit testimony that purports to prove such claims.

An accountant might be able to determine with reasonable precision what Sargon's profits would have been *if* it had achieved a market share comparable to one of the "Big Six." The problem here, however, is that the expert's testimony provided no logical basis to infer that Sargon *would* have achieved that market share. The lack of sound methodology in the expert's testimony for determining what the future would have brought supported the trial court's ruling.

CA(15)[↑] **(15)** The Court of Appeal majority was concerned that "[t]he trial court's ruling is tantamount to a flat prohibition on lost profits in any case involving a revolutionary breakthrough in an industry." We disagree. Other avenues might exist to show lost profits. An expert could use a **[***640]** company's actual profits, a comparison to the profits of similar companies, or other objective evidence to project lost profits. Sargon itself argues that the record in this case contains evidence of specific lost sales and canceled contracts due to USC's failure to complete the study. Evidence of this kind might support reasonably certain lost profit estimates. **[****69]** [7] The trial court's ruling merely meant Sargon could not obtain a massive verdict based on speculative projections of future spectacular success.

The trial court properly acted as a gatekeeper to exclude speculative expert testimony. Its ruling came within its discretion. The majority in the Court of Appeal erred in concluding otherwise.
[*782]

III. Conclusion

We reverse the judgment of the Court of Appeal and remand the matter to that court for further proceedings consistent with this opinion.

Cantil-Sakauye, C. J., Kennard, J., Baxter, J., Werdegar, J., Corrigan, J., and Liu, J., concurred.

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[7] Sargon notes that the trial court had ruled that at least some of this evidence was insufficient to support a claim of intentional interference with prospective economic advantage. The court found no evidence the lost sales were related to USC's actions or omissions. It is not clear how this ruling would have affected a lost profit claim. What is clear is that the ruling is not before us on appeal. Moreover, even if this type of evidence would not have been sufficient to support a lost profit claim in this case, similar evidence might support such a claim in some other case.

Table1 (*Return to related document text***)**

	Sargon (1998)	**AstraZeneca (1999)**	**Dentsply (1998)**	**Biomet 3i (2000)**	**Nobel**[2] **(1998)**
Employees	< 20	> 55,000	> 6,000	> 4,000	> 1,000
R&D	$ 46,000	$ 2,923,000,000	$ 18,200,000	$ 40,208,000	$ 8,741,808
Net Sales	$ 1,748,612	$ 18,445,000,000	$ 795,122,000	$ 920,582,000	$ 164,747,305
Net Profits	$ 101,113	$ 1,143,000,000	$ 34,825,000	$ 173,771,000	$ 5,868,080
Assets	$ 544,977	$ 19,816,000,000	$ 895,322,000	$ 1,218,448,000	$ 243,621,260
Market Share (2007)[3]	N/A	4.8%	7%	17%	22-23%

Table1 (*Return to related document text***)**

Table2 (*Return to related document text***)**

Market Share	**3.75% (Astra Tech)**	**5% (Dentsply)**	**10% (Biomet 3i)**	**20% (Nobel/Strau.)**
Lost Profits 1998–2009	$ 120,011,000	$ 181,020,949	$ 335,940,541	$ 640,232,628
Value Post 2009	100,473,347	134,343,563	269,824,425	540,786,150
TOTAL:	$ 220,484,347	$ 315,364,512	$ 605,764,968	$ 1,181,018,778

Table2 (*Return to related document text***)**

End of Document

[2] The Court of Appeal explained that these figures were converted from Swedish kroner using the exchange rate in effect in 1998. Nobel Biocare acquired another implant company in 1999, which increased its market share and added products to its portfolio.

[3] The Court of Appeal **[****15]** explained that "Straumann, another comparator company for which there was no data in the record during the relevant period, had attained a 22 percent global market share in 10 years."

OR RULES of CIVIL PROCEDURE
ORCP 36. General provisions governing discovery.

A Discovery methods. Parties may obtain discovery by one or more of the following methods: depositions upon oral examination or written questions; production of documents or things or permission to enter upon land or other property, for inspection and other purposes; physical and mental examinations; and requests for admission.

B Scope of discovery. Unless otherwise limited by order of the court in accordance with these rules, the scope of discovery is as follows:

B(1) **In general.** For all forms of discovery, parties may inquire regarding any matter, not privileged, which is relevant to the claim or defense of the party seeking discovery or to the claim or defense of any other party, including the existence, description, nature, custody, condition, and location of any books, documents, or other tangible things, and the identity and location of persons having knowledge of any discoverable matter. It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.

B(2) **Insurance agreements or policies.**

B(2)(a) A party, upon the request of an adverse party, shall disclose:

B(2)(a)(i) the existence and contents of any insurance agreement or policy under which a person transacting insurance may be liable to satisfy part or all of a judgment which may be entered in the action or to indemnify or reimburse for payments made to satisfy the judgment; and

B(2)(a)(ii) the existence of any coverage denial or reservation of rights, and identify the provisions in any insurance agreement or policy upon which such coverage denial or reservation of rights is based.

B(2)(b) The obligation to disclose under this subsection shall be performed as soon as practicable following the filing of the complaint and the request to disclose. The court may supervise the exercise of disclosure to the extent necessary to insure that it proceeds properly and expeditiously. However, the court may limit the extent of disclosure under this subsection as provided in section C of this rule.

B(2)(c) Information concerning the insurance agreement or policy is not by reason of disclosure admissible in evidence at trial. For purposes of this subsection, an application for insurance shall not be treated as part of an insurance agreement or policy.

B(2)(d) As used in this subsection, “disclose” means to afford the adverse party an opportunity to inspect or copy the insurance agreement or policy.

B(3) **Trial preparation materials.** Subject to the provisions of Rule 44, a party may obtain discovery of documents and tangible things otherwise discoverable under subsection B(1) of this rule and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative (including an attorney, consultant, surety, indemnitor, insurer, or agent) only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of such party's case and is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of such materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.

A party may obtain, without the required showing, a statement concerning the action or its subject matter previously made by that party. Upon request, a person who is not a party may obtain, without the required showing, a statement concerning the action or its subject matter previously made by that person. If the request is refused, the person or party requesting the statement may move for a court order. The provisions of Rule 46 A(4) apply to the award of expenses incurred in relation to the motion. For purposes of this subsection, a statement previously made is (a) a written statement signed or otherwise adopted or approved by the person making it, or (b) a stenographic, mechanical, electrical, or other recording, or a transcription thereof, which is a substantially verbatim recital of an oral statement by the person making it and contemporaneously recorded.

C Court order limiting extent of disclosure. Upon motion by a party or by the person from whom discovery is sought, and for good cause shown, the court in which the action is pending may make any order which justice requires to protect a party or person from annoyance, embarrassment, oppression, or undue burden or expense, including one or more of the following: (1) that the discovery not be had; (2) that the discovery may be had only on specified terms and conditions, including a designation of the time or place; (3) that the discovery may be had only by a method of discovery other than that selected by the party seeking discovery; (4) that certain matters not be inquired into, or that the scope of the discovery be limited to certain matters; (5) that discovery be conducted with no one present except persons designated by the court; (6) that a deposition after being sealed be opened only by order of the court; (7) that a trade secret or other confidential research, development, or commercial information not be disclosed or be disclosed only in a designated way; (8) that the parties simultaneously file specified documents or information enclosed in sealed envelopes to be opened as directed by the court; or (9) that to prevent hardship the party requesting discovery pay to the other party reasonable expenses incurred in attending the deposition or otherwise responding to the request for discovery.

If the motion for a protective order is denied in whole or in part, the court may, on such terms and conditions as are just, order that any party or person provide or permit discovery. The provisions of Rule 46 A(4) apply to the award of expenses incurred in relation to the motion.

OR RULES of CIVIL PROCEDURE
ORCP 44. Physical and mental examination of persons; reports of examinations.

A Order for examination. When the mental or physical condition or the blood relationship of a party, or of an agent, employee, or person in the custody or under the legal control of a party (including the spouse of a party in an action to recover for injury to the spouse), is in controversy, the court may order the party to submit to a physical or mental examination by a physician or a mental examination by a psychologist or to produce for examination the person in such party's custody or legal control. The order may be made only on motion for good cause shown and upon notice to the person to be examined and to all parties and shall specify the time, place, manner, conditions, and scope of the examination and the person or persons by whom it is to be made.

B Report of examining physician or psychologist. If requested by the party against whom an order is made under section A of this rule or the person examined, the party causing the examination to be made shall deliver to the requesting person or party a copy of a detailed report of the examining physician or psychologist setting out such physician's or psychologist's findings, including results of all tests made, diagnoses and conclusions, together with like reports of all earlier examinations of the same condition. After delivery the party causing the examination shall be entitled upon request to receive from the party against whom the order is made a like report of any examination, previously or thereafter made, of the same condition, unless, in the case of a report of examination of a person not a party, the party shows inability to obtain it. This section applies to examinations made by agreement of the parties, unless the agreement expressly provides otherwise.

C Reports of examinations; claims for damages for injuries. In a civil action where a claim is made for damages for injuries to the party or to a person in the custody or under the legal control of a party, upon the request of the party against whom the claim is pending, the claimant shall deliver to the requesting party a copy of all written reports and existing notations of any examinations relating to injuries for which recovery is sought unless the claimant shows inability to comply.

D Report; effect of failure to comply.

D(1) **Preparation of written report.** If an obligation to furnish a report arises under sections B or C of this rule and the examining physician or psychologist has not made a written report, the party who is obliged to furnish the report shall request that the examining physician or psychologist prepare a written report of the examination, and the party requesting such report shall pay the reasonable costs and expenses, including the examiner's fee, necessary to prepare such a report.

D(2) **Failure to comply or make report or request report.** If a party fails to comply with sections B and C of this rule, or if a physician or psychologist fails or refuses to make a detailed report within a reasonable time, or if a party fails to request that the examining physician or psychologist prepare a written report within a reasonable time, the court may require the physician or psychologist to appear for a deposition or may exclude the physician's or psychologist's testimony if offered at the trial.

E Access to individually identifiable health information. Any party against whom a civil action is filed for compensation or damages for injuries may obtain copies of individually identifiable health information as defined in Rule 55 H within the scope of discovery under Rule 36 B. Individually identifiable health information may be obtained by written patient authorization, by an order of the court, or by subpoena in accordance with Rule 55 H.

OR RULES of CIVIL PROCEDURE
ORCP 47. Summary judgment.

A For claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move, with or without supporting affidavits or declarations, for a summary judgment in that party's favor upon all or any part thereof.

B For defending party. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move, with or without supporting affidavits or declarations, for a summary judgment in that party's favor as to all or any part thereof.

C Motion and proceedings thereon. The motion and all supporting documents shall be served and filed at least 60 days before the date set for trial. The adverse party shall have 20 days in which to serve and file opposing affidavits or declarations and supporting documents. The moving party shall have five days to reply. The court shall have discretion to modify these stated times. The court shall grant the motion if the pleadings, depositions, affidavits, declarations and admissions on file show that there is no genuine issue as to any material fact and that the moving party is entitled to prevail as a matter of law. No genuine issue as to a material fact exists if, based upon the record before the court viewed in a manner most favorable to the adverse party, no objectively reasonable juror could return a verdict for the adverse party on the matter that is the subject of the motion for summary judgment. The adverse party has the burden of producing evidence on any issue raised in the motion as to which the adverse party would have the burden of persuasion at trial. The adverse party may satisfy the burden of producing evidence with an affidavit or a declaration under section E of this rule. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

D Form of affidavits and declarations; defense required. Except as provided by section E of this rule, supporting and opposing affidavits and declarations shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant or declarant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit or a declaration shall be attached thereto or served therewith. The court may permit affidavits or declarations to be supplemented or opposed by depositions or further affidavits or declarations. When a motion for summary judgment is made and supported as provided in this rule an adverse party may not rest upon the mere allegations or denials of that party's pleading, but the adverse party's response, by affidavits, declarations or as otherwise provided in this section, must set forth specific facts showing that there is a genuine issue as to any material fact for trial. If the adverse party does not so respond, the court shall grant the motion if appropriate.

E Affidavit or declaration of attorney when expert opinion required. Motions under this rule are not designed to be used as discovery devices to obtain the names of potential expert witnesses or to obtain their facts or opinions. If a party, in opposing a motion for summary judgment, is required to provide the opinion of an expert to establish a genuine issue of material

fact, an affidavit or a declaration of the party's attorney stating that an unnamed qualified expert has been retained who is available and willing to testify to admissible facts or opinions creating a question of fact, will be deemed sufficient to controvert the allegations of the moving party and an adequate basis for the court to deny the motion. The affidavit or declaration shall be made in good faith based on admissible facts or opinions obtained from a qualified expert who has actually been retained by the attorney who is available and willing to testify and who has actually rendered an opinion or provided facts which, if revealed by affidavit or declaration, would be a sufficient basis for denying the motion for summary judgment.

F When affidavits or declarations are unavailable. Should it appear from the affidavits or declarations of a party opposing the motion that such party cannot, for reasons stated, present by affidavit or declaration facts essential to justify the opposition of that party, the court may deny the motion or may order a continuance to permit affidavits or declarations to be obtained or depositions to be taken or discovery to be had, or may make such other order as is just.

G Affidavits or declarations made in bad faith. Should it appear to the satisfaction of the court at any time that any of the affidavits or declarations presented pursuant to this rule are presented in bad faith or solely for the purpose of delay, the court shall forthwith order the party employing them to pay to the other party the amount of the reasonable expenses which the filing of the affidavits or declarations caused the other party to incur, including reasonable attorney fees, and any offending party or attorney may be subject to sanctions for contempt.

H Multiple parties or claims; limited judgment. If the court grants summary judgment for less than all parties and claims in an action, a limited judgment may be entered if the court makes the determination required by Rule 67 B.

O.R.S. § 40.190. Rule 408. Compromise and offers to compromise

(1)(a) Evidence of furnishing or offering or promising to furnish, or accepting or offering or promising to accept, a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability for or invalidity of the claim or its amount.

(b) Evidence of conduct or statements made in compromise negotiations is likewise not admissible.

(2)(a) Subsection (1) of this section does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations.

(b) Subsection (1) of this section also does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution. [1981 c.892 §28]

O.R.S § 701.565 Notice of defect requirement; contents; mailing

(1) Except as provided in ORS 701.600, an owner may not compel arbitration or commence a court action against a contractor, subcontractor or supplier to assert a claim arising out of or related to any defect in the construction, alteration or repair of a residence or in any system, component or material incorporated into a residence located in this state unless the owner has sent that contractor, subcontractor or supplier a notice of defect as provided in this section and has complied with ORS 701.575.

(2) An owner must send a notice of defect by registered or certified mail, return receipt requested. If a notice of defect is sent to a contractor or subcontractor, the owner must send the notice to the last known address for the contractor or subcontractor as shown in the records of the Construction Contractors Board. If a notice of defect is sent to a supplier, the owner must send the notice to the Oregon business address of the supplier or, if none, to the registered agent of the supplier.

(3) A notice of defect sent by an owner must include:

(a) The name and mailing address of the owner or the owner's legal representative, if any;

(b) A statement that the owner may seek to compel arbitration or bring a court action against the contractor, subcontractor or supplier;

(c) The address and location of the affected residence;

(d) A description of:

(A) Each defect;

(B) The remediation the owner believes is necessary; and

(C) Any incidental damage not curable by remediation as described in subparagraph (B) of this paragraph; and

(e) Any report or other document evidencing the existence of the defects and any incidental damage. [2003 c.660 §2; 2011 c.268 §1]

O.R.S. § 40.225. Rule 503. Lawyer-client privilege.

(1) As used in this section, unless the context requires otherwise:

(a) "Client" means:

(A) A person, public officer, corporation, association or other organization or entity, either public or private, who is rendered professional legal services by a lawyer, or who consults a lawyer with a view to obtaining professional legal services from the lawyer.

(B) A person, public officer, corporation, association or other organization or entity, either public or private, who consults a lawyer referral service with a view to obtaining professional legal services from a lawyer.

(b) "Confidential communication" means a communication not intended to be disclosed to third persons other than those to whom disclosure is in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication.

(c) "Lawyer" means a person authorized, or reasonably believed by the client to be authorized, to practice law in any state or nation.

(d) "Lawyer referral service" means an entity that, as a regular part of its business, refers potential clients to lawyers, including but not limited to a public nonprofit entity sponsored or operated by the Oregon State Bar.

(e) "Representative of the client" means:

(A) A principal, an officer or a director of the client; or

(B) A person who has authority to obtain professional legal services, or to act on legal advice rendered, on behalf of the client, or a person who, for the purpose of effectuating legal representation for the client, makes or receives a confidential communication while acting in the person's scope of employment for the client.

(f) "Representative of the lawyer" means one employed to assist the lawyer in the rendition of professional legal services, but does not include a physician making a physical or mental examination under ORCP 44.

(2) A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client:

(a) Between the client or the client's representative and the client's lawyer or a representative of the lawyer;

(b) Between the client's lawyer and the lawyer's representative or the client's lawyer referral service;

(c) By the client or the client's lawyer to a lawyer representing another in a matter of common interest;

(d) Between representatives of the client or between the client and a representative of the client; or

(e) Between lawyers representing the client.; or

(f) Between the client or a representative of the client and a lawyer referral service.

(3) The privilege created by this section may be claimed by the client, a guardian or conservator of the client, the personal representative of a deceased client, or the successor, trustee, or similar representative of a corporation, association, or other organization, whether or not in existence. The person who was the lawyer or lawyer referral service or the lawyer's representative at the time of the communication is presumed to have authority to claim the privilege but only on behalf of the client.

(4) There is no privilege under this section:

(a) If the services of the lawyer or lawyer referral service were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or reasonably should have known to be a crime or fraud;

(b) As to a communication relevant to an issue between parties who claim through the same deceased client, regardless of whether the claims are by testate or intestate succession or by inter vivos transaction;

(c) As to a communication relevant to an issue of breach of duty by the lawyer or lawyer referral service to the client or by the client to the lawyer or lawyer referral service;

(d) As to a communication relevant to an issue concerning an attested document to which the lawyer or lawyer referral service is an attesting witness; or

(e) As to a communication relevant to a matter of common interest between two or more clients if the communication was made by any of them to a lawyer retained or consulted in common, when offered in an action between any of the clients.

(5) Notwithstanding ORS 40.280, a privilege is maintained under this section for a communication made to the office of public defense services established under ORS 151.216 for the purpose of seeking preauthorization for or payment of nonroutine fees or expenses under ORS 135.055.

(6) Notwithstanding subsection (4)(c) of this section and ORS 40.280, a privilege is maintained under this section for a communication that is made to the office of public defense services established under ORS 151.216 for the purpose of making, or providing information regarding, a complaint against a lawyer providing public defense services.

(7) Notwithstanding ORS 40.280, a privilege is maintained under this section for a communication ordered to be disclosed under ORS 192.311 to 192.478.

336 Or. 392
Supreme Court of Oregon,
En Banc.

Gary Todd STEVENS, Petitioner–Relator,
v.
Stan CZERNIAK, Superintendent of Oregon State Penitentiary, Defendant Adverse Party.

CC 99C20086; SC S50103.
|
Argued and Submitted Nov. 7, 2003.
|
Decided Feb. 5, 2004.

Synopsis

Background: Prisoner filed action for post-conviction relief, alleging trial counsel had been constitutionally inadequate. The Circuit Court, Marion County, Dennis Graves, J., ordered pretrial disclosure of prisoner's expert witnesses' names and testimony. Prisoner petitioned for writ of mandamus.

[Holding:] The Supreme Court, Kistler, J., held that trial court lacked statutory authority to require disclosure of names of prisoner's expert witnesses' and their testimony.

Writ issued.

****140** Original proceeding in mandamas. [*]

Attorneys and Law Firms

***393** Kenneth Lerner, Portland, argued the cause and filed the briefs for petitioner-relator.

****141** Timothy A. Sylwester, Assistant Attorney General, Salem, argued the cause for defendant-adverse party. With him on the brief were Hardy Myers, Attorney General, and Mary H. Williams, Solicitor General.

Marc Sussman, P.C., Portland, filed the brief for amicus curiae Oregon Criminal Defense Lawyers Association.

David Sugerman, Paul and Sugerman, P.C., Portland, filed the brief for amicus curiae Oregon Trial Lawyers Association.

Opinion

***394** KISTLER, J.

This mandamus case arises out of a post-conviction proceeding. Petitioner (the relator in the mandamus case) contends that the trial court impermissibly required him to rely on written submissions to prove his case and to provide pretrial disclosure of his expert witnesses' names and testimony. We conclude that the premise of petitioner's first objection—that the court required him to prove his case by written submissions—is not well taken. We agree, however, that the court lacked authority to order pretrial disclosure of petitioner's expert witnesses' names and testimony. We conclude that a peremptory writ should issue directing the trial court to delete or modify that portion of its order.

Although this litigation has a lengthy history, the dispute that gives rise to this mandamus proceeding can be summarized fairly simply. Petitioner filed a petition for post-conviction relief alleging that his trial counsel had been constitutionally inadequate. In an effort to make the hearing more efficient, the trial court limited the parties' ability to call witnesses at the hearing. The court directed the parties to submit their evidence in written form unless an assessment of a witness's credibility was necessary to resolve a factual dispute. Petitioner objected, explaining that his post-conviction case involved complex factual issues that should be explored through in-court testimony rather than written submissions. He also argued that the court's order impermissibly required pretrial disclosure of his expert witnesses' names and testimony. [1]

To clarify its ruling, the trial court entered a trial management order and later an amended trial management order. After the trial court entered the amended trial management order, petitioner asked this court to issue an alternative writ of mandamus. Specifically, petitioner sought relief from the rulings in the amended trial management ***395** order that (1) "compell[ed] pretrial disclosure of attorney-client privileged information in the form of affidavits of expert witnesses' opinions and required deposition testimony"; (2) directed that "the record [be] held open after the trial date to permit Defendant–Adverse Party additional time in which to take further depositions and produce responsive evidence"; and (3) "refus[ed] Petitioner–

Relator the right to present relevant live expert witness testimony at his post-conviction hearing."

This court issued an alternative writ of mandamus directing the trial court "to vacate the Amended Trial Management Order of December 2, 2002, and enter a trial management order consistent with the relief sought in the petition, or in the alternative to show cause for not doing so." In response to the alternative writ, the trial court issued a second amended trial management order. In a cover letter to counsel, the court stated that it believed that the second amended trial management order "is consistent with the relief sought in the Petition for Alternative Writ of Mandamus."

The second amended trial management order begins by reciting a series of findings. The fifth finding provides that, "[w]here a specific credibility question exists between two witnesses on a factual matter, live testimony will be allowed." The order then states in part:

> "1. Petitioner's Motion for Reconsideration is granted in part. The findings and Orders announced on August 14, 2002 and ****142** on November 6, 2002 are clarified and supplemented as indicated herein.
>
> " * * * * *
>
> "3. The parties are ordered within 21 days to supply the court with the names of the witnesses to be called at trial. Counsel shall summarize the substance of each witness' expected testimony with an explanation of how that testimony relates to the issues raised by the pleadings. The summary will be used by the court in working with the parties to make a determination whether the witness should appear and testify in person, or whether a stipulation of counsel as to the witness' testimony can be achieved, or an affidavit of the witness would be sufficient.
>
> ***396** "4. Prior to trial, opposing counsel may depose any witness who has provided an affidavit, and so perpetuate the witness' cross-examination for the consideration of the court at the post conviction trial. As in any other case, the court may order that the record be left open at the conclusion of trial for the receipt of additional evidence in the event of any unexpected or surprise witness.
>
> " * * * * *
>
> "7. At trial, testimony shall be presented in the form of affidavits, deposition testimony and live testimony as described herein, except as expressly provided otherwise by further order of this court, and upon good cause shown."

The trial court also issued an order vacating the amended trial management order and replacing it with the second amended trial management order.

Although the trial court thought that the second amended trial management order complied with the alternative writ, petitioner argues that it does not do so. He raises two objections to the order. First, he contends that the order impermissibly limits his right to call live witnesses. He argues that, under the terms of the order, he can call live witnesses only if an assessment of the witness's credibility is necessary to resolve a disputed issue of material fact. Second, petitioner argues that the second amended trial management order impermissibly requires pretrial disclosure of his expert witnesses' names and testimony. [2]

We begin with petitioner's first objection. Paragraph 3 of the second amended trial management order sets out a process for the court and counsel to follow in determining the form in which the parties will submit their evidence. That paragraph directs counsel to "summarize the substance of each witness' expected testimony with an explanation of how that testimony relates to the issues raised by the pleadings." The paragraph then provides that the summaries "will be ***397** used by the court in working with the parties to make a determination whether the witness should appear and testify in person, or whether a stipulation of counsel as to the witness' testimony can be achieved, or an affidavit of the witness would be sufficient."

Having considered the terms of the second amended trial management order, we conclude that it does not have the effect that petitioner perceives. Paragraph 3 describes a general process by which the court and the parties will work together to identify which testimony the parties will present through live witnesses, by stipulation, and in writing. Unlike the trial court's earlier orders, the terms of the second amended trial management order leave the result of that process open.

Petitioner argues, however, that we should read the order in light of the findings that precede it. As noted, one finding states that, "[w]here a specific credibility question exists between two witnesses on a factual matter, live testimony will be allowed." Given that finding, petitioner argues that the apparently open-ended process described in paragraph 3 will lead ineluctably to one conclusion: He may not call a witness to testify unless the **143 witness's credibility bears on a disputed factual issue. Petitioner reads too much into the court's finding. That finding states one circumstance in which the court *will* allow live testimony; it does not exhaust those circumstances. Given the wording of the second amended trial management order, [3] we decline to assume that the trial court will permit live testimony only in the one circumstance that it mentioned.

Petitioner also argues that we should read paragraph 3 in light of earlier statements that the court made. Those statements make clear, he contends, that the court will allow witnesses to testify only in very limited circumstances. The terms of the written order, however, control over the *398 court's earlier statements. *See State v. Swain/Goldsmith,* 267 Or. 527, 530, 517 P.2d 684 (1974) (stating principle). Moreover, the court entered the second amended trial management order in response to the alternative writ and in the stated belief that the order complied with the writ. Even if we were to consider the order's context, we cannot ignore the fact that the second amended trial management order reflects the court's stated intent to provide petitioner with the relief that he sought in the alternative writ. [4]

In short, the second amended trial management order leaves the trial court with discretion to determine the form in which the parties will submit "each witness['s]" testimony; it does not predetermine how the court will exercise its discretion. We assume that, consistently with paragraph 3 of the second amended trial management order, the trial court will not impose the blanket limitation on calling live witnesses that the amended trial management order did. We also assume that the trial court will exercise sound discretion in implementing the second amended trial management order to ensure that the parties have a full and fair opportunity to present their evidence. At this point in the process, we cannot say that this aspect of the second amended trial management order is unlawful. [5]

Petitioner challenges a second aspect of the second amended trial management order. He contends that the order impermissibly requires pretrial disclosure of the identity of his expert witnesses and the substance of their testimony. Defendant does not contend that the trial court may require that disclosure; rather, he argues that the order does not have that effect. We begin with the terms of the order and *399 then turn to the question whether the court had authority to enter it.

As noted, the second amended trial management order requires both parties, in advance of trial, to supply the court with the names of the witnesses to be called at trial, to summarize the substance of "each witness' expected testimony," and to explain how that testimony relates to the issues raised by the pleadings. It then provides that the court and the parties will work together to determine the form that the evidence will take. The second amended trial management order contains no exception for expert witnesses; it requires the parties to disclose the names and a summary of the testimony of "each witnes[s]" that they expect to call. [6]

**144 By its terms, the second amended trial management order requires pretrial disclosure of petitioner's experts' names and the substance of their testimony. Defendant argues, however, that the second amended trial management order "expressly incorporates the 'findings and orders' contained" in the amended trial management order. Specifically, defendant contends that a paragraph in the amended trial management order that treated expert witnesses differently [7] remains in effect, and he argues that that paragraph cures the defect that petitioner identifies. Defendant misperceives what the second amended trial management order says.

Paragraph 1 of the second amended trial management order states: "The findings and Orders announced on August 14, 2002 and on November 6, 2002 are clarified and supplemented as indicated herein." The trial court announced its findings orally during a hearing on August 14, *400 2002, and issued a letter to the parties on November 6, 2002. The trial court did not issue the amended trial management order until December 2, 2002. The second amended trial management order does not refer to, much less incorporate, the terms of the amended

trial management order.[8] Rather, the trial court entered an order vacating the amended trial management order.

Because the second amended trial management order requires pretrial disclosure of petitioner's experts' names and the substance of their testimony, we turn to the question whether Oregon law authorized the trial court to require petitioner to disclose that information in advance of trial. Petitioner contends, and defendant does not dispute, that the trial court lacked authority to do so. For the reasons set out below, we agree.

[1] **[2]** We note, as a threshold matter, that the Oregon Rules of Civil Procedure apply to post-conviction proceedings. *Mueller v. Benning,* 314 Or. 615, 621 & n. 6, 841 P.2d 640 (1992). We also note that, in a civil action, a party has no obligation to disclose information to another party in advance of trial unless the rules of civil procedure or some other source of law requires the disclosure. *See State ex rel Union Pacific Railroad v. Crookham,* 295 Or. 66, 68–69, 663 P.2d 763 (1983) (stating principle). We accordingly turn to the question whether the rules of civil procedure require pretrial disclosure of an expert's name and the substance of the expert's testimony.

Both petitioner and *amicus* Oregon Trial Lawyers Association focus on ORCP 36, and we begin with the text and context of that rule. *See Pamplin v. Victoria,* 319 Or. 429, 433, 877 P.2d 1196 (1994) (applying statutory construction methodology to rules of civil procedure). Petitioner notes that, although the text of ORCP 36 does not address expert discovery specifically, one subsection of the rule bears on that ***401** issue. That subsection defines the scope of discovery and provides that, "[f]or all forms of discovery, parties may inquire regarding any matter, not privileged, which is relevant to the claim or defense of the party seeking discovery or the claim or defense of any other party." ORCP 36 B(1).

It may be that the text of that subsection, if read in isolation, could be interpreted to permit expert discovery if it is (1) relevant and (2) not privileged. As the court has reiterated, however, text should not be read in isolation but must be considered in context. ****145** *State v. Barrett,* 331 Or. 27, 32, 10 P.3d 901 (2000); *PGE v. Bureau of Labor and Industries,* 317 Or. 606, 610–11, 859 P.2d 1143 (1993). In this case, the context cuts in a different direction.

[3] **[4]** Context includes other provisions of the same statute, the session laws, and related statutes. *Owens v. Maass,* 323 Or. 430, 434, 918 P.2d 808 (1996); *PGE,* 317 Or. at 611, 859 P.2d 1143. It also includes "the preexisting common law and the statutory framework within which the law was enacted." *Denton and Denton,* 326 Or. 236, 241, 951 P.2d 693 (1998). In interpreting the rules of civil procedure, context may include the federal counterparts of the Oregon rules. *See Pamplin,* 319 Or. at 433, 877 P.2d 1196 (considering, at first level of analysis, United States Supreme Court cases interpreting federal rule on which Oregon based its rule).

A related statute and the session laws combine to provide relevant context. ORS 1.735(1) directs the Council on Court Procedures to promulgate rules of civil procedure. It then provides that those rules "shall be submitted to the Legislative Assembly at the beginning of each regular legislative session" and "shall go into effect on January 1 following the close of that session" unless the legislature, "by statute, amend[s], repeal[s] or supplement[s]" them. ORS 1.735(1). In this instance, the session laws reveal that the 1979 Legislative Assembly enacted a statute to amend ORCP 36. *See* Or. Laws 1979, ch. 284, § 23 (amending ORCP 36 by deleting ORCP 36 B(4)).[9] Specifically, the legislature passed a statute ***402** deleting ORCP 36 B(4). *Id.* Had the legislat.ure not acted, ORCP 36 B(4) would have gone into effect and would have required a party to disclose, upon request, "the name and address of any person [that the] party reasonably expects to call as an expert witness at trial and the subject matter upon which the expert is expected to testify." *Id.* At a minimum, this legislative action undercuts the suggestion that the phrase "any matter" in ORCP 36 B(1) necessarily includes expert witnesses. *See State ex rel Juv. Dept. v. Ashley,* 312 Or. 169, 179, 818 P.2d 1270 (1991) (explaining that legislature's decision to amend proposed evidence rule by deleting "drug addiction" from "mental or emotional condition" differs from situation in which legislature fails to adopt proposed amendment).[10]

Another contextual clue points in the same direction. ORCP 36 essentially tracks FRCP 26(b), with one major exception. *Compare* ORCP 36 *with* FRCP 26(b); *see* Fredric R. Merrill, *Oregon Rules of Civil Procedure 1992 Handbook* 97 (staff comment) (explaining that council generally modeled ORCP 36 on FRCP 26(b)). FRCP 26(b)(1) defines the "scope of discovery" in much the

same terms as ORCP 36 B(1).[11] FRCP 26(b)(4) then specifically authorizes expert discovery. Although ORCP 36 and FRCP 26(b) contain similar definitions of the scope of discovery, ORCP 36 omits the specific authorization for expert discovery that FRCP 26(b) includes. The presence of a specific provision authorizing expert discovery in FRCP 26 and the omission of a similar provision in ORCP 36 suggest that Oregon intended to depart from the federal model and not authorize expert discovery.

***403** Although it appears that the legislature deleted ORCP 36 B(4) because it disagreed with the Council on Court Procedures's decision ****146** to authorize expert discovery, another inference is possible. The legislature could have concluded that specific authorization for expert discovery was unnecessary in light of ORCP 36 B(1), which provides for discovery of any relevant matter that is not privileged. The latter inference is a weak one, however. We assume that, if the legislature had intended to depart from Oregon's longstanding practice of not allowing expert discovery, it would have said so specifically. We cannot, however, discount the latter inference completely and look to the legislative history to determine the legislature's intent. *See PGE,* 317 Or. at 611–12, 859 P.2d 1143 (explaining when courts may look to legislative history).[12]

As noted, the Council on Court Procedures promulgated a rule authorizing expert discovery. Council on Court Procedures, Proposed Rules of Civil Procedure 94 (Nov. 24, 1978). Fredric Merrill, the council's executive director, had explained to the council that initially the federal rules lacked a section that specifically addressed expert discovery. Fredric Merrill, Memorandum on the Discovery of Experts 1–3, Council on Court Procedures (1978).[13] The resulting federal decisions on that issue had been varied, if not inconsistent, and the federal government had resolved that inconsistency by adding FRCP 26(b)(4). *Id.* After considerable debate, a divided council agreed to adopt a variation of FRCP 26(b)(4). Minutes, Council on Court Procedures (Apr 1, 1978). ORCP 36 B(4), as finally promulgated by the council, required the parties, upon request, to disclose their experts' names and addresses and the subject matter upon which the parties ***404** expected their experts to testify. Council on Court Procedures, Proposed Rules of Civil Procedure 94 (Nov. 24, 1978).

Consistently with ORS 1.735(1), the council submitted that and other procedural rules to the legislature. Or. Laws 1979, ch. 284. Before the legislature, Frank Pozzi appeared on behalf of the council members who had opposed permitting expert discovery. Minutes, Joint House–Senate Committee on the Judiciary, HB 3131, Feb. 6, 1979, 7. He focused on the increased costs that expert discovery brings and on the peer pressure against testifying that can occur when a party discloses his or her expert's name. *Id.* at 9; Minutes, Joint House–Senate Committee on the Judiciary, HB 3131, Apr. 5, 1979, 10. Pozzi reasoned that the current system, which he described as not permitting expert discovery, was an efficient and fair way to try civil cases. *Id.* Garr King testified on behalf of the committee members who had supported expert discovery; he maintained that disclosure allows the parties to prepare their cases more thoroughly. Minutes, Joint House–Senate Committee on the Judiciary, HB 3131, Mar. 8, 1979, 1. After both sides explored that debate over several hearings, a majority of the joint committee found the opponents' arguments persuasive and voted to delete the section authorizing expert discovery. Minutes, Joint House–Senate Committee on the Judiciary, HB 3131, Apr. 5, 1979, 11.

Consistently with ORS 1.735(1), the bill, as it came out of the joint committee, affirmatively deleted ORCP 36 B(4), and a majority in both houses voted in favor of the bill. Or. Laws 1979, ch 284, § 23. The debates surrounding the bill reveal that the legislature neither understood nor intended that ORCP 36 B(1) would authorize discovery of nonprivileged expert testimony. Rather, in deleting ORCP 36 B(4), the legislature made a policy choice to continue the practice of not authorizing ****147** expert discovery in civil actions in state courts.

[5] Having considered the text, context, and legislative history of ORCP 36, we agree with petitioner that the legislature did not intend to authorize pretrial disclosure of either an expert's name or the substance of the expert's testimony. Without a specific provision authorizing expert discovery, the ***405** trial court lacked authority to require the parties to disclose that information in advance of trial. *State ex rel Union Pacific Railroad v. Crookham,* 295 Or. at 68–69, 663 P.2d 763. A peremptory writ shall issue directing the trial court to correct that aspect of the second amended trial management order.

Peremptory writ to issue.

All Citations

336 Or. 392, 84 P.3d 140

Footnotes

* On petition for a writ of mandamus from an order of Marion County Circuit Court, Dennis Graves, Judge.

1 Petitioner's counsel told the trial court that he intended to offer expert testimony on three issues: (1) the adequacy of petitioner's legal representation below; (2) whether the conduct of prior counsel conformed to bar disciplinary rules and ethical requirements; and (3) battered women's syndrome.

2 Petitioner raises another issue in his opening brief. He asks us to order that the trial judge recuse himself. That separate issue is not fairly within the scope of the alternative writ. *See State ex rel Kashmir Corp. v. Schmidt,* 291 Or. 603, 606 n. 1, 633 P.2d 791 (1981) (stating that alternative writ functions as complaint). Neither is it a matter that fairly can be said to lie within the expected relief from the matters that are within the scope of the writ. Therefore, we do not address it.

3 The amended trial management order contained the following finding: "Where a specific credibility question exists between two witnesses on a factual matter, live testimony will be allowed. *Otherwise, testimony will be by deposition and affidavit.*" (Emphasis added.) The finding in the second amended trial management order omits the underscored sentence, supporting the conclusion that the trial court will allow live testimony in other circumstances.

4 We also note that, in entering the amended trial management order, the trial court agreed with defendant that ORS 138.580 authorized it to require petitioner to submit his evidence solely in written form unless a disputed factual issue turned on a witness's credibility. Defendant now acknowledges that neither ORS 138.580 nor ORS 138.620(2) gives a trial court authority to tell the parties how to present their evidence.

5 We recognize that the trial court may deny petitioner the right to call some of his witnesses to testify. We also recognize that, depending on the circumstances, such rulings may be erroneous. At this juncture, however, it would be premature to speculate on what the court's specific rulings will be or whether the circumstances will justify them. If the court errs, appeal remains an important avenue for resolving any remaining or nascent issues.

6 Paragraph 4 of the order provides that "the court may order that the record be left open at the conclusion of the trial for the receipt of additional evidence in the event of an unexpected or surprise witness." Petitioner's expert witnesses, however, are neither unexpected nor a surprise.

7 Paragraph 4 of the amended trial management order provided:

> "Prior to trial, counsel shall exchange the affidavits of witnesses. Affidavits shall be exchanged at such time as the parties and the Court mutually agree. In the event that counsel chooses not to exchange the identity and affidavits of expert witnesses in advance of trial, the trial record may be left open to allow the opposing party to rebut the experts' testimony. Rebuttal testimony will be in the form of deposition and affidavit unless the parties and the Court agree otherwise."

8 In its November 6, 2002, letter, the trial court recognized that it could not require petitioner to disclose his expert witnesses in advance of trial. The terms of the second amended trial management order are inconsistent with that recognition, however, and we are left with the terms of the order. *See Swain/Goldsmith,* 267 Or. at 530, 517 P.2d 684 (stating principle).

9 Section 6 of the act notes that, in amending the Oregon Rules of Civil Procedure, "matter in italic and bracketed i[s] existing matter to be deleted." Or. Laws 1979, ch. 284, § 6. Section 23 of the act then sets out ORCP 36 B(4) in italics and brackets. Or. Laws 1979, ch. 284, § 23.

10 Ordinarily, the legislature's failure to enact legislation does not provide persuasive evidence of its intent. *See Red Lion Broadcasting Co. v. FCC,* 395 U.S. 367, 381–82 n. 11, 89 S.Ct. 1794, 23 L.Ed.2d 371 (1969) (observing that "unsuccessful attempts at legislation are not the best guides to legislative intent"); *Berry v. Branner,* 245 Or. 307, 311, 421 P.2d 996 (1966) (same). This is not a case, however, in which the legislature failed to act. Rather, it is a case in which the legislature passed a law deleting a subsection of ORCP 36 that, had the legislature not acted, would have gone into effect. The legislature's action and the reasons for it thus provide valuable evidence of the legislature's intent. *See Ashley,* 312 Or. at 179, 818 P.2d 1270 (recognizing principle).

11 FRCP 26(b)(1) provides that the "[p]arties may obtain discovery regarding any matter, not privileged, that is relevant to the claim or defense of any party."

12 Because we conclude that the text and context of ORCP 36 are sufficiently ambiguous to look to the legislative history, we need not decide whether the 2001 amendments to ORS 174.020 apply to this mandamus proceeding. *See* Or. Laws

2001, ch. 438, § 1 (directing court to "give the weight to the legislative history that the court considers to be appropriate"). Those amendments apply only to "actions commenced on or after" the act's effective date. Or. Laws 2001, ch. 437, § 2. More specifically, we need not decide whether the term "action" refers in this case to the underlying post-conviction action, which began before the act's effective date, or the mandamus proceeding, which began after it.

13 The memorandum is not dated. It appears, however, to have been submitted to the council sometime after February 18, 1978. *See* Minutes, Council on Court Procedures (Feb. 18, 1978) (deferring motion to reject proposed rule permitting expert discovery until Merrill had had a chance to research issue).

Section 11.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th, and 18th, 2018

Grand Ballroom

Thursday, May 17th 2018
4:00 PM – 5:00 PM

Course Title:
Claims Managers Speak - A Retrospective & Prospective Discussion

Rachel Ehrlich, Esq., Karen Rice, Todd Schweitzer,
Linda Tonkovich, Steve Lokus, and Phyllis Modlin

Claims Managers Speak
West Coast Casualty 2018

Things to know about insurance claims management that will help you regardless of what role you play in a construction defect matter (claim, repair notice, lawsuit, or other dispute).

Once a construction defect matter is initiated the property owners, plaintiff attorneys, defense attorneys, insurance claims people, insurance coverage attorneys, experts, and other service providers should have a common goal, resolve the matter as expeditiously as possible. Expectations and views of those in claims management influence the perspectives of the claims professionals which in turn can drive the funding of the entire matter.

While we could look at the inner workings of insurance companies and the insurance industry that influence the views of claims managers, it seems more useful to the West Coast Casualty Seminar audience to draw attention to a couple of things that affect claims management views upon which much of the WCC Seminar goers can actually act upon. For this reason, the readers' attention is drawn to several pieces that provide readily accessible information on certain topics. Even when these articles are referencing auto claims or other non-construction defect subjects the core subject is translatable/transferrable to construction defect.

Insurance Company Reserves: *"Don't Miss Your Golden Opportunity to Help the Insurer Set an Appropriate Reserve"* by Travis Hse, James Publishing, September 10, 2014 https://jamespublishing.com/2014/dont-miss-golden-opportunity-help-insurer-set-appropriate-reserve/ This article assumes a personal injury claim but the principles are the same, provide information that insurance professionals need to evaluate coverage, liability, and damages allows them to have needed internal communications and set reserves timely. Providing the information in a straightforward and easily accessible format is the shortest distance between initiation of the construction defect matter and resolution.

Relationship With Lawyers: *"An inside job: Becoming a valued strategic business partner"* by Susan Hackett, Legal Solutions USA Thomson Reuters, August 2015 https://legalsolutions.thomsonreuters.com/law-products/news-views/corporate-counsel/an-inside-job-becoming-a-valued-strategic-business-partner *"Insurers need to stop seeing lawyers as the enemy – expert"* by Sam Boyer, Insurance Business America April 10, 2017 https://www.insurancebusinessmag.com/us/news/breaking-news/insurers-need-to-stop-seeing-lawyers-as-the-enemy--expert-64841.aspx Insurance companies seem to have a complicated relationship with lawyers and this somewhat depends on the category of lawyer. What these two articles posit is that lawyers hired by insurance companies can be partners of the insurance company in solving the problems faced by the companies in resolving claims. What plaintiff attorneys, experts, and others can do is keep these issues in mind when working with the lawyers hired by insurance companies so that when in the settlement set up phase of a matter the lawyers hired by the insurance companies are well set up to be partners with the insurance company in resolving the matter. This is not to suggest that plaintiff attorneys should

give up strategy and other information that would put their clients at a disadvantage if the matter does not settle.

History of CD: *"Construction Defect and Occurrence: Still Crazy After All These Years"* by Patrick Wielinski, IRMI Expert Commentary, June 2014 https://www.irmi.com/articles/expert-commentary/construction-defect-and-occurrence-still-crazy-after-all-these-years *"Analyzing construction defects: Practical considerations"* by Jamie Shooks, Milliman, October 30, 2017 http://www.milliman.com/insight/2017/Analyzing-construction-defects-Practical-considerations/ The first is an article regarding recent decisions on faulty workmanship as an occurrence, a core issue in the CD arena for more than thirty years. The second an overview article that identifies the issues that need to be considered when insurance companies are looking at construction risks. In addition, there are a host of articles regarding the history of construction defect litigation in various states.

Section 12.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

South Ballroom

Friday, May 18th 2018
8:30 AM – 9:30 AM

Course Title:
Known Knowns and Known Unknowns, the Ins and Outs of Extrapolation

Tracy Myers, Elizabeth Rhode Esq. and Dwight Duncan

Known Knowns & Known Unknowns

The Ins and Outs of Extrapolation

West Coast Casualty's Construction Defect Seminar

Anaheim, California
May 18, 2018

Presenters

Elizabeth Rhode, JD
Partner, Gillaspy & Rhode, PLLC

Tracy Myers, AIA, NCARB, GC, RRO, LEED, AP
Senior Forensic Architect, Lombard Consulting Services

Dwight Duncan, M.S., CFA
Founder & Managing Director, EconLit, LLC

2

Introduction

- Overview:
  - Use & misuse of extrapolation in the context of construction defect litigation, from the perspectives of an attorney, an expert witness, and a statistician
- Learning Targets:
  - Learn the legal standards for admissibility of expert witness testimony
  - Learn about common errors in the use of statistical extrapolation
  - Learn about the challenges of using extrapolation from a design and construction perspective
  - Learn how to ensure that data collection and extrapolation is performed and presented in such a way that it will hold up to challenges in court

3

From a Legal Perspective

Standard for Admissibility:

FRE 702: A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:

1. The expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue
2. The testimony is based on **sufficient facts or data**
3. The testimony is the product of **reliable principles and methods**; and
4. The expert has reliably applied the principles and methods to the facts of the case

Court as Gatekeeper:

FRE 104: The court must decide any preliminary question about whether a witness is qualified, a privilege exists, or evidence is admissible…. The court may admit the proposed evidence on the condition that the proof be introduced later.

Most states have some variation of both FRE 702 & 104

4

From a Legal Perspective

Standard under *Daubert* – 4-Prong Test

- Whether the expert's theory or technique can be (and has been) tested
- Whether the theory or technique has been subjected to peer review and publication
- Whether the theory or technique has an acceptable known or potential rate of error and the existence and maintenance of standards controlling the technique's operation
- Whether the theory or technique has attained "general acceptance"

Daubert v. Merrell Dow Pharmaceuticals, 509 U.S. 579 (1993).

5

From a Legal Perspective

Application of *Daubert* by state:

Oregon

"Unless the… proffered evidence is supported by appropriate validation, it cannot qualify as "scientific knowledge;" and (ii) "'appropriate validation' refers to the scientific validity;" thus (iii) 7 "admissibility of scientific evidence requires a showing that it is based on a scientifically valid 8 principle."[1]

Washington

Uses the general acceptance test, rather than the *Daubert* standard:

The "general acceptance" test looks to the scientific community to determine whether the evidence in question has a valid, scientific basis. If there is significant dispute among experts in the relevant scientific community as to the validity of the scientific evidence, it is not admissible. If expert testimony does not concern novel theories or sophisticated and technical matters, it need not meet stringent requirements for general scientific acceptance.[2]

1. *State v. O'Key*, 321 Or 285, 301-303 (1995).
2. *State v. Copeland*, 130 Wash. 2d 244, 261, 922 P.2d 1304, 1315 (1996).

6

From a Legal Perspective

Application of *Daubert* by state:

- **Illinois:** denied admission of extrapolated defects in condo complex when sample was admittedly "non-random"
  Harbor House Condominium Association v. Mass. Bay Insur. Co., 703 F. Supp. 1313, 1321 (N.D. Ill. 1988).
- **Texas:** damages calculated from 101 properties could not be extrapolated to forecast the loss to 62 additional properties because extrapolated projections were unreliable, failed to account for alternative causes, and were speculative
  Wyndam Intern., Inc. v. Ace Am. Ins. Co., 186 S.W.3d 682 (Tex.App. 2006)
- **Indiana:** expert's extrapolation methods were unreliable and inadmissible
  Wallace v. Meadow Acres Manufactured Housing, Inc., 730 N.E.2d 809 (Ind.App. 2000)
- **Nevada:** plaintiff was barred from offering expert extrapolation data without better assurances of randomness of structural elements sampled
  In re CityCenter Construction and Lien Master Litigation, Case No. A-10-612676-B (July 23, 2012 Clark County District Court, Nevada)

7

From a Legal Perspective

Sample Jury Instructions:

California CACI 219

During the trial you heard testimony from expert witnesses. The law allows an expert to state opinions about matters in his or her field of expertise even if he or she has not witnessed any of the events involved in the trial.

You do not have to accept the expert's opinion. As with any other witness, it is up to you to decide whether you believe the expert's testimony and choose to use it as a basis for your decision. You may believe all, part, or none of an expert's testimony. In deciding whether to believe an expert's testimony, you should consider:

a. The expert's training and experience;
b. The facts the expert relied on; and
c. The reasons for the expert's opinion.

Oregon UCJI 10.06

An expert witness may give an opinion on any matter in which that witness has special knowledge, skill, experience, training, or education.

The opinion may be given in response to a hypothetical question.

You should consider the qualifications and credibility of the expert witness, the reasons given for the opinion, and the reasonableness of any assumptions underlying the opinion. You are not bound by the opinion. Give it the weight, if any, to which you consider it entitled.

Washington WPIC 2.10

A witness who has special training, education, or experience may be allowed to express an opinion in addition to giving testimony as to facts.

You are not, however, required to accept his or her opinion. To determine the credibility and weight to be given to this type of evidence, you may consider, among other things, the education, training, experience, knowledge, and ability of the witness. You may also consider the reasons given for the opinion and the sources of his or her information, as well as considering the factors already given to you for evaluating the testimony of any other witness.

8

From a Legal Perspective

Standards for Admissibility of Experts & Discrediting Expert Testimony

- Testimony must be rooted in scientifically valid statistical evidence
- While an expert may not have to be a statistician *per se*, opposing counsel can attack the data via the FRE 702 factors and the Daubert analysis:
  I. Expert lacks expertise in area
  II. Expert did not use reliable theories or techniques[1]

1. In the construction defect context, this could mean:
   - Cherry-picking "damage" and apply to overall project (not a representative sample)
   - Sample not random
   - Theory does not follow sampling design and procedures
   - Insufficient size of sample

9

From a Legal Perspective

California's "Right to Repair Act" SB 800:

- Enacted in 2002
- Sets forth pre-litigation procedures that must be followed prior to initiation of formal litigation, as well as rules for post-claim litigation
- Recent ruling clarified that individual homeowners could not extrapolate from home to home to conclude that a violation of a particular standard existed, and that each individual homeowner has the burden to prove every element of their damages by preponderance of the evidence.

> "Courts are not going to allow statisticians to testify as to whether Schrodinger's cat is alive or dead when all they have to do is look and know for certain"

Cosio v. McMillin Homes (Super. Ct. Imperial County Superior Court, Feb, 6,2013, No. ECU05937).

10

From a Legal Perspective

Impacts of SB 800 / *Cosio* ruling:

- Limits extrapolation among individual homes
- Plaintiffs' Costs and Fees increase = effect on settlement negotiations
- Affects the burden of proof contractors have against subcontractors
- Increases the burden of proof for Plaintiffs

11

From a Legal Perspective

The Court as Gatekeeper – *Real Life Examples*

- When to go to the judge:
  - California:
    - Expert Witness pretrial discovery & depositions allowed
    - Simultaneous disclosure of expert witness information, including discoverable reports
  - Oregon:
    - Trial by Ambush
  - Washington
    - Similar to California – Pretrail expert discovery is allowed
- What's in…
- What's out…

12

From an Expert Perspective

Qualitative versus Quantitative Sampling

- Overview

13

From an Expert Perspective

Sampling and Extrapolation in Construction Defect Cases

- **Inspection**
- **Analysis**
  - Condition similarities and / or differences
  - Quantification
  - Applicable standards
- **Findings**
  - Defect or not a defect
  - Unique condition or widespread

14

From an Expert Perspective

Extrapolation challenges

- **Construction variables**
  - Sub-contractors / staffing
  - Weather conditions
- **Design variables**
  - Unique conditions
  - Product selection
- **Other variables**
  - Access issues
  - Logistical issues

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From an Expert Perspective

Construction Repair

- **Similar to litigation process**
  - Inspection
  - Analysis
  - Findings
- **Recommend repair**
- **Implement repair**

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From an Expert Perspective

Case Study 1 (Litigation)

- Custom single family residence
- Reported window leaks
- Prior testing by other expert firm
- LCS to determine cause of leak(s)
  - Product vs. Installation

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From an Expert Perspective

Case Study 1 (Litigation)

- Limited sample due to extensive prior testing
- Windows not isolated during prior testing
- Cause of leak not determined during prior testing

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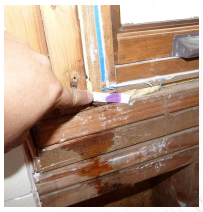
From an Expert Perspective

Case Study 1 (Litigation)

- Leak documented during isolation testing



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From an Expert Perspective

Case Study 1 (Litigation)

- Intrusive investigation performed
- Installation-related defects confirmed at tested locations

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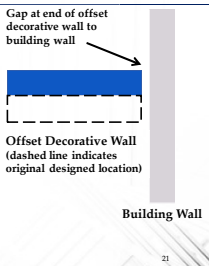
From an Expert Perspective

Case Study 2 (Non-litigation, repair)

- **Reported moisture intrusion**
- **Visual observations**
- **Decorative walls offset at some locations**
- **Possible discontinuity of waterproofing**
  - Under decorative walls
  - At building connections



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From an Expert Perspective

Case Study 2 (Non-litigation, repair)

- **Intrusive investigation performed**
  - Remove portions of offset decorative walls at building
  - Expose condition under wall
- **Lack of waterproofing confirmed at building wall**
- **Waterproofing confirmed under offset decorative wall**
- **Full repair at two investigated locations. Limited repair at other offset wall locations**
- **No additional leaks observed**

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Econ Lit — Statistically Speaking…

Summary of Opinions:

1. **Lack of a Sample Selection Protocol**
   - *Likely introduction of sampling bias*
2. **Lack of a Random Sample**
   - *Cannot apply statistical concepts to extrapolate data*
3. **Failure to Compute a Margin of Error**
   - *No opinion on precision of estimated defect rate*
4. **Inadequate Sample Size**
   - *Imprecise estimates that are meaningless*
5. **Inappropriate sample design**
   - *Sample design does not "sample" repair costs; method used by Claimant's construction experts expected to misstate cost of repair*

Claimant's construction experts failed to use proper statistical sampling procedures.

The procedures used are critically flawed and likely to introduce a high level of imprecision

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Econ Lit — Statistically Speaking…

1. Probability Sample (Simple Random Sample) ← Did Claimant's construction experts obtain a probability sample?

↓

2. Application of Probability Theory ← If NO, then probability theory cannot be applied.

↓

3. Extrapolation
- **Unbiased Estimate**
- **Confidence Interval**

← Sample likely biased and confidence interval cannot be calculated.

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Statistically Speaking…

Proper Sample Selection Protocol

- Developed prior to start of sampling
- Predetermined sample sizes
- Description of how sampling is to be performed
- Description of how to handle non-responses

Claimant's Sampling

- No evidence that a sample selection protocol was developed
- Without a properly-specified sample selection protocol, Claimant's construction experts cannot assume that a random sample was obtained

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Statistically Speaking…

Development	Sampling Performed
1. Two windows in a given residence	No discussion how the two windows (out of a total of 13 windows) in the Residence were selected for testing.
2. 46 windows in entire Development	No discussion how the 46 windows (out of approximately 750 windows) in the Development were selected for testing.
3. One grout pocket per Residence	No discussion how the single grout pocket (out of a total of 20 grout pockets) was selected for testing.

Claimant's construction experts cannot simply assume that a random sample was obtained.

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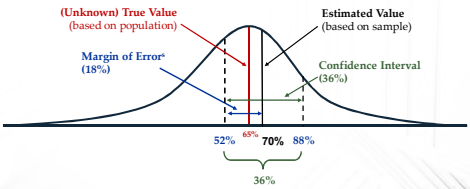
Statistically Speaking…

Illustration of the Extrapolation Process – Calculate Margin of Error:



When sampling is performed 100 times, 95 times out of 100, the true population value is within the computed confidence interval.

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Statistically Speaking…

- Small Sample Sizes → Very Large Margins of Error
- Large margins of error render point estimates for population values so imprecise that they are statistically meaningless or of limited use
- Using the windows example:

	Residence	Development
Sample Sizes:	2 out of 13 windows	46 out of approx. 750 windows

- Using the grout pocket example:

	Residence
Sample Sizes:	1 out of 20 grout pockets

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Statistically Speaking…

Required sample sizes under the assumption that it is equally likely that the alleged defect may or may not exist:

N = 13		Margin of Error				
		1.0%	2.5%	**5.0%**	7.5%	10.0%
Confidence Level	99%	13	13	13	12	12
	95%	13	13	**13**	12	12
	90%	13	13	12	12	11

All 13 windows would have to be chosen and sampled in order to be able to make a statement about the population value at a 95% confidence level with a margin of error of 5%.

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Statistically Speaking…

- Level of imprecision based on a sample size of 2:

N = 13		Margin of Error		
		87%	**66%**	56%
Confidence Level	99%	2		
	95%		**2**	
	90%			2

- If testing determined that 1 of 2 windows (or approximately 50%) contain the alleged defect, a sample of 2 has a margin of error of 66% (at 95% confidence).
- Which means between approximately 15% and 100% of the population of windows contain the defect.(*)

(*) The above margin of error is approximated as ½ of the confidence interval using a normal distribution for illustrative purposes. The exact distribution is the hypergeometric distribution. At the 95% confidence level, the lower bound of the estimate using the hypergeometric distribution is 23%, and the upper bound is 100%.

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Statistically Speaking…

Question: Is EconLit's critique applicable to other construction elements?

Answer: Yes. EconLit's critique is applicable to every construction element for which the testing results from a sample are applied to untested construction elements.

- **Level of imprecision based on a sample size of 1.**

N = 20		Margin of Error		
		100%	**98%**	82%
Confidence Level	99%	1		
	95%		**1**	
	90%			1

- **For example, Claimant's construction experts tested 1 grout pocket and extrapolated the result of the single grout pocket to all untested grout pockets at the residence.**
- **However, at a 95% confidence level, the margin of error is 98% (implying a lower bound of 2%). In other words, the extrapolation of the test results to the entire residence is meaningless.(*)**

(*) The above margin of error is approximated as ½ of the confidence interval using a normal distribution for illustrative purposes. The exact distribution is the hypergeometric distribution. At the 95% confidence level, the lower bound of the estimate using the hypergeometric distribution is 5%, and the upper bound is 100%.

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Statistically Speaking…

- **Required sample sizes under the assumption that it is equally likely that the alleged defect may or may not exist:**

N = 750		Margin of Error				
		1.0%	2.5%	**5.0%**	7.5%	10.0%
Confidence Level	99%	718	585	352	212	136
	95%	696	504	**254**	139	85
	90%	675	443	199	104	62

A total of 254 windows would have to be chosen and sampled in order to be able to make a statement about the population value at a 95% confidence level with a margin of error of 5%.

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Statistically Speaking…

- **Level of imprecision based on a sample size of 46:**

N = 750		Margin of Error		
		18%	**14%**	12%
Confidence Level	99%	46		
	95%		**46**	
	90%			46

- **If testing determined that 23 of 46 windows (or approximately 50%) contain the alleged defect, a sample of 46 has a margin of error of 14% (at 95% confidence).**
- **Which means between approximately 36% and 64% of the population of windows contain the defect.(*)**

(*) The above margin of error is approximated as ½ of the confidence interval using a normal distribution for illustrative purposes. The exact distribution is the hypergeometric distribution. At the 95% confidence level, the lower bound of the estimate using the hypergeometric distribution is 59% assuming Claimant's 71% estimate of the defect rate is correct.

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Statistically Speaking…

Summary of Opinions:

1. **Lack of a Sample Selection Protocol**
   - *Likely introduction of sampling bias*
2. **Lack of a Random Sample**
   - *Cannot apply statistical concepts to extrapolate data*
3. **Failure to Compute a Margin of Error**
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Claimant's construction experts failed to use proper statistical sampling procedures.

The procedures used are critically flawed and likely to introduce a high level of imprecision

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Discussion

Elizabeth Rhode
503-688-5020
erhode@gillsapyrhode.com

Tracy Myers
714-840-8230
tmyers@lombardcx.com

Dwight Duncan
602-264-1400
dwight@econlit.net

Section 13.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

Grand Ballroom

Friday, May 18th 2018
8:30 AM – 9:30 AM

Course Title:
Risk Transfer Alphabet Soup - A twelve-year lookback on legislative tinkering with anti-indemnity statutes - where are we now?

Jim Kurkhill, Esq. James Orland Esq., Larry Kent, Esq., Gary Baumann, Esq. and Jack Rubin, Esq.

Risk Transfer Alphabet Soup

A Twelve-Year Lookback on Legislative Tinkering with Anti-Indemnity Statutes

Agenda

Panel host: Jim Kurkhill

A Twelve Year Look at Anti Indemnity Statutes in California

(See following 32-page handout)

Panelists:

Gary Baumann (Baumann, Gant & Keeley, PA) :

Indemnity in Florida & settlement tactics – assignments in Florida

Larry Kent (Law Offices of Larry Kent) & **Jack Rubin** (Newmeyer & Dillion):

Issues that arise when assigning indemnity rights as part of a settlement; practical implications involving good faith settlement motions.

James Orland (Orland Law Group – Abota Member)

California Indemnity from the trial lawyer's perspective

Table of Contents

ALPHABET SOUP
A LOOKBACK OF ANTI-INDEMNITY STATUTES IN CALIFORNIA

1 EXPRESS INDEMNITY IN CALIFORNIA

1.1 Overview

The interpretation of indemnity obligations in California construction law has, in some sense, become a much simpler task over the past dozen years. After years of subcontractors taking a pounding by the imposition of Type 1 indemnity agreements, the legislature has all but gutted the ability of owners and general contractors to shift risk to parties who have little, if any, liability in residential construction. What was once a complicated exercise in contract interpretation overlain by a hodgepodge of confusing case law has become reduced to, in most cases, simply apportioning liability based on comparative fault. Getting to that result has not been easy, as the legislature has introduced sweeping changes over the past twelve years. Now, owners and general contractors are severely restricted as to when and how they can shift risk to subcontractors or design professionals to recover defense and indemnity costs for things other than the indemnitor's proportionate share of negligence, recklessness or willful misconduct. This article presents a brief overview of where we were, where we are, and how we got here.

1.2 Step by Step

The first step in unpacking any express indemnity provision is to figure out what the indemnity agreement says. For this, there are five questions to ask, addressed in Section 2. The next step is to interpret those provisions in the context of the pre-anti-indemnity statute case law. Finally, we explore the effects of the statutes which changed the rules: AB758, AB2738, & SB972, SB 474 and SB 496. We end with the pending Senate Bill 1326, just introduced in March, 2018.

1.3 Insurance Triggers - Caveat

This article mostly addresses contractual indemnity only and is not intended to address the carrier's obligations in defending or indemnifying an insured or additional insured.

2 THE FIVE QUESTIONS

There are only five questions to ask when analyzing any express indemnity provision:

1. What is the trigger of the defense obligation?
2. What is the scope of the defense obligation?
3. What is the trigger of the indemnity obligation?

4. What is the scope of the indemnity obligation?
5. Can the indemnitee recover its attorney's fees to enforce the terms of the indemnity obligation?

The most striking aspect of California indemnity law is that the triggering event for defense or indemnity can be the presentation of a claim rather than a judicial determination of fault. The default trigger for the obligation to indemnify, absent a contrary intention, is the when the indemnitee "becomes liable". (Civil Code § 2778). The scope of the defense or indemnity obligation can be partial (based on comparative fault) or complete, irrespective of comparative fault. It is because of the court's willingness to allow the parties freedom to contract, and the perceived unfairness of the result of doing so, which gave way to the spate of anti-indemnity statutes in California.

2.1 Classification of Indemnity Provisions: Type I, II, and III

Historically, California appellate cases have classified indemnity provisions as falling into three broad categories, Type I, II, and III. Though the courts initially used these classifications to assist in determining whether and how risk could be shifted, this broad classification scheme does little to foretell the parties' indemnity obligations. There are several reasons for this. First, the classifications do not effectively describe the multiple variations in indemnity provisions. Indeed, many indemnity provisions may have overlapping provisions that make the attempt at classification impossible. Additionally, the Type I, II and III classifications say nothing about the indemnitor's separate duty to defend or the trigger of that obligation. Finally, even if you could properly characterize an indemnity clause as fitting within one of the three types, the classifications themselves have effectively been rendered moot by a half dozen statutory amendments since 2005.

Given these shortcomings, caution should be made when classifying indemnity provisions, as doing so says little about the parties' respective obligations. Nonetheless, it is still useful to understand these classifications, as they still form the foundation of applying the appropriate statute to the indemnity contract provision.

2.2 Indemnity Clause Structure

The structure of most indemnity provisions follows the following format:

- I (subcontractor) will [immediately or later] defend, [partially or fully] indemnify, and hold you [contractor and/or owner] harmless…
- from any liabilities (e.g. claims, damages, awards, injuries) ….
- arising out of or connected to your work …
- for your (contractor or owner's) negligence or breach

"Even if" or "Whether or Not" modifiers (limitless possibilities to add to the above):

- Even if I (subcontractor) was not at fault
- Even if you (contractor/owner) were partially at fault
- Even if someone else (third party / orphan share) was at fault
- Even if no one was determined to be at fault
  (the indemnity obligation exists based on the claim that it arose out of your work)

2.2.1 Type I, II and III Classifications

The court in MacDonald & Kruse v. San Jose Steel (1972) 29 Ca1.App.3d413 analyzed numerous decisions and classified indemnification provisions into three basic types. The classifications formed the basis of decades of decisions interpreting and enforcing indemnity provisions.

However, due to the complexity of many modern contracts, it is rare to find a pure Type I, II or III indemnity provision, and so the utility of the classification system is limited. Since most custom drafted indemnity provisions contain a mix, one cannot readily use the MacDonald classification scheme as a basis for determining a party's liability. Instead of trying to figure out if you have a Type I, II or III, it is better to apply the Five Questions as the starting point in the analysis, and follow up with applying Civil Code section 2782. That said, a brief review of the Type I, II, and III indemnity classifications is in order.

2.3 **Type I – Specific Indemnity**

A Type I provides expressly and unequivocally that the indemnitor (subcontractor) is to indemnify the indemnitee (contractor/owner) for, among other things, the negligence of the indemnitee (contractor/owner). When the contract language specifies that the indemnity obligation arises even when the contractor is partially at fault, it is said to be a "specific" indemnity provision.

Examples of a Type I provision:

Subcontractor will indemnify general contractor for injury/damage against any claims…(add one or more modifiers below):

- whether or not such claims are based upon contractor's or the owner's alleged active or passive negligence or participation in the wrong or upon any alleged breach of any statutory duty or obligation on the part of contractor or the owner;
- whether or not the claims were caused in part by acts or omissions of the contractor or owner;

- whether or not the claims were caused in party by any party indemnified hereunder; and
- whether or not the contractor or owner were negligent.

A Type I is said to be a *specific indemnity* provision, because the language specifies that the obligation to indemnify occurs even where the party seeking to be indemnified is partially at fault. It specifies that indemnitee's negligence is not a bar to obtaining indemnity. Thus a subcontractor found to be at fault in the most superficial way can have enormous liability. Thus, if you can prove only 1% fault (or some tiny fraction) on behalf of the subcontractor, the indemnity provision is triggered.

2.4 Type II – General Indemnity (Active & Passive Negligence)

Prior to 1975, the interpretation and outcome of the indemnity obligation was dependent on a determination of active or passive negligence on the part of the indemnitee (contractor or owner). Type II-style language would provide the general contractor indemnity from its own acts of passive negligence, but not its own acts of active negligence. This rule was articulated in MacDonald & Kruse, Inc. v. San Jose Steel Co. (1972) 29 Cal. App. 3d 413, 418 and soon criticized by the California Supreme Court in Rossmoor Sanitation, Inc. v. Pylon, Inc. (1975) 13 Cal. 3d 622. The Supreme Court in Rossmoor explained that provisions purporting to hold an owner harmless "in any suit at law," "from all claims for damages to persons," and "from any cause whatsoever," without expressly mentioning an indemnitee's negligence, are "general" indemnity clauses. "If an indemnity clause does not address itself to the issue of an indemnitee's negligence, it is referred to as a 'general' indemnity clause. [Citations]. While such clauses may be construed to provide indemnity for a loss resulting in part from an indemnitee's passive negligence, they will not be interpreted to provide indemnity if an indemnitee has been actively negligent. [Citations.] Provisions purporting to hold an owner harmless 'in any suit at law'… 'from all claims for damages to persons' … and 'from any cause whatsoever' . without expressly mentioning an indemnitee's negligence, have been deemed to be 'general' clauses." Rossmoor at 628-629.

The rule articulated in Rossmoor was applied in McCrary Construction Company v. Metal Deck Specialists, Inc. (2005) 133 Cal.App.4th 1528. In McCrary, the general contractor was found liable for wrongful death of worker who fell through a hole on the roof at jobsite, but was not entitled to indemnity from sheet metal subcontractor who cut the hole and did not cover it. The general contractor directed the sheet metal subcontractor to cover the hole, but was negligent in not ensuring the hole was properly covered. The general contractor's negligence in failing to ensure the holes were properly covered arose out of its jobsite responsibilities assumed by virtue of its status as general contractor, and the language of the indemnity clause in contract with sheet metal contractor did not purport to require indemnity from subcontractor for such conduct by contractor. The court opined there was nothing otherwise to suggest that the intent of the parties was to provide indemnity under these circumstances, and that there was no reason to depart from the general rule that an actively negligent indemnitee cannot recover under a general indemnity contract.

2.4.1 Examples of 'Type II' indemnity language:

Subcontractor will indemnify general contractor for injury/damage….

- howsoever same may be caused;
- regardless of responsibility for negligence;
- arising from the use of the premises, facilities, or services of the indemnitee;
- which might arise in connection with the agreed work' [citation],
- caused by or happening in connection with the equipment or the condition, maintenance, possession, operation or use thereof; or
- from any and all claims for damages to any person or property by reason of the use of the leased property.
- arising out of the subcontractor's work. However this indemnification shall not apply if such claims, demands or liability are ultimately determined to have arisen through the sole negligence of Contractor. *(Note: The court in the Heppler case refers to this last example as a Type I – I disagree).*

2.4.2 Legislative update – Active and Passive Negligence Distinction is Alive and Well

The Type II classification, and more particularly the distinction between indemnity obligations based on active vs. passive negligence of the indemnitee, had seemed to fade into case law oblivion, only to be resurrected by statute. See, e.g. SB 474, effective January 1, 2013 and the corresponding new Civil Code § 2782.05; see also the pending SB 1326, introduced March 22, 2018.

2.5 Type III – General Indemnity (akin to contributory negligence)

A Type III provision "is that which provides that the indemnitor is to indemnify the indemnitee for the indemnitee's liabilities caused by the indemnitor, but which does not provide that the indemnitor is to indemnify the indemnitee for the indemnitee's liabilities that were caused by other than the indemnitor. Under this type of provision, any negligence on the part of the indemnitee, either active or passive, will bar indemnification against the indemnitor irrespective of whether the indemnitor may also have been a cause of the indemnitee's liability." *MacDonald & Kruse, Inc. v. San Jose Steele Co.*, (1972) 29 Cal.App.3d 413, 420. Thus, if a general contractor's or owner's negligence contributed to the claim, whether it was active or passive, the subcontractor is not required to indemnify the general contractor or owner.

Type III indemnity agreements are rare, and virtually all appellate decisions address Type I and Type II provisions.

3 DUTY TO INDEMNIFY: THE TRINITY – CONTINENTAL HELLER ('99), HEPPLER ('97) & CENTEX ('00)

The following three cases, taken together, best summarized the state of California indemnity law prior to 2000. Continental Heller stated the rule, Heppler attempted to put the brakes on it, and Centex re-asserted the holding in Continental Heller in a construction defect context.

3.1 Continental Heller Corp. v. Amtech Mechanical Services, Inc.

(1997) 53 Cal. App. 4th 50 (T*he Case of the Exploding Hot Dog Factory Refrigerator).*

CASE SUMMARY:

Subcontractor had a duty to defend and indemnify general contractor under an agreement in an action by employees injured in an explosion at an Oscar Meyer's plant caused by the failure of a valve installed by subcontractor (manufactured by third party) in the course of its work (the installation of a refrigeration system at a production plant) even though the subcontractor was found not negligent in installing the valve which caused the explosion.

FACTS:

General contractor settled the claim for $20,000 by employees injured in an explosion caused by the failure of a valve installed by subcontractor. General contractor then sued subcontractor for contractual indemnity seeking to recover the settlement plus its costs and attorney fees.

There were two clauses in the indemnity agreement which the court focused its attention on. First, the indemnity agreement requires subcontractor to indemnify general contractor for a loss which "*arises out of or is in any way connected* with the performance of work under this Subcontract." Second, the contract further provides subcontractor's liability for indemnity "shall apply to *any acts or omissions*, willful misconduct or negligent conduct, whether active or passive, on the part of Subcontractor." (Emphasis added by court of appeals)

In interpreting the above, the court held that subcontractor's duty to indemnify general contractor applies "to *any* acts or omissions . . . on the part of subcontractor not just to its "willful misconduct or negligent conduct." *Note in the Heppler v. JM Peters case, below, the court noted that its indemnity provisions were similar to the first clause in the Continental case, but not the second clause.*

The agreement by subcontractor to indemnify respondent for loss which arose out of or was in any way connected with subcontractor's acts or omissions in the performance of its work did not require a showing that subcontractor was at fault in causing respondent's loss or that its performance was a substantial or predominating cause of the loss. The language of the agreement left no doubt the parties intended subcontractor would indemnify respondent irrespective of whether respondent's loss arose by reason of subcontractor's negligence or for any other reason except for the sole negligence or willful misconduct of respondent. The court found the risk allocation in the agreement was commercially reasonable and the court concluded the parties bargained and understood their agreement.

The court did provide hypothetical limitations on the subcontractor's indemnity obligations. Subcontractor's liability must be connected to an "act" or "omission" in the performance of its subcontract, not merely to the performance itself. Therefore, the fact subcontractor installed the refrigeration system in the plant would not make it liable for indemnity for the loss incurred in paying damages to someone who suffered food poisoning from eating an Oscar Meyer hot dog on the theory that but for the refrigeration system Oscar Meyer could not have made the hot dog. The general contractor in this hypothetical case would have to establish the loss was in some way connected to a specific act or omission of subcontractor. Subcontractor is not liable for *any* act or omission connected with the performance of work under the subcontract, but only acts or omissions "on the part of subcontractor, its agents, subcontractors or employees." As a further limitation on its liability, subcontractor is expressly not required to indemnify general contractor for losses arising from the sole negligence or the sole misconduct of general contractor, its officers, agents, servants, or independent contractors.

HOLDING:

The court held that subcontractor had a duty to defend and indemnify general contractor in an action by employees injured in an explosion caused by the failure of a valve installed by subcontractor. The court

also held that the subcontractor is liable to the contractor for its attorney fees in prosecuting this action to recover under the agreement.

3.2 Heppler v. J.M. Peters Co. (1999) 73 Cal. App. 4th 1265

CASE SUMMARY: Appellate court upheld the trial court ruling that the plaintiff homeowners (who were assigned the indemnity rights from the developers) take nothing from several non-negligent nonsettling subcontractors whose contracts contained express indemnity clauses. The court held that the indemnity provisions in question required a showing of negligence to trigger the indemnity obligation and since there was a verdict in favor of the nonsettling subs, there was no duty to defend or indemnify.

OVERVIEW: This case arose from construction defect litigation involving a residential development, in which the developer, as part of a global settlement, assigned its indemnification rights against nonsettling subcontractors to plaintiffs -- a certified class of homeowners. The court held that the trial court correctly determined that negligence on the part of these subcontractors was necessary to trigger the indemnity obligation as provided by the subcontracts, and the jury was effectively informed of the presumption regarding the total amount of the settlement, and there was no merit to plaintiffs' contention regarding the presumption about the reasonableness of the allocations. The court reversed the award of attorney fees and remanded for a redetermination of how much of plaintiffs' attorney fees should be properly allocated against the other appellant because under these circumstances, the trial court's failure to apportion the attorney fees was an abuse of discretion.

ANALYSIS:

In Heppler, there were two separate indemnity provisions in question, were standard "Type II" provisions. Combined, the essence of these provisions is as follows:

Subcontractor agrees to indemnify contractor harmless from all claims or damage to property arising out of or growing out of or in connection with Subcontractor's performance or execution of the work.[1]

A. "Specific Language" Needed For Indemnity Trigger Without Subcontractor Negligence

The indemnity language contained in the subcontracts does not evidence a mutual understanding of the parties or contain any language that specifies the contractor's conduct or fault is of no consequence in determining whether the indemnity obligation is triggered. Had the parties intended to include an indemnity provision that would apply regardless of the subcontractor's negligence, they would have had to use specific, unequivocal contractual language to that effect.

Moreover, the attendant circumstances--subcontractors performing a limited scope of work that was to be combined with the work and materials of numerous others to build mass-produced residences--do not support an expansive indemnity obligation. Absent specific contractual language, the notion there was a meeting of minds that these subcontractors would be liable if they were not negligent does not pass scrutiny. Rather, it is much more credible the parties intended the subcontractors' indemnity obligation to arise only if the subcontractors performed negligently and caused damage.

B. Policy Considerations: Developer Is Strictly Liable for Defects and the Subs are Not

Plaintiffs' contention that language found in these contracts is sufficient to trigger indemnity obligations regardless of the indemnitor's fault also runs afoul of public policy considerations and

[1] Provision A: To the fullest extent permitted by law, Subcontractor hereby agrees to defend, indemnify and hold Contractor harmless from all claims, demands or liability for death or injury to persons or damage to property arising out of or in connection with Subcontractor's . . . performance of the Work and for any breach or default of the Subcontractor in the performance of its obligations under this Agreement. However this indemnification shall not apply if such claims, demands or liability are ultimately determined to have arisen through the sole negligence of Contractor." *The trial judge, Judge May characterized this provision as a type I – how Judge May arrived at that conclusion is curious as the provision reads clearly as a simple Type II and does not specifically mention that the subcontractor is to indemnify the contractor for the contractor's negligence, the prime distinguishing characteristic of a Type I provision. The only way one can conclude this is a Type I agreement is the inference drawn from the second sentence which states that the indemnification does not apply if the claims arise out of the Contractor's sole negligence. This does not appear to be an "express and unequivocal" statement that the subcontractor will indemnify the Contractor for the Contractor's negligence.*

Provision B: Contractor does agree to indemnify and save Owner harmless against all claims for damages to persons or to property growing out of the execution of the work, and at his own expense to defend any suit or action brought against Owner founded upon a claim of damage . . . .

decisional law, which impose vastly different responsibility on a developer versus a subcontractor. In a case such as this, plaintiffs' position would have the effect of transferring the developer's strict liability as a developer to the subcontractors, without the use of specific contractual language that unambiguously manifested this intent. However, the law makes a distinction between the liabilities of a housing developer and those of a subcontractor for defects in construction; namely, the developer is strictly liable and the subcontractor is not. Residential developers are held strictly liable because of a recognition they are the best positioned to bear the costs associated with construction defects and the best positioned to monitor and coordinate construction from start to finish. Developers usually are the best capitalized and most likely insured of the various entities involved in home construction. Also, residential developers are held strictly liable because they are essentially the manufacturers of the finished product or residence, as well as the marketer (distributor) of the finished product. The strict liability of residential developers therefore is in keeping with the public policy behind the doctrine of strict liability, which evolved to afford protection to individual consumers by fixing responsibility for injuries caused by defective products where it will most efficiently reduce safety hazards inherent in defective products in the marketplace. Recognizing the distinctions between a developer and a subcontractor places the liability for defects in construction where the responsibility and spoils lay. Moreover, the realities of the real estate construction/development business weigh heavily in deciding against an extension of strict liability to subcontractors. To extend the doctrine to the subcontractors would seriously impact that industry and the home-buying public. The additional costs to the subcontractor for insurance premiums for the newly created exposure would be passed on to developers who in turn would pass the costs on to the consumer, resulting in higher housing costs.

C. Distinguishing Continental Heller

The Continental Heller court found the contractual language before it leaves no doubt the parties intended the subcontractor should indemnify owner irrespective of whether owner's loss arose by reason of contractor's negligence or for any other reason except for the sole negligence or willful misconduct of owner. Here, the indemnity provisions of the subcontracts do not contain the 'shall apply to any acts or omissions, willful misconduct or negligent conduct, whether active or passive, on the part of Subcontractor' language or any similar language that specifies the contractor's conduct or fault is of no

consequence in determining whether the indemnity obligation is triggered.

Also, the court noted another distinction in that the indemnity agreement in Continental Heller was agreed to in a commercial setting and the contractor negotiated the terms of the agreement with the owner. Therefore, the risk allocation was held to be "commercially reasonable".

OUTCOME:

The court determined negligence on the part of the subcontractors was necessary to trigger the indemnity obligation as provided by subcontracts based on the language of these particular indemnity provisions, as well as considering various policy issues.

COMMENTS:

Beware before you accept an assignment of rights of indemnity against nonsettling subcontractors. If you have an indemnity agreement which requires proving negligence to trigger the indemnity requirements, you bear some real risk in proceeding to trial in terms of recovering both defense and indemnity costs, and the costs incurred to prosecute your complaint for indemnity. In addition, you risk the potential of paying the defense's attorney's fees and expert costs incurred by the nonsettling subcontractors if the subcontractors defense the case, assuming the subcontract contains an attorney's provision, as was the case in Heppler.

There is no discussion in Heppler about the different triggers of the defense obligation and the indemnity obligation – the court treated them the same, since the language of the express indemnity provision did not distinguish between these two separate obligations. This is not always the case, however, and you should check the language of the indemnity provision you are involved with.

One should also take note regarding the Heppler court's focus on many policy issues, the absence of which is palpable in the Continental Heller and the Centex decisions. These policy issues may well surface in future construction defect cases, softening the effects of Centex.

3.3 Centex Golden Construction Co. v. Dale Tile Co.,

(2000) 78 Cal.App.4th 992 (*The Case of the Defectively*

Installed Tile That Wasn't)

SUMMARY:

Defendant tile contractor executed a subcontract that included a broad indemnification provision in favor of plaintiff general contractor. The owner made several claims against plaintiff, including a claim that the tile work was defective. The general settled all the claims made by the owner and demanded indemnity from the subcontractors whose work had given rise to the claim, and brought this action against defendant. Although a jury found neither party negligent, the trial court entered judgment for plaintiff for defendant's share of the settlement and attorneys fees. The court erred in instructing the jury that defendant bore the burden of proving that the owner's claim arose out of plaintiff's sole negligence or willful misconduct. The appellate panel affirmed; the erroneous instruction on burden of proof was harmless. The indemnification provision was consistent with the particular commercial setting; defendant had control over its own work. The agreement did not amount to insurance. The Centex indemnity provision is as follows:

General Indemnity--All work covered by this Agreement done at the site of construction or in preparing or delivering materials or equipment, or any or all of them, to the site shall be at the risk of Subcontractor exclusively. Subcontractor shall, with respect to all work which is covered by or incidental to this contract, indemnify and hold Contractor harmless from and against all of the following: "1. Any claim, liability, loss, damage, cost, expenses, including reasonable attorneys' fees, awards, fines or judgments arising by reason of the death or bodily injury to persons, injury to property, design defects (if design originated by Subcontractor), or other loss, damage or expense, including any if the same resulting from Contractor's alleged or actual negligent act or omission, regardless of whether such act or omission is active or passive. . . . However, Subcontractor shall not be obligated under this Agreement to indemnify Contractor with respect to the sole negligence or willful misconduct of Contractor, his agents or servants or subcontractors who are directly responsible to Contractor, excluding Subcontractor herein."

The court held that "such an allocation of risk to an indemnitor requires some expression in the agreement which indicates that "the *indemnitor's* conduct or fault is of no consequence in determining whether the indemnity obligation is triggered." Id. at 998, citing Heppler v. J. M. Peters Co. (1999) 73 Cal. App. 4th 1265, 1280.

The Centex court held that the expression of the subcontractor's agreement to provide indemnity in the absence of any fault is even clearer than that in Continental Heller. The indemnity clause of the contract begins by providing that all work performed by subcontractor

"shall be at the risk of Subcontractor exclusively" and goes on to require indemnity for all claims covered by or incidental to the subcontract, even those which involve the "alleged or actual negligent act or omission" of the general contractor. More than the language considered in Continental Heller, the express and exclusive assumption by the subcontractor of "the risk" attendant to its work on the project, including allegations of negligence, plainly contemplates more than the narrow risk of its own actual negligence or fault. This language includes the obvious risk of unmeritorious claims made by third parties.

OUTCOME:

Judgment affirmed because the broad language of indemnity did not require that the plaintiff general contractor prove that the defendant subcontractor bore any responsibility for the claims. The fact that plaintiff had paid the claims in good faith entitled it to indemnification.

Under the contract, the contractor was only required to show that the claim was connected to the subcontractor's work and that it did not grow out of the contractor's sole negligence or willful misconduct.

4 DUTY TO DEFEND: THE TRIGGERS UNDER CRAWFORD & UDC V. CH2M HILL

4.1.1 Trigger to Defend is When Claim is Made (Crawford v Weather Shield)

In Crawford v Weather Shield (2008) 44 Cal.4th 541, the court held that the trigger of the duty to defend (this is not an insurer's duty, but that of the indemnitor) is triggered upon the presentation of the claim, so long as the indemnity provision clearly states that the indemnitor has a duty to defend claims arising out of the work of the indemnitor, even if the indemnitor is later to be found non-negligent. Though this case was hailed as "new law" when it first published, it really only confirmed the concept that parties' duties of either defense or indemnity are as stated in the express indemnity clause.

4.1.2 Defense Obligation is Triggered Even When Indemnitor is Non-Negligent (UDC v. CH2M Hill)

The Crawford trigger was also found to apply in the context of design professional liability. In UDC-Universal Development, LP v. CH2M Hill (2010) 181 Cal.App.4th 10, the indemnitor (CH2M Hill) challenged its obligation to defend the indemnitee (UDC) when UDC was not properly licensed to perform the work. This case arose out of a claim by an

Homeowners' Association against the developer, UDC, whereby UDC cross complained against its design professional, CH2M Hill. The court held that although CH2M Hill was found not to be negligent in the performance of its services, it nonetheless was still required to pay for the defense of UDC in the underlying complaint that gave rise to the dispute.

4.1.3 Legislative Response to these Decisions

The holdings in Crawford and UDC were considered too severe; the legislative response was swift, as SB 972, discussed below, was introduced to clarify what a subcontractor's responsibilities were to defend its indemnitee.

5 ALPHABET SOUP – THE EVOLUTION OF CIVIL CODE §§ 2772 – 2782

Below is a brief overview of the Civil Code sections governing indemnity, with references to the dates and types of legislative changes that have been made in response to "Type I" style indemnity agreements.

5.1 Summary Chart: Statutes Governing Indemnity Contracts

California Civil Code	Description *(Summarized Where Indicated by Asterisk *)*
2772 – 2777	* Imposes miscellaneous limits on party liability and overall scope of indemnity agreements
2778 Rules of interpretation of indemnity contracts. This provision provides the basis for determining the obligation to indemnify unless the contracting parties express their intention that these rules do not apply	In the interpretation of a contract of indemnity, the following rules are to be applied, unless a contrary intention appears: 1. Upon an indemnity against liability, expressly, or in other equivalent terms, the person indemnified is entitled to recover upon becoming liable; 2. Upon an indemnity against claims, or demands, or damages, or costs, expressly, or in other equivalent terms, the person indemnified is not entitled to recover without payment thereof; 3. An indemnity against claims, or demands, or liability, expressly, or in other equivalent terms, embraces the costs of defense against such claims, demands, or liability incurred in good faith, and in the exercise of a reasonable discretion; 4. The person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity, but the person indemnified has the right to conduct such defenses, if he chooses to do so; 5. If, after request, the person indemnifying neglects to defend the person indemnified, a recovery against the latter suffered by him in good faith, is conclusive in his favor against the former;

	6. If the person indemnifying, whether he is a principal or a surety in the agreement, has not reasonable notice of the action or proceeding against the person indemnified, or is not allowed to control its defense, judgment against the latter is only presumptive evidence against the former; 7. A stipulation that a judgment against the person indemnified shall be conclusive upon the person indemnifying, is inapplicable if he had a good defense upon the merits, which by want of ordinary care he failed to establish in the action.
2779	* Indemnitor entitled to be reimbursed for settlements due to liabilities of indemnitee
§ 2782 Construction Contracts; void and unenforceable indemnification provisions; agreements between subcontractors, builders and general contractors	
2782 (a) & (b)	(a) It is against public policy to indemnify others for their willful misconduct or sole negligence. It is also against public policy to indemnify others for defects in design furnished by those other persons. (* Summarized) (b) (1) Except as provided in Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract with a public agency entered into before January 1, 2013, that purport to impose on the contractor, or relieve the public agency from, liability for the active negligence of the public agency are void and unenforceable. (2) Except as provided in Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract with a public agency entered into on or after January 1, 2013, that purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the public agency from, liability for the active negligence of the public agency are void and unenforceable.

2782 (c) & (d) Eliminates Type I indemnity for Owners (c) & Builders (d) History: AB 758 (Effective 1/1/2006) Amended by AB 2738 (Effective 1/1/2009) Amended by SB 474 (Effective 1/1/13) ** Pending: SB 1326 (March 2018) (eliminates obligation to indemnify if Owner found "actively negligent" in subsection (c)); "to the extent" language replaced with "if caused by…"	(c) (1) Except as provided in subdivision (d) and Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract entered into on or after January 1, 2013, with the owner of privately owned real property to be improved and as to which the owner is not acting as a contractor or supplier of materials or equipment to the work, that purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the owner from, liability are unenforceable to the extent** of the active negligence of the owner, including that of its employees. (2) For purposes of this subdivision, an owner of privately owned real property to be improved includes the owner of any interest therein, other than a mortgage or other interest that is held solely as security for performance of an obligation. (3) This subdivision shall not apply to a homeowner performing a home improvement project on his or her own single family dwelling. (d) For all construction contracts, and amendments thereto, entered into after January 1, 2009, for residential construction, as used in Title 7 (commencing with Section 895) of Part 2 of Division 2, all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any construction contract, and amendments thereto, that purport to insure or indemnify, including the cost to defend, the builder, as defined in Section 911, or the general contractor or contractor not affiliated with the builder, as described in subdivision (b) of Section 911, by a subcontractor against liability for claims of construction defects are unenforceable to the extent the claims arise out of, pertain to, or relate to the negligence of the builder or contractor or the builder's or contractor's other agents, other servants, or other independent contractors who are directly responsible to the builder, or for defects in design furnished by those persons, or to the extent the claims do not arise out of, pertain to, or relate to the scope of work in the written agreement between the parties. This section shall not be waived or modified by contractual agreement, act, or omission of the parties. Contractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties. Nothing in this subdivision shall prevent any party from exercising its rights under subdivision (a) of Section 910. This subdivision shall not affect the obligations of an insurance carrier under the holding of Presley Homes, Inc. v. American States Insurance Company (2001) 90 Cal.App.4th 571. Nor shall this subdivision affect the obligations of a builder or subcontractor pursuant to Title 7 (commencing with Section 895) of Part 2 of Division 2.

2782 (e) Sub's Defense Obligation *(addresses trigger & extent of the obligation)* History: SB 138 (2008) then Amended by AB 2738 (Sept 2008)	(e) Subdivision (d) does not prohibit a subcontractor and builder or general contractor from mutually agreeing to the timing or immediacy of the defense and provisions for reimbursement of defense fees and costs, so long as that agreement does not waive or modify the provisions of subdivision (d) subject, however, to paragraphs (1) and (2). A subcontractor shall owe no defense or indemnity obligation to a builder or general contractor for a construction defect claim unless and until the builder or general contractor provides a written tender of the claim, or portion thereof, to the subcontractor which includes all of the information provided to the builder or general contractor by the claimant or claimants, including, but not limited to, information provided pursuant to subdivision (a) of Section 910, relating to claims caused by that subcontractor's scope of work. This written tender shall have the same force and effect as a notice of commencement of a legal proceeding. If a builder or general contractor tenders a claim for construction defects, or a portion thereof, to a subcontractor in the manner specified by this provision, the subcontractor shall elect to perform either of the following, the performance of which shall be deemed to satisfy the subcontractor's defense obligation to the builder or general contractor: (1) Defend the claim with counsel of its choice, and the subcontractor shall maintain control of the defense for any claim or portion of claim to which the defense obligation applies. If a subcontractor elects to defend under this paragraph, the subcontractor shall provide written notice of the election to the builder or general contractor within a reasonable time period following receipt of the written tender, and in no event later than 90 days following that receipt. Consistent with subdivision (d), the defense by the subcontractor shall be a complete defense of the builder or general contractor of all claims or portions thereof to the extent alleged to be caused by the subcontractor, including any vicarious liability claims against the builder or general contractor resulting from the subcontractor's scope of work, but not including claims resulting from the scope of work, actions, or omissions of the builder, general contractor, or any other party. Any vicarious liability imposed upon a builder or general contractor for claims caused by the subcontractor electing to defend under this paragraph shall be directly enforceable against the subcontractor by the builder, general contractor, or claimant. (2) Pay, within 30 days of receipt of an invoice from the builder or general contractor, no more than a reasonable allocated share of the builder's or general contractor's defense fees and costs, on an ongoing basis during the pendency of the claim, subject to reallocation consistent with subdivision (d), and including any amounts reallocated upon final resolution of the claim, either by settlement or judgment. The builder or general contractor shall allocate a share to itself to the extent a claim or claims are alleged to be caused by its work, actions, or omissions, and a share to each subcontractor to the extent a claim or claims are alleged to be caused by the subcontractor's work, actions, or omissions, regardless of whether the builder or general contractor actually tenders the claim to any particular subcontractor, and regardless of whether that subcontractor is participating in the defense. Any amounts not collected from any particular subcontractor may not be collected from any other subcontractor.
2782.05 Obligations to indemnify another for their "active negligence" are void History: Added by SB 474 (Effective 1/1/2013)	This section was added as part of SB 474 and is extensive. In some sense, SB 474 is the commercial version of SB 2738. Due to its size, it is summarized briefly: Section 2782.05 applies to indemnity obligations by subcontractors in favor of general contractors, construction managers, or other subcontractors on both public and private projects for contracts entered into after January 1, 2013. Obligations purporting have a subcontractor provide indemnity to the general contractor, construction manager, or subcontractor for their active negligence are void and unenforceable. This section also prohibits terms that would require indemnity (including costs to defend) by subcontractors for claims that "do not arise out of the scope of work of the subcontractor pursuant to the construction contract." Section 2782.05 also specifies how the indemnification obligation is satisfied and sets forth a number of statutory exceptions. § 2782.05(b). The exceptions, among other things, specify that this new section does not apply to contracts for residential construction that are subject to the SB800 statutes, wrap-up insurance policies, indemnity agreements required by sureties, and contracts with design professionals.

2782.1	Nothing contained in Section 2782 shall prevent a contractor responsible for the performance of a construction contract, as defined in Section 2783, from indemnifying fully a person, firm, corporation, state or other agency for whose account the construction contract is not being performed but who, as an accommodation, enters into an agreement with the contractor permitting such contractor to enter upon or adjacent to its property for the purpose of performing such construction contract for others.
2782.2	Owner can indemnify professional engineer against liability for negligence if certain criteria are met.
2782.5	Specifically provides that parties are free to limit liability in a construction contract. Nothing contained in Section 2782 shall prevent a party to a construction contract and the owner or other party for whose account the construction contract is being performed from negotiating and expressly agreeing with respect to the allocation, release, liquidation, exclusion, or limitation as between the parties of any liability (a) for design defects, or (b) of the promisee to the promisor arising out of or relating to the construction contract. Annotation: In Markborough California, Inc. v. Superior Court (1991) 227 Cal. App. 3d 705, developer hired defendant engineer to design a man made lake. The lake liner ruptured, casing extensive property damage, for which developer sued the engineer responsible for design. The court held that Cal. Civ. Code § 2782.5, permits parties to a construction contract to limit liability through negotiation and express agreement. The court held that a contract provision that limited liability was valid if it the parties had a fair opportunity to accept reject or modify the provision. The court noted that defendant had sent a draft of the contract to petitioner with a letter discussing the procedure if petitioner wished to change the contract. The court determined that there was no evidence that petitioner did not have the opportunity to accept, reject or modify the contract. The provision was upheld, and the engineer's liability was limited to the terms of the contract.
2782.6	Hazardous Waste Indemnity: Owner can indemnify professional engineer or geologist from liability in providing hazardous materials identification, evaluation, preliminary assessment, design, remediation services or other [specified] services [in H&S code §§ 25322, 25323].
2783	Provides definition of construction contract
2784.5	Indemnity provisions regarding hauling and trucking.
2782.6	Professional engineers or geologists;
2782.7	Reserved
2782.8 Restricts defense & indemnity obligations of all design professionals (no longer just public agency contracts) to the extent of indemnitor's negligence History:	(a) For all contracts, and amendments thereto, entered into on or after January 1, 2018, for design professional services, all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any such contract, and amendments thereto, that purport to indemnify, including the duty and the cost to defend, the indemnitee by a design professional against liability for claims against the indemnitee, are unenforceable, except to the extent that the claims against the indemnitee arise out of, pertain to, or relate to the negligence, recklessness, or willful misconduct of the design professional. In no event shall the cost to defend charged to the design professional exceed the design professional's proportionate percentage of fault. However, notwithstanding the previous sentence, in the event one or more defendants is unable to pay its share of defense costs due to bankruptcy or dissolution of the business, the design professional shall meet and confer with other parties regarding unpaid defense costs. The duty to indemnify, including the duty and the cost to defend, is limited as provided in this section. This section shall not be waived or modified by contractual agreement, act, or omission of the parties. Contractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties. (b) All contracts and all solicitation documents, including requests for proposal, invitations for bid, and other solicitation documents for design professional services are deemed to incorporate by reference the provisions of this section. (c) For purposes of this section, "design professional" includes all of the following:

Added by AB 573 (Effective 1/1/2007) Amended by SB 972 (Effective 1/1/2011) Amended by SB 496 (Effective 1/1/2018)	(1) An individual licensed as an architect pursuant to Chapter 3 (commencing with Section 5500) of Division 3 of the Business and Professions Code, and a business entity offering architectural services in accordance with that chapter. (2) An individual licensed as a landscape architect pursuant to Chapter 3.5 (commencing with Section 5615) of Division 3 of the Business and Professions Code, and a business entity offering landscape architectural services in accordance with that chapter. (3) An individual registered as a professional engineer pursuant to Chapter 7 (commencing with Section 6700) of Division 3 of the Business and Professions Code, and a business entity offering professional engineering services in accordance with that chapter. (4) An individual licensed as a professional land surveyor pursuant to Chapter 15 (commencing with Section 8700) of Division 3 of the Business and Professions Code, and a business entity offering professional land surveying services in accordance with that chapter. (d) This section shall apply only to a professional service contract, or any amendment thereto, entered into on or after January 1, 2018. (e) The provisions of this section pertaining to the duty and cost to defend shall not apply to either of the following: (1) Any contract for design professional services, or amendments thereto, where a project-specific general liability policy insures all project participants for general liability exposures on a primary basis and also covers all design professionals for their legal liability arising out of their professional services on a primary basis. (2) A design professional who is a party to a written design-build joint venture agreement. (f) Nothing in this section shall abrogate the provisions of Section 1104 of the Public Contract Code. (g) Indemnitee, for purposes of this section, does not include any agency of the state.

5.2 AB 758 (Effective January 1, 2006) Limits on Type I Agreements

5.2.1 Elimination of Type I Agreements for Subcontractors in Residential Construction

AB 758 was the first in a string of legislative amendments. AB 758 made unenforceable all provisions in contracts for residential construction that require a subcontractor to indemnify and defend a builder for claims of construction defects to the extent they relate to the builder's negligence

5.2.2 Definition of a Builder

A "builder" can be a "builder, developer, general contractor, contractor, or original seller" as defined in Civil Code section 911 as follows:

> 911. (a) For purposes of this title, except as provided in subdivision (b), "builder" means any entity or individual, including, but not limited to a builder, developer, general contractor, contractor, or original seller, who, at the time of sale, was also in the business of selling residential units to the public for the property that is the subject of the homeowner's claim or was in the business of building, developing, or constructing residential units for public purchase for the property that is the subject of the homeowner's claim.

> (b) For the purposes of this title, "builder" does not include any entity or individual whose involvement with a residential unit that is the subject of the homeowner's claim is limited to his or her capacity as general contractor or contractor and who is not a partner, member of, subsidiary of, or otherwise similarly affiliated with the builder. For purposes of this title, these nonaffiliated general contractors and nonaffiliated contractors shall be treated the same as subcontractors, material suppliers, individual product manufacturers, and design professionals. (Emphasis supplied).

Note that in 911(b), there is a specific carve out for "non-affiliated" general contractors, that is, general contractors who are not financially affiliated with the developer. After AB758, Type I indemnity agreements were seemingly and well as between non-affiliated general contractors and their subcontractors, which rendered the net effect of AB 758 relatively ineffective. That loophole was closed with SB 138, effective in January 1, 2008.

5.2.3 Restrictions on Type I Agreements: AB 758 (Civil Code § 2782(c) & (d))

Assembly Bill 758, which was introduced in the summer of 2005, attempted to put an end to Type I agreements in residential construction contracts. Now codified as Civil Code § 2782(c) & (d), AB 758 provides that in all contracts for residential construction and amendments entered into after Jan. 1, 2006 that purport to indemnify the builder[2], including the cost of defense, by a subcontractor [3] against liability for claims of construction defects or other injury to property arising from the negligence of the builder or the builder's other agents, servants, or independent contractors who are directly responsible to the builder, or for defects in design furnished by those persons, are unenforceable.

5.2.4 Overview of AB 758 / Civil Code 2782 (c) & (d)

Below are the key aspects of the changes to CC § 2782(c) & (d):

No	*Issue*	*Application*	
1	Effective dates	Applies to contracts entered into after 1/1/06	
		Applies To:	***Does Not Apply To:***
2	Parties	• Developer or Owner (a/k/a "builder" / General Contractor contracts • Developer or Owner (a/k/a "builder") / Subcontract contracts • Affiliated General Contractor (a/k/a "builder") / Subcontractor contracts	General contractor / Subcontractor contracts (CC § 911(b)) "Orphan share" protection (indemnitor not responsible to provide indemnity for claims arising out of third party negligence).
3	Project Type	Residential construction	Commercial construction
		Statute does not specifically address mixed use projects, e.g. residential over commercial or condo/hotel projects	
4	Claims	Construction Defect	Personal injury; delay claims; damage to property
		Statute does not address mixed claim, e.g. mold causing personal injury	
5	Trigger of Defense Obligation Joint Defense Agreements	Allows parties to agree to joint defense agreements[4] or fronting language where indemnitor fronts defense costs pending ultimate determination of fault;	

[2] See definition of a "builder" below; builder is the developer, not the general contractor.
[3] "Subcontractor" is not a defined term in the Civil Code
[4] "Common Interest doctrine" protects attorney work product in joint defense agreements, see Meza v. H. Muehlstein (2009) 176 Cal.App.4th [Attorneys who engaged in joint defense strategy with other defense counsel did not waive their work product when communicating with other defense counsel regarding their respective clients' common interests; Meza was a personal injury claim against 15 defendants allegedly responsible for exposing plaintiff to toxic chemicals].

	(CC § 2782(d))	*Leaves open reimbursement of defense costs during settlements without determining comparative fault, effectively giving greater settlement leverage to the indemnitee who has received the benefit of the defense during the lawsuit. This provision will likely foster greater use of fronting language in indemnity agreements, resulting in an unintended effect.* Does not affect obligations of insurance carrier under the holding of Presley Homes v American States Ins. Co (2001) 90 Cal.App.4th 571 [insurer owes duty to defend additional insured against entire action, not just the covered claims].
6	Other	Does not affect SB 800 obligations. CC 2782(c) & (d) may not be waived or modified by agreement.

5.2.5 Policy Goals of AB 758 – Excerpt from Press Release

It is safe to say that the legislature failed to achieve the stated policy goals, as can be gleaned from the discussion above and from reading the excerpt copied from a press release on the subject:

> AB 758 is designed to provide relief to residential subcontractors in the future from expensive, hard-to-get liability insurance. AB 758 would eliminate the need for subcontractors to buy indemnity insurance that only protects the general contractor from losses and claims even though the general contractor was solely negligent.
>
> "This is a solid bill that makes sense for the industry and will help lower the costs of building new homes," said Assemblyman Calderon. "The three-year study on this subject clearly showed that making subcontractors obtain excessive and unnecessary indemnity agreements to protect only the general contractor is redundant and unfounded. Subcontractors only need to insure and guarantee their work product and not that of others."
>
> AB 758 also protects California consumers. "Nothing in this bill weakens a consumer's right to seek restitutions from the general or subcontractor for poor craftsmanship," said Assemblyman Calderon. "The goal of the bill is to reduce the burden of cost for subcontractors in defending claims against work they had not performed. In doing so the cost of building the home would drop as well."
>
> The costs subcontractors incur when obtaining these expensive indemnity agreements have traditionally been passed on to the home buyer. Reducing the costs involved with building of the homes will lower the overall price new homes are sold at.
>
> Under current law, the cost of defect insurance and the costs associated with providing a defense for work not done by the subcontractor have been passed on to the home buyer or absorbed by the sub.
>
> This new public policy effectively strips those costs out of the equation, resulting in lower housing prices and increased affordability.
>
> The scope of work protections will ensure that a sub's work is of the highest quality and reliability because they are solely on the hook to defend against defect litigation.
>
> By eliminating Type 1 and 2 indemnity agreements in construction contracts, AB 758 would ensure that a subcontractor will only be responsible for insuring their scope of work. Furthermore, this measure will reduce the costs associated with providing a defense against

construction defect litigation, thereby resulting in lower housing prices and increased affordability," said Norwood.

5.3 AB 573 (Effective January 1, 2007) Design Professionals – Added § 2782.8

5.3.1 What it Does

This bill codified Civil Code section 2782.8. The key issue underlying this statute, per the assembly committee, was whether "public agencies be allowed to impose contract provisions on design professionals making them responsible for the wrongful acts of the public agency itself or other persons, such as subcontractors chosen by the public agency, over whom the design professional has no control and is not otherwise legally responsible?" This section was later amended by SB 972 and SB 496.

5.3.2 Legislative Counsel's Digest

Existing law provides that agreements contained in or affecting any construction contract that purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage, or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants, or independent contractors who are directly responsible to the promisee, or for defects in design furnished by those persons, are against public policy and are void and unenforceable, except as specified. Existing law also provides that provisions, clauses, covenants, or agreements relating to construction contracts with a public agency that purport to impose on the contractor, or relieve the public agency from liability for the active negligence of the public agency, are void and unenforceable.

This bill would provide, for all contracts, and amendments thereto, entered into on or after January 1, 2007, with a public agency for design professional services, that all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any such contract, and amendments thereto, that purport to indemnify, including the cost to defend, the public agency by a design professional against liability for claims against the public agency, are unenforceable, except for claims that arise out of or relate to the negligence, recklessness, or willful misconduct of the design professional.

5.4 AB 2738 (Effective January 1, 2009) Further limits defense & indemnity obligations; integrates wrap-up policies into the indemnity framework

5.4.1 What it Does

AB 2738 amends Section 2782 for residential construction contracts entered into after January 1, 2009 and adds three new statutes which are designed to integrate wrap-up programs into the indemnity analysis.

5.4.2 Indemnity Obligations Limitations (Amend. § 2782(c))

Provisions that purport to require a subcontractor to defend or indemnify the builder or contractor for construction defects are unenforceable to the extent the claims relate to the negligence of the builder, contractor, or those who are directly responsible to the builder, or to defects in designs furnished by those persons.

5.4.3 Subcontractor's Defense Obligations (Amend. § 2782(c))

AB 2738 modified Civil Code § 2782 to address the both the defense trigger and share of defense costs:

If a builder or general contractor properly tenders a construction defect claim to a subcontractor, the subcontractor must elect within a reasonable period, but not more than 90 days, to defend the claim with counsel of its choice, and the subcontractor shall maintain control of the defense. Alternatively, the subcontractor can elect to pay a reasonably allocated share of the builder's or general contractor's defense fees and costs on an ongoing basis during the pendency of the claim, subject to reallocation upon final resolution of the claim. The builder or general contractor must allocate a share to itself and to each subcontractor to the extent a claim is alleged to be caused by each party's work, actions or omissions.

§ 2782(c) does not prohibit the parties from mutually agreeing to the timing or immediacy of the obligation to provide a defense and provisions for reimbursement of defense fees and costs, so long as that agreement does not waive or modify the provisions of subdivision (c).

5.4.4 New Rules for Wrap-Up Insurance Programs – Addition of Civil Code sections 2782.9, 2782.95 and 2782.96

The added statutes are extensive. Some of the salient features of these new statutes include:

§ 2782.9:

- Indemnity clauses that require an enrolled subcontractor to indemnify another for a claim covered by the wrap-up program are unenforceable.
- However, the parties may agree to require a reasonably allocated contribution from a subcontractor or other participant to the self insured retention or deductible required under such insurance program, if the maximum amount and method of collection of the participant's contribution is disclosed in the contract and the contribution is reasonably

limited so that each participant may have some financial obligation in the event of a claim alleged to be caused by that participant's scope of work.

§§ 2782.95 and 2782.96

- Applies to wrap insurance programs bid after January 1, 2009
- Bid documents to disclose credit or compensation contributed by enrolled parties
- Named insured must disclose in the limits, exclusions and policy term in the contract documents
- Numerous other disclosure requirements regarding the wrap up policy must be made

5.5 SB 972 (Effective January 1, 2011) Design professionals – Public Agency

5.5.1 A Brief Background

The following press release is from the bill's sponsor, American Council of Engineering Companies (ACEC), provides a concise history of this bill, which was a direct response to the holdings in Crawford and UDC.

> On Sept. 29, 2009 Governor Arnold Schwarzenegger signed SB 972 authored by state Senator Lois Wolk (D-Davis) concerning the duty of design professionals to defend public agencies. This bill, which was sponsored by ACEC California, was introduced in response to two terrible court decisions, *Crawford v. Weather Shield and UDC v. CH2M Hill*. Those two rulings have the effect of requiring design professionals, including engineers and land surveyors, to pay the costs of others to defend third-party lawsuits—even when the engineering and surveying firms were neither negligent nor in breach of contract.
>
> Unfortunately, there is simply no insurance available to cover the open-ended liability exposure created by the *Crawford* and *UDC* rulings. So in effect the two rulings force design firms to become insurance companies insuring clients for damages caused by others—damages over which engineering and surveying firms have neither responsibility nor control. The rulings place engineering and surveying firms in the untenable position of having to bet the future existence of their firms every time they sign a contract.
>
> The original version of SB 972, which simply overturned the two terrible court rulings, drew widespread opposition from many public and private sector organizations. Senator Wolk, her staff and ACEC California representatives then participated in countless meetings and other communications with many organizations—mostly local public agency organizations—the net result of which is the final version of SB 972.

SB 972, as ultimately approved by the Legislature and the Governor, makes the important step of tying the duty to defend others against third party lawsuits to the negligence of the design professionals—a tie that does not exist in the court rulings. SB 972 is without a doubt a substantial step forward toward achieving fair and insurable contract clauses—a goal which benefits both local public agencies and the design professionals from whom they procure services.

5.5.2 SB 972 - Legislative Counsel's Digest

Existing law provides, for all contracts, and amendments to contracts, entered into on or after January 1, 2007, with a public agency for design professional services, all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting these contracts, that purport to indemnify, including the cost to defend, the public agency by a design professional against liability for claims against the public agency, are unenforceable, except for claims that arise out of, pertain to, or relate to the negligence, recklessness, or willful misconduct of the design professional.

This bill would provide, with respect to contracts and amendments to contracts entered into on or after January 1, 2011, with a public agency for design professional services, that all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting these contracts or amendments to contracts that purport to require the design professional to defend the public agency under an indemnity agreement, including the duty and the cost to defend, are unenforceable, except for claims that arise out of, pertain to, or relate to the negligence, recklessness, or willful misconduct of the design professional. The bill would provide that all contracts and all solicitation documents between a public agency and a design professional are deemed to incorporate these provisions by reference.

5.6 SB 474 (Effective January 1, 2013) Type I Unenforceable for Active Negligence – Now Applies to Commercial Contracts

5.6.1 What it Does

SB 474 in many respects is the commercial version of SB 2738 by adding an entire new civil code section, 2782.05. In addition to this new section, SB 474 also amended existing law to expand the application to commercial contexts in both public and private contracts.

5.6.2 Added New Civil Code section 2782.05

Section 2782.05 applies to indemnity obligations by subcontractors in favor of general contractors, construction managers, or other subcontractors on both public and private projects for contracts entered into after January 1, 2013. Obligations purporting have a subcontractor provide indemnity to the general contractor, construction manager, or subcontractor for their

active negligence are void and unenforceable. Section 2782.05 also prohibits indemnity clauses "to the extent the claims do not arise out of the scope of work of the subcontractor pursuant to the construction contract."

The new section also specifies how the indemnification obligation is satisfied and sets forth a number of statutory exceptions. The exceptions, among other things, specify that this new section does not apply to contracts for residential construction that are subject to the SB800 statutes, wrap-up insurance policies, indemnity agreements required by sureties, and contracts with design professionals.

5.6.3 Changes to Public Contracts – Added § 2782(b)(2)

SB 474 extended 2782(b) to apply to subcontractors and suppliers. Prior to this change, indemnity provisions in construction contracts for public projects were unenforceable where the indemnity provisions purported to shift liability for the active negligence of a public agency from the government to the general contractor. The provision was expanded to include "any contractor, subcontractor or supplier of goods and services." Cal. Civ. Code § 2782 (b)(2).

5.6.4 Change to Private Contracts – Changes to § 2782(c)

SB 474 added a new provision to Section 2782(c) prohibiting indemnification for active negligence to owners of private construction projects entered into after January 1, 2013.

5.6.5 Legislative Counsel's Digest for SB 474 (Approved October 9, 2011)

Existing law provides that provisions in construction contracts, as defined, that purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss arising from the sole negligence or willful misconduct of the promisee or the promisee's agents who are directly responsible to the promisee, or for defects in design furnished by those persons, are against public policy and are void and unenforceable. Existing law provides that provisions in construction contracts with a public agency that purport to impose on the contractor, or relieve the public agency from, liability for the active negligence of the public agency are void and unenforceable. Existing law excepts from these provisions agreements to indemnify with professional engineers, among others. Existing law prescribes different requirements and prohibitions for residential construction contracts entered on and after January 1, 2009.

This bill would provide, for construction contracts and amendments executed on and after January 1, 2013, that are not for residential construction or a direct contract with a public agency or the owner of private property, as specified, that purport to insure or indemnify, including the cost to defend, a general contractor, construction manager, or other subcontractor, by a subcontractor against liability for claims of death or bodily injury to persons, injury to property, or any other loss, damage, or expense are unenforceable to the

extent the claims relate to the active negligence or willful misconduct of that general contractor, construction manager, or other subcontractor, or their other agents, as specified, or for defects in design furnished by those persons, or to the extent the claims do not arise out of the scope of work of the subcontractor in the written agreement between the parties. The bill would require that California law be applied to these contracts regardless of any choice-of-law rules that might otherwise apply. The bill would except certain contractual provisions and types of insurance from these provisions, including an agreement between a subcontractor and general contractor or construction manager as to the timing or immediacy of the defense and provisions for reimbursement of defense fees and costs, as specified. The bill would provide that waiver of these provisions is contrary to public policy, void, and unenforceable.

This bill would provide, for construction contracts entered into on and after January 1, 2013, with a public agency, that purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the public agency from, liability for the active negligence of the public agency are void and unenforceable. The bill also would provide, for construction contracts entered into on and after January 1, 2013, with the owner of privately owned real property to be improved, as specified, and as to which the owner is not acting as a contractor, construction manager, or supplier of materials or equipment to the work, that purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the owner from, liability are unenforceable to the extent of the active negligence of the owner, including that of its employees. The bill would except from these provisions a homeowner performing improvement projects on his or her own single family dwelling.

This bill would expand the definition of "construction contract" for purposes of these provisions, to include agreements for renovations and would include agreements respecting, among other things, utility, water, sewer, oil, and gas lines.

5.7 **SB 496 (Effective January 1, 2018) Design Professionals**

5.7.1 § 2782.8 Now Applies to Both Public and Private Projects

SB 496 signed on April 28, 2017 and is effective as of January 1, 2018, this bill amended section 2782.8 to apply to all design service contracts entered into by design professionals on or after January 1, 2018. The new section 2782.8 limits defense and indemnification obligations of design professionals with respect to all service contracts. This new provision removed the public agency limitation from Section 2782.8 making it applicable to all contracts for design professional services.

5.7.2 Defense Costs Capped to Design Professional's Proportionate Fault

Section 2782.8 now also limits the defense costs to the design professional's proportionate percentage of fault, but allows for a "meet and confer" process to address

payment of additional defense costs in the event there are orphan share parties, that is, those which that cannot contribute to the defense.

5.7.3 Exceptions for Wrap Ups and Design Build Joint Venture Agreements

The design professionals defense obligation limits do not apply to (1) any contract for design professional services where a project-specific general liability policy insures all project participants for general liability exposures on a primary basis and also covers all design professionals for their legal liability arising out of their professional services on a primary basis; or (2) a design professional who is a party to a written design-built joint venture agreement.

6 WHAT'S NEXT – THE SAGA CONTINUES – SB 1326 (MARCH 22, 2018)

6.1 SB 1326 – Proposed Changes to Civil Code § 2782

SB 1326, just introduced on March 22, 2018, seeks to further limit the ability to shift risk to a subcontractor by eliminating any recovery if the owner is found to be actively negligent.

6.1.1 Text from the Legislative Counsel's Digest:

> Existing law, with specified exceptions, provides that provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract entered into on or after January 1, 2013, with the owner of privately owned real property to be improved and as to which the owner is not acting as a contractor or supplier of materials or equipment to the work, that purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the owner from, liability are unenforceable to the extent of the active negligence of the owner, including that of its employees.
>
> This bill would clarify that the contractual provisions described above are unenforceable if the liability purported to be imposed is caused, in whole or in part, by the active negligence of the owner or its employees. The bill, in addition, would make unenforceable, except as specified, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract with the owner or privately owned real property to be improved as to which the owner is not acting as contractor or supplier of materials or equipment to the work, that purport to require a contractor or subcontractor to indemnify the owner for death or bodily injury to persons, or for injury to property, other than that caused by the negligence of the contractor or subcontractor. (Emphasis supplied.)

6.1.2 Proposed Text of Statute

SECTION 1. *Section 2782 of the Civil Code is amended to read:*

2782. (a) Except as provided in Sections 2782.1, 2782.2, 2782.5, and 2782.6, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract and that purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants, or independent contractors who are directly responsible to the promisee, or for defects in design furnished by those persons, are against public policy and are void and unenforceable; provided, however, that this section shall not affect the validity of any insurance contract, workers' compensation, or agreement issued by an admitted insurer as defined by the Insurance Code.

(b) (1) Except as provided in Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract with a public agency entered into before January 1, 2013, that purport to impose on the contractor, or relieve the public agency from, liability for the active negligence of the public agency are void and unenforceable.

(2) Except as provided in Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract with a public agency entered into on or after January 1, 2013, that purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the public agency from, liability for the active negligence of the public agency are void and unenforceable.

(c) (1) Except as provided in subdivision (d) and Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract entered into on or after January 1, 2013, with the owner of privately owned real property to be improved and as to which the owner is not acting as a contractor or supplier of materials or equipment to the work, that purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the owner from, liability are unenforceable ~~to the extent~~ of if the liability is caused, in whole or in part, by the active negligence of the owner, including that or of its employees.

(2) Except as provided in subdivision (d), and Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract, entered into on or after January 1, 2019, with the owner or privately owned real property to be improved as to which the owner is not acting as contractor or

supplier of materials or equipment to the work, that purport to require a contractor or subcontractor to indemnify the owner for death or bodily injury to persons, or for injury to property, other than that caused by the negligence of the contractor or subcontractor are unenforceable.

Section 14.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

North Ballroom

Friday, May 18th 2018
8:30 AM – 9:30 AM

Course Title:
Florida - Opening Pandora's Box
and How to Close It

Joseph Miele, Esq., Mark Boyle, Esq. and Paul Amirata, Esq.

FLORIDA CD

Opening Pandora's Box and How To Close It

PRESENTERS:

Joseph R. Miele, Jr., Esq.
Kaufman Dolowich & Voluck, LLP
401 East Las Olas Blvd., Suite 1400
Fort Lauderdale, FL 33301
Phone: (954) 712-7472
email: jmiele@kdvlaw.com
www.kdvlaw.com

Mark A. Boyle., Esq.
Boyle & Leonard, P.A.
2050 McGregor Blvd.
Fort Myers, FL 33901
Phone: (239) 337-1303
email: mboyle@insurance-counsel.com
www.insurance-counsel.com

Paul A. Amirata., Esq.
Senior Vice President, CD/CGL Claims
Cranmore
150 2nd Avenue North, 3rd Floor
St. Petersburg, FL 33701
Cell: (727) 424-0888
paul.amirata@cranmore.com

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BIOGRAPHY

Joseph R. Miele, Jr. Esq., Partner
Kaufman, Dolowich & Voluck, LLP
jmiele@kdvlaw.com

Mr. Miele began his insurance career over twenty five years ago when admitted to the New Jersey Bar in 1991. He first worked as a Home Office Supervisor for AIG in New York overseeing Environmental and Toxic Tort coverage litigation. He was admitted to the New York Bar in 1992 and the District of Columbia Bar in 1994. Following AIG Mr. Miele entered private practice as a coverage and "bad faith" associate. In 2000 he moved to Florida and was admitted to Bar. Mr. Miele has particular expertise in the areas of Construction Defect, First Party, Environmental/Toxic Tort and Employment Liability coverage. He has appeared in hundreds of coverage and "bad faith" proceedings and frequently lectures on insurance coverage law and claim handling practices. He received his law degree from New York Law School in 1991 and graduated Seton Hall University in 1987.

Mark A. Boyle, Esq., Partner
Boyle & Leonard, P.A.
Mboyle@insurance-counsel.com

Mr. Boyle is the Managing Partner of the Boyle & Leonard, P.A. located in Fort Myers, Florida. His practice is devoted to all aspects and types of insurance recovery including coverage and claim handling matters at trial and on appeal. Mr. Boyle's focus is representing policyholders in construction insurance disputes and catastrophic losses. He represented J.S.U.B., Inc. in *United States Fire Insurance Company v. J.S.U.B., Inc.*, 979 So. 2d 871 (Fla. 2007), the leading Florida Supreme Court case on insurance coverage for defective construction claims. Mr. Boyle was formerly an Assistant County Attorney for Pasco County in New Port Richey, Florida and an associate general counsel for Armor Insurance Company in Tampa, Florida. He received his law degree from Stetson University in 1993 and graduated from the University of South Florida in 1990.

Paul A. Amirata, Esq.
Senior Vice President,
Construction Defect/General Liability Claims
Enstar (US), Inc.

Mr. Amirata has over twenty five years of experience in the insurance industry and private practice. Prior to his career at Enstar he was the head of claims for AXA Insurance Company where he oversaw all of AXA Corporate Solution's domestic claims, the majority of which being property and casualty. Prior to AXA, Mr. Amirata was an Assistant Vice President of RiverStone Claims Management LLC in Manchester, NH. His responsibilities included overseeing the construction defect claims department. Mr. Amirata is well respected in the industry and routinely speaks at industry conferences and seminars. He has also been quoted in The Wall Street Journal and made television appearances on Bloomberg News.

PREFACE

This paper is intended to provide the reader with an understanding of the construction defect coverage claim and litigation process from inception through compromised resolution. It also provides an outline of an Insurer's claim handling obligations. Many of these principals are of general application. Accordingly, this paper is comprised of three parts. Part I is a summary of Florida law on the typical policy provisions and common coverage issues that arise. Part II is a discussion of claim facilitation and resolution strategies. Part III outlines an insurer's general claim handling duties under Florida law. Every claim must be evaluated based upon its own facts in relation to the particular insurance policy under review. This paper may not be applicable to and should not be relied upon in connection with the evaluation of any particular claim. In addition, neither this paper nor the live presentation are intended to be, and shall not be construed as, the position or opinion of the individual speakers or of any the entities with whom they may be associated.

PART I
THE BASICS OF FLORIDA COVERAGE LAW

I. THE DUTY TO DEFEND AND TO INDEMNIFY

A. Duty to Defend a Legal Action Brought Against the Insured

The duty to defend is broader than the duty to indemnify and is generally determined solely by the allegations in the complaint and any attachments to it, *i.e.*, the "eight corners" rule. The duty exists even where the allegations are groundless, false or fraudulent or the legal theories unsound. *State Farm Fire & Cas. Co. v. CTC Dev. Corp.*, 720 So.2d 1072, 1077 (Fla. 1998); *National Union Fire Ins. Co.v. Lenox Liquors, Inc.*, 358 So.2d 533, 535 (Fla. 1977); *West Am. Ins. Co. v. Silverman*, 378 So.2d 28, 30 (Fla. 4th DCA 1979).

There is an exception to the "eight corners" rule. An insurer may deny a defense based on uncontroverted facts outside of the pleading that are unnecessary to the claimant's cause of action or which would not normally be set forth in the complaint. A court may likewise look at such facts in determining the insurer's duty to defend. Examples include the timing of notice, certain policy conditions and prior litigation. *Composite Structures, Inc. v. The Continental Ins. Co.*, 560 Fed.Appx. 861, 864-866 (11th Cir. 2014), citing *Higgins v. State Farm Fire and Cas*. Co., 894 So. 2d 5, 10 n.2 (Fla. 2005); *Acosta, Inc. v. Nat'l Union Fire Ins. Co.*, 39 So. 3d 565, 567-568; 574-575 (Fla. 1st DCA 2010); *Nationwide Mut.Fire Ins. Co. v. Keen*, 658 So. 2d 1101, 1103 (Fla. 4th DCA 1995). This rule could also apply to such things as recorded Certificates of Occupancy and permit dates.

The insurer must defend the entire action if a complaint contains both covered and uncovered claims. *West American Ins. Co. v. Silverman*, 378 So.2d at 30. The duty to defend would only end when the potentially covered count (or counts) are eliminated from the case. *State Farm Fire and Cas. Co. v. Higgins*, 788 So.2d 992, 996 (Fla. 4th DCA 2001).

In practice, the cases addressing the duty to defend standard are inconsistent. Generally speaking, however, the benefit of the doubt is given to the insured. In *Biltmore Constr. Co., Inc.* v. *Owners Ins. Co.*, 842 So.2d 947 (Fla. 2d DCA 2003) the Court found a duty to defend despite the absence of any specific allegation of damage to property other than the defective work itself. It reasoned that allegations of damage due to severe water intrusion were sufficient because "it could obviously include damage to property other than the improperly constructed windows and exterior walls, as it could include damage to carpeting and drywall." *Id*. at 949.

Going even further, the court in *Carithers v. Mid-Continent Cas. Co*., 782 F.3d 1240, 1247 (11th Cir. 2015) found that an ambiguity in the law is a relevant factor in determining a duty to defend. It viewed an uncertain legal issue as the equivalent of an uncertain factual issue. Because the appropriate trigger of coverage was undecided, the insurer was required to resolve that uncertainty in favor of the insured and afford a defense.

Taking a more narrow approach, the Court in *Auto-Owners Ins. Co. v. Elite Homes, Inc.*, 160 F.Supp. 3d 1307 (M.D. Fla. 2016), aff'd, 2017 U.S. App. LEXIS 1132 (11th Cir.), found that no duty to defend was owed to a general contractor where it was alleged that water intrusion caused "extensive damage to other property includ[ing] the frame subsurface, sheething, insulation, drywall and interior finishes". It reasoned that the underlying complaint could not be fairly read to factually allege damages unrelated to the structure of the home.

The duty to defend is personal in nature and there is no right of contribution for defense costs between coinsurers. Each insurer owes an independent contractual duty to defend its insured and an insurer that agrees to defend cannot seek reimbursement from a non-defending coinsurer. *Penn. Lumbermans Mut. Ins. Co. v. Ind. Lumbermans Mut. Ins. Co.*, 43 So. 3d 182, 188-189 (Fla. 4th DCA 2010); *Argonaut Ins. Co. v. Md. Cas. Co*., 372 So. 2d 960, 963 (Fla. 3d DCA 1979). Nor are such defense costs recoverable by an insurer under traditional principles of subrogation. *Cont. Cas. Co. v. United Pac. Ins. Co.*, 637 So.2d 270, 272 (Fla. 5th DCA 1994).[1]

B. Duty to Defend Upon Service of a §558 Notice

Florida Statute §558 was enacted to create a pre-suit "alternative dispute resolution mechanism" to resolve construction defect claims. §558.001. A claimant cannot bring suit unless it first complies with certain notice requirements and allows the offending contractor the opportunity to correct its defects. §558.004. The claimant and potential defendant may, however, opt out of this process. §558.005.

While the §558 process can be helpful in avoiding litigation it nevertheless can be quite expensive. The investigation process itself can be costly. And, the statute goes beyond the defect itself. §558.004(1)(b) states that "[t]he notice of claim must describe in reasonable detail the nature of each alleged construction defect and, if known, the damage or loss resulting from that defect".[2]

[1] See also, *Zurich Am. Ins. Co. v. Southern-Owners Ins. Co*., 248 F.Supp.3d 1268 (M.D. 2017); *Zurich Am. Ins. Co. v. Amerisure Ins. Co*., 2017 U.S. Dist. LEXIS 8366 (S.D. Fla.).

[2] Note that as discussed below, this language coincides with the Florida Supreme Court's interpretation of the phrase "Property damage" *i.e*., damage to property other than the defective work itself.

On December 14, 2017 the Florida Supreme Court rendered its decision in *Altman Contrs., Inc. v. Crum & Forster Specialty Ins. Co*., 232 So.3d 273 (Fla. 2017) ostensibly determining whether a duty to defend arises upon tender of a §558 Notice. Unfortunately, the Court left many unanswered questions.

The core issue addressed was whether the §558 proceeding qualifies as a "Suit". The policy contains the following pertinent provisions:

> **a.** We will pay those sums that the insured becomes legally obligated to pay as damages because of … "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for … "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result … .
>
> * * * *
>
> The word "suit" is defined as follows, in part:
>
> 18. "Suit" means a civil proceeding in which damages because of … "property damage" … to which this insurance applies are alleged". Suit" includes:
>
> **a.** An arbitration proceeding in which such damages are claimed and to which the insured must submit or does submit with our consent; or
>
> **b.** Any other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent.

After analyzing §558 the Court concluded that it was not a "civil proceeding" under section **a.** but was an "alternative dispute resolution proceeding" under section **b.** It therefore held that:

> "[T]he policy's definition of 'suit' under subparagraph (b) requires [the insurer's] consent to [the insured's] submission to the 'alternative dispute resolution proceeding' in order to invoke [the insurer's] duty to defend [the insured] under the policy."

Id. at 279.

The Court's ruling creates a conundrum for an insured. If it determines that it is in its own best interest to participate but the insurer does not consent, it is subject to a voluntary assumption of liability defense.

C. Insurer's Response to a Tender of the Defense

An insurer generally has three options when it receives a request for a defense. It can deny the claim, accept the defense under a reservation of rights or accept the defense unconditionally. The right choice depends on the circumstances.

1. The Claims Administration Statute

If an insurer wishes to preserve its ability to assert certain defenses to coverage, it must reserve its rights and take other actions in strict compliance with the Claims Administration Statute, §627.426 Fla. Stat. ("CAS")[3]. As interpreted by the Florida Supreme Court, the defenses that can be waived are breaches of policy Conditions such as late notice. Non-compliance with the CAS will not create coverage where it is barred by exclusion or does not initially fall within the Insuring Agreement. *AIU Ins. Co. v. Block Marina Inv. Inc.*, 544 So.2d 998, 1000 (Fla. 1989); *Mid-Continent Cas. Co. v. King*, 552 F. Supp. 2d 1309 (N.D. Fla. 2008). See also, *Sharp General Contractors, Inc. v. Mt. Hawley Ins. Co.*, 604 F. Supp. 2d 1360 (S.D. Fla. 2009) (claim administration statute did not apply where the defense to coverage was non-compliance with a contractor's endorsement); *EmbroidMe.com, Inc. v. Travelers Prop. Cas. Co. of Am*., 845 F.3d 1099 (11th Cir. 2017)(non-compliance with the claim administration statute does not preclude an insurer from challenging an insured's right to recover its pre-tender defense costs).

Under the CAS, a liability insurer is not permitted to deny coverage based on a particular coverage defense unless, within thirty (30) days after the liability insurer knew or should have known of the coverage defense, written notice of reservation of rights to assert it is given to the named insured by registered or certified mail or hand delivery to the last known address of the insured. In addition, within sixty (60) days of compliance with the notice of reservation of rights requirement or receipt of a summons and complaint naming the insured as a defendant, whichever is later, but in no case later than thirty (30) days before trial, the insurer must:

a. Give written notice to the named insured by registered or certified mail of its refusal to defend the insured;

b. Obtain from the insured a nonwaiver agreement following full disclosure of the specific facts and policy provisions upon which the coverage defense is asserted and the duties, obligations, and liabilities of the insurer during and following the pendency of the subject litigation; or

c. Retain independent counsel that is mutually agreeable to the parties.

The 11th Circuit Court of Appeals addressed this statute in the context of a construction defect claim in *Mid-Continent Cas. Co. v. Basdeo*, 477 Fed.Appx. 702 (11th Cir. 2012). There, the insured-contractor was sued for defective work in two separate lawsuits, one brought by a

[3] This statute, however, is inapplicable to authorized Surplus Lines insurers. *Essex Ins. Co. v. Integrated Drainage Solutions, Inc.*, 124 So.3d 947 (Fla. 2d DCA 2013)(Florida Statute §626.913(4) applies retroactively to exempt surplus lines insurers from Chapter 627 of the insurance code including Florida Statute §627.426).

resident who suffered property damage and another by the condominium association that had retained it. The contractor never provided notice to the insurer of either lawsuit and hence never requested a defense. The resident ultimately provided a copy of the suit to the insurer and also advised that a default had been entered. The insurer was unsuccessful in contacting the insured and a final default judgment was entered against in both suits. *Id*. at 704-705.

The insurer argued that there was no coverage because the insured never provided notice and had not requested a defense. The Court rejected this argument holding that the defenses were waived by non-compliance with the the notice requirements of the CAS. *Id*. at 705-706.

2. Accepting the Defense Under a Reservation of Rights

A common response to a tender of defense is that the insurer will agree to defend and appoint counsel under a reservation of rights. An insured is not obligated to accept it and can instead reject the reservation and demand an unconditional defense. It can also accept the defense and later reject it if the insurer materially changes its position. Upon proper rejection an insured may take control of its own defense and is not subject to a forfeiture of coverage based on the lack of cooperation. An insured's subsequent settlement of an action against it without the insurer's consent does not relieve the insurer of its obligation to pay under the policy. But, once the insured accepts the defense under a reservation, the insured is obligated to cooperate with the insurer and cannot settle without the insurer's consent.[4] *Safeco Ins. Co. v. Taylor*, 361 So.2d 743, 746-747 (Fla. 1st DCA 1978); *Mid-Continent Cas. Co. v. Am. Pride Building Co*., 601 F.3d 1143, 1148-1150 (11th Cir. 2010); *Western Heritage Ins. Co. v. Montana*, 30 F. Supp. 3d 1366, 1371-1375 (M.D. Fla. 2014).

3. Response to a §558 Notice

Two typical scenarios arise. First, the claimant and the insured will agree to opt out of the §558 process and go directly to suit. The insured will send the complaint to the insurer and demand a defense. At that point the suit can be stayed and the insured, claimant and insurer can work together towards an agreeable resolution of the claim.

Second, even without a suit it is often beneficial for the insurer to be involved at the beginning of the investigation. It will have input into the investigative process and obtain valuable information that may otherwise be lost. If the insurer delays in its "investigation" the insured and claimant may very well move forward with inspections and destructive testing to mitigate further damage.

Additional complications can arise if a coinsurer participates from inception. It will control the investigation and gather facts beneficial to its position. It is under no obligation to share information and may not gratuitously provide it. It may require payment, a cost sharing agreement going forward or both.

[4] Under Florida law an insurer can recover its defense costs only if that is a condition specifically asserted in the reservation of rights letter. *Jim Black & Associates, Inc. v. Transcon Ins. Co*., 932 So. 2d 516 (Fla. 2d DCA 2006); *Colony Ins. Co. v. G & E Tires & Serv., Inc*., 777 So.2d 1034 (Fla. 1st DCA 2000).

4. Denial of Coverage and the "Coblentz Agreement"

Any decision by an insurer to deny a defense leaves it exposed to an agreed-consent judgment between its insured and the claimant. In *Coblentz v. Am. Sur. Co. of New York*, 416 F.2d 1059 (5th Cir. 1969), the Court concluded that if a liability insurer is informed of an action against its insured and declines to defend, it is bound to a consent judgment between the claimant and the insured absent a showing of fraud or collusion. *Id*. at 1662 - 1663. The amount of the judgment may exceed the policy limits. The insured or its assignee has the burden to prove: 1) that the insurer wrongfully refused to defend the insured; 2) that the insurer had an indemnification obligation under the policy; and, 3) that the settlement with the claimant was reasonable and in good faith. *Stephens v. Mid-Continent Cas. Ins. Co*., 749 F.3d 1318, 1321 (11th Cir. 2014); *Petro v. Travelers Cas. & Sur. Co.*, 2014 WL 4920787 *4 (N.D. Fla.).

A fourth requirement for the enforcement of a consent judgment has developed through more recent case law. The assignee must also allocate between covered and uncovered claims and damages. If an assignee cannot carry its burden of proof and specifically connect some amount of the consent judgment to damages covered under the insurance policy the entire judgment is unenforceable. *Bradfield v. Mid-Continent Cas. Co.*, 143 F. Supp. 3d 1215, 1245-1247 (M.D. Fla. 2015); *Trovillion Construction and Development, Inc. v. Mid-Continent Casualty Co*., 2014 WL 201678 at *8-9 (M.D. Fla.); *Nova Cas. Co. v. Willis*, 39 So. 3d 434, 437 (Fla. 3d DCA 2010)(trial court erred in determining insurer liable for all elements of claim; it is insured's burden to prove the dollar amount of each element of covered loss).

D. The Duty to Indemnify

In contrast to the duty to defend, the duty to indemnify is determined solely by the underlying facts of the claim and not the factual allegations in the complaint. *State Farm Fire & Cas. Co. v. CTC Dev. Corp.*, 720 So.2d at 1077.

The burden of proof is on the party seeking coverage to establish a claim within the coverage afforded by the policy. *Castillo v. State Farm Florida Ins. Co.*, 971 So.2d 820, 824 (Fla. 3d DCA 2007). The burden of proof shifts to the insurer to prove an exclusion to coverage. The burden of proof shifts back to the insured to prove an exception to an exclusion. *East Florida Hauling, Inc. v. Lexington Ins. Co.*, 913 So.2d 673, 678 (Fla. 3d DCA 2005).

1. Allocation of Covered and Non-Covered Damages

An insured's burden of proof requires it to affirmatively segregate covered from non-covered damages. This issue primarily arises in two ways.

First, as was discussed above an insured and claimant must allocate between covered and non-covered damages in order for a claimant to recover on a consent judgment. Second, the

insured's allocation obligation extends through the conclusion of a trial on the merits. This issue was addressed in the significant decision of *Duke v. Hoch*, 468 F.2d 973 (5th Cir. 1972).[5]

In *Duke*, a judgment creditor attempted to secure insurance proceeds of the debtor/insured through a garnishment proceeding. The insurer did furnish a defense to its insured through appointed counsel under a reservation of rights. Personal counsel also represented the insured. The matter proceeded through trial and a general verdict against the insured was rendered. It included both covered and non-covered damages. *Id*. at 974 - 977. The insurer prevailed in the subsequent garnishment proceeding because covered damages could not be proven. *Id*. On appeal the Fifth Circuit reversed.

The significance of the reversal is that it was *not* premised on any error by the trial court requiring an allocation. Instead, it was based on the insurer's failure to affirmatively inform the insured of its burden to secure an appropriate verdict form that would allow it to segregate covered damages.

The Court explained that once the insurer satisfied its burden of proof to show some non-covered *acts,* the burden shifted back to the insured to separate covered damages from the verdict - unless he "was somehow relieved of his burden of proof". *Id*. at 98 - 98. Ultimately, the Court did find that the insured/judgment creditor was relieved of this burden because of a non-disclosed conflict of interest. *Id*. at 979 - 980.

According to the Court a conflict of interest arose between the insured and the insurer during the course of the liability trial. It was in the insurer's best interest to secure a non-allocated verdict whereas it was in the insured's best interest that covered damages be apportioned. *Id*. at 979. At that point it was incumbent on appointed counsel to advise the insured of the conflict.[6] Because there was no evidence that such disclosure had been made, the insured was relieved of its burden to prove only covered damages. *Id*. at 980.[7]

II. POLICY COVERAGE AND EXCLUSIONS

A. Who is Insured Under the Policy

Typical general liability policies cover three classifications of insureds and the scope of available coverage is not the same. These are the “Named Insured”; “Insured”; and, “Additional Insured”. The “Named Insured” is the person or entity specifically identified in the policy Declarations as the “Named Insured”. The Named Insured has the full benefits of the policy.

The “**Who Is An Insured**” section of the policy identifies others who have insured status. For example, depending on the organizational structure of the Named Insured the policy

[5] While Florida Federal trial courts are now bound by Eleventh Circuit precedent they are bound by decisions of the Fifth Circuit prior to September 30, 1981. *Bonner v. Prichard*, 661 F.2d 1206 (11th Cir. 1981).

[6] The Court explicitly held that the mere issuance of a reservation of rights letter itself is insufficient to inform the insured of the conflict and of the steps it must take to preserve its coverage claim.

[7] The Court also provided instructions to the trial court on further proceedings. In essence the judge was required to review the initial trial court proceedings and parse out covered damages. If the court was unable to do so on the current record it could take additional evidence. *Id*. at 984 - 985.

may cover members, partners, officers, directors and employees. In general terms, the insureds that are identified in this section are only insured for liability arising as a result of their conduct in the Named Insured's business.

It is critical to understand joint venture coverage. A joint venture is not insured simply because of a Named Insured's participation in it. Likewise, a Named Insured is not covered for its conduct as part of a joint venture. Rather, the joint venture must itself be the Named Insured. In situations where the Named Insured is a joint venture its members will be insured for their conduct in its business.

1. Additional Insured Coverage

Developers and up-stream contractors virtually always require that their contracted workers afford them Additional Insured coverage.[8] These "insureds", while strangers to the policy, nevertheless enjoy the same benefits as a Named Insured including the right to a defense.[9]

Additional Insured coverage is available for both Operations and Completed Operations hazards. These coverages are mutually exclusive. "Operations coverage" affords insurance coverage only for liability that arises when the insured is actually doing its work. "Completed operations coverage" only affords coverage for liability and damage that occurs *after* the insured has completed its work. *Tucker Constr. Co. v. Michigan Mut. Ins. Co.*, 423 So. 2d 525, 526-527 (Fla. 5th DCA 1982)(operations coverage and completed operations coverage are mutually exclusive); *United States Fire Ins. Co. v. J.S.U.B., Inc*., 979 So. 2d 871, 891 (Fla. 2007)(damage caused to a completed project by the faulty work of a subcontractor is a covered "occurrence" under the general contractor's liability policy affording completed operations coverage absent any applicable coverage exclusion); *Essex Ins. Co. v. Kart Const, Inc.*, 2015 WL 4730540 (M.D. 2015)(same). See also, *Travelers Prop. Cas. Co. of Am. V. Amerisure Ins. Co*. 161 F.Supp. 3d 1133, 1136 -1137 (N.D. Fla. 2015), aff'd, 2017 U.S. Dist. LEXIS 8366 (11th Cir.)(Additional Insured coverage can lie for both operations and completed operations risks in the same policy).

A typical Operations coverage Additional Insured endorsement provides:

ADDITIONAL INSURED – OWNERS, LESSEES OR CONTRACTORS – SCHEDULED PERSON OR ORGANIZATION

Name of Person or Organization:
Any person or organization, trustee, estate or government entity to whom or to which the Named Insured is obligated, by virtue of written contract to provide Insurance, Such As Is Afforded By This Policy

[8] Additional Insured coverage is most commonly afforded by separate endorsement and is discussed below.

[9] See, *e.g*., *Travelers Prop. & Cas. Co., v. Amerisure Ins. Co*., 2015 WL5769247 at *2-3 finding that the general contractor was an Additional Insured because the subcontract obligated the subcontractor to procure coverage on its behalf.

A. **Section II – Who Is An Insured** is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured.

B. With respect to the insurance afforded to these additional insureds, the following exclusion is added:

2. Exclusions

This insurance does not apply to "bodily injury" or "property damage" occurring after:

(1) All work, including materials, parts or equipment furnished in connection with such work, on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the site of the covered operations has been completed; or

(2) That portion of "your work" out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or subcontractor engaged in performing operations for a principal as part of the same project.

Conversely, a typical Completed Operations coverage Additional Insured endorsement provides:

ADDITIONAL INSURED – OWNERS, LESSEES OR CONTRACTORS – COMPLETED OPERATIONS

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

SCHEDULE

Name of Person or Organization: Any person or organization, trustee, estate or government entity to whom or to which the Named Insured is obligated, by virtue of written contract to provide Insurance, Such As Is Afforded By This Policy
Location And Description of Completed Operations: **FL**

Section II – Who Is An Insured is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of "your work" at the location designated and described in the schedule of this endorsement performed for that insured and included in the "products-completed operations hazard."

An equally important difference in the scope of Additional Insured coverage Endorsements limiting coverage to vicarious liability vary. Some endorsements do so by incorporating the "Insured Contract" definition utilized in the Contractual Liability exclusion.[10] Other endorsements use variations of limiting language making clear that Additional Insured coverage only exists for the negligence of the Named Insured, *e.g.*, "liability directly attributable to" the Named Insured's performance of its work". This limiting language precludes coverage for the Additional Insured's own negligence. See, *King Cole Condo. Ass'n, Inc. v. Mid-Continent Cas. Co*., 21 F.Supp. 3d 1296 (S.D. Fla. 2014)(Additional Insured coverage was not available to condominium association under the general contractor's policy because there were no allegations by the underlying plaintiff of vicarious liability of the Association).

In *Mid-Continent v. Constr. Serv. and Cons.* 2008 WL 896221 at * 3-5 (S.D. Fla.), a Developer contracted with a General Contractor to build a series of houses. A subcontractor's employee who was injured on the job-site sued the Developer and the General Contractor. The Developer and its insurer tendered the claim to the General Contractor. The contract between the Developer and the General Contractor contained an indemnification provision whereby the General Contractor was required to indemnify the Developer for *its own* negligence. The contract also required the General Contractor to name the Developer as an Additional Insured on its policy.

The Additional Insured endorsement obtained by the General Contractor provided that the Developer qualified for AI coverage only where: 1) the General Contractor was required to obtain AI coverage in an "Insured Contract"; and 2) the Developer's liability arose from the work of the General Contractor.

The Court began its analysis by looking at Florida Statute §725.06. It precludes indemnity for the indemnitee's own negligence unless there is a specific monetary limitation. Otherwise, the provision is stricken from the contract. The contract did not contain the limitation so the indemnification provision was unenforceable. Because the only allegations against the Developer were for its own negligence it was not entitled to AI coverage. See also, *Amerisure Ins. Co. v. Orange & Blue Constr., Inc., et. al.,* 913 F. Supp. 2d 1363, 1370 (S.D. Fla. 2012).

However, where a policy simply uses a phrase similar to "liability arising out of your operations" or, "to operations by or on behalf of the Named Insured", Additional Insured coverage is not limited to vicarious liability. It is sufficient if the injured person was present at the scene of the accident in connection with performing the Named Insured's business even if the cause of the injury was the negligence of the Additional Insured. *Container Corp. of America v. Maryland Cas. Co.*, 707 So. 2d at 735-737 (Fla. 1998); *Amerisure Ins. Co. v. Orange & Blue Constr., Inc., et. al.,* 913 F. Supp. 2d at 1370.

[10] *Bradenfield* 2015 WL 6956543 at *10 finding no Additional Insured coverage because there was no written "Insured Contract" and no allegations of vicarious liability but only causes of action for direct liability. *Travelers Prop. Cas. Co. of Am. V. Amerisure Ins. Co*. 161 F.Supp. 3d 1133, 1137 (N.D. Fla. 2015), aff'd, 2017 U.S. Dist. LEXIS 8366 (11th Cir.). See also, *King Cole Condo. Ass'n, Inc. v. Mid-Continent Cas. Co*., 21 F.Supp. 3d 1296 (S.D. Fla. 2014)(Additional Insured coverage was not available to condominium association under the general contractor's policy because there were no allegations by the underlying plaintiff of vicarious liability of the Association).

Finally, it is important to examine the scope of coverage required by the subcontract. This issue was addressed in *Great Divide Insurance Company v. Amerisure Insurance Company*, 2018 U.S. Dist. LEXIS 41443 (S.D.Fla.).

In this case a Developer hired Aventura Construction to build a convenience store. Aventura was insured by Great Divide. This contract required Aventura to carry completed operations coverage and to name the Developer as an Additional Insured. ("Prime Contract").

Aventura hired sub-contractor, Dawdy Concrete who was insured by Amerisure The sub-contract required Dawdy to procure insurance and to add Aventura as an Additional Insured but did not require it to obtain completed operations coverage. After construction was completed a patron fell and was injured. The patron sued Aventura who tendered the claim to Amerisure because of an indemnification provision in the subcontract. Amerisure denied coverage. Great Divide defended and settled then filed suit against Amerisure to recover.

The Amerisure policy contained an endorsement affording Additional Insured coverage upon two conditions. First, the subcontract must have required completed operations coverage and second, it must have been shown on a Certificate of Insurance "on file" with Amerisure.

The Court ruled in favor of Amerisure finding that the policy only afforded operations coverage. First, the subcontract did not require Gawdy to carry completed operations coverage. Second, while Aventura was identified as a "holder" on the Certificate of Insurance, it did not say that the insurance afforded completed operations coverage. The Court noted that the subcontract could have included a "flow-down" clause that required the subcontractor to be bound by the obligation in the Prime Contract. Having not done so, Aventura did not have Additional Insured coverage for completed operations.

(a) Obligations Owed to an Additional Insured

An insurer faces a significant challenge when it receives a claim by both its Named Insured and an Additional Insured. They are each entitled to the benefits of the policy and are each owed the equivalent duty of good faith. *Contreras v. U.S. Sec. Ins. Co*., 927 So.2d 16, 21 (Fla. 4th DCA 2006).

Florida's expectations for "good faith" claim handling are well established. In part, an insurer must advise an insured of settlement opportunities, advise it of the probable outcome of the litigation, warn it of the possibility of an excess judgment, and advise it of any steps that it may take to avoid it. It is incumbent on the insurer to investigate the facts, give fair consideration to a settlement offer that is not unreasonable under the facts, and settle, if possible, where a reasonably prudent person, faced with paying the total recovery, would do so. *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So. 2d 783, 785 (Fla. 1980).

The Court in *Nova Cas. Co. v. OneBeacon America Ins. Co.*, 603 Fed.Appx 898 (11th Cir. 2015) addressed these principles in an Additional Insured claim. The procedural history was somewhat unique because it arose from a dispute between two insurers with independent Named Insureds but with overlapping Additional Insured coverage.

The action arose from a shooting at a bank. The victim sued Silverhunt Associates, Ltd. ("Silverhunt"), the lessor of the property and New York Community Bancorp ("NYCB"), the bank operator. Silverhunt was a Named Insured on a policy issued by Nova Casualty Co. ("Nova") with $1,000,000 primary limits and $4,000,000 excess limits. Silverhunt was an Additional Insured on a policy issued by OneBeacon America Ins. Co. ("OneBeacon") to NYCB with $1,000,000 primary limits and $20,000,000 excess limits.

OneBeacon refused to defend Silverhunt and Nova defended it alone. Nova entered settlement discussions and invited OneBeacon to participate. OneBeacon failed to do so and Nova settled the victim's suit against Silverhunt for $1,500,000. After Nova settled the suit against Silverhunt, OneBeacon settled the suit against NYCB in an undisclosed amount exhausting its primary limits. Nova filed suit against OneBeacon seeking a declaration that OneBeacon had a duty to defend and indemnify Silverhunt and for equitable subrogation for its settlement payment.

The issue before the Court was weather OneBeacon's exhaustion of its primary limits in settlement of the suit against NYCB absolved it of any responsibility to Silverhunt even though its primary limits were fully available at the time that Nova settled the suit against Silverhunt. The Court held that OneBeacon was not relieved of liability and that the "burden of funding" Nova's settlement "falls squarely on OneBeacon's shoulders". *Id*. at 904.

Central to the Court's decision was that OneBeacon owed the equivalent duty of good faith to Silverhunt, as Additional Insured, as it did to NYCB, as the Named Insured. *Id*. at 901-902. However, OneBeacon took no steps to protect Silverhunt and in fact, declined to do so by initially refusing to defend it.[11] OneBeacon thus became responsible up to its $1,000,000 primary limits for settlement of the Silverhunt suit. The Court found OneBeacon's subsequent exhaustion irrelevant because its limits were fully available at the time Nova settled. In other words, the subsequent exhaustion in settlement of the Named Insured's claim could not act to excuse its earlier breach of its obligation to pursue settlement of the Additional Insured claim against Silverhunt. *Id*. at 903.

B. The Insuring Agreement and Trigger of Coverage

Four conditions of the Insuring Agreement must be satisfied to initially bring a claim within the scope of coverage: 1) there must be an "Occurrence"; 2) there must be "Property damage"; 3) the "Property damage" must be caused by the "Occurrence"; and, 4) the "Property damage" must happen during the effective dates of the policy. The applicable policy must also be "triggered" as defined under the law.

[11] For reasons not explained in the opinion, the Court regarded OneBeacon as Silverhunt's primary insurer and Nova as its excess insurer.

1. The "Occurrence" and "Property Damage" Requirements

General Liability policies typically contain provisions similar to the following:

> **Insuring Agreement**
>
> **a.** We 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. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result. But: …
>
> **b.** This insurance applies to "bodily injury" and "property damage" only if:
>
> (1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory", and
>
> (2) The "bodily injury" or "property damage" occurs during the policy period. …
>
> * * * *
>
> **Definitions**
>
> "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.
>
> "Property damage" means:
>
> (1) Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it … .

The Florida Supreme Court first addressed these issues in a construction defect coverage case in *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871. There, improper soil compaction, use and testing by a subcontractor resulted in damage to the foundation, drywall and other interior portions of several homes after construction was completed. The insurer argued that there was no coverage under the general contractor's General Liability policy because faulty construction that resulted in damage to the general contractor's own work did not constitute "Property damage" caused by an "Occurrence". The Court rejected the insurer's argument using a two-step analysis. First, it determined that faulty workmanship that is neither intended nor expected from the standpoint of the insured can constitute an "accident" and, thus, an "Occurrence."

Second, it determined that faulty workmanship by a subcontractor that has damaged the completed project can constitute "physical injury to tangible property" within the definition of "Property damage" in the policy. *Id*. at 883-884; 889-890.

The Supreme Court further defined the "Occurrence" and "Property damage" requirements in *Auto–Owners Ins. Co. v. Pozzi Window Co.*, 984 So.2d 1241 (Fla. 2008). There, a subcontractor defectively installed windows purchased by the homeowner in a multimillion-dollar home. The window manufacturer settled with the builder, took an assignment and sued the builder's CGL insurer to recover the costs to repair or replace the windows. The Court explained that there is no "Property damage" where the only damages being sought are associated with the repair and replacement of defective work without any physical injury to "some other tangible property." Thus, whether a defective product is installed or there is defective installation, there is no covered "Property damage" unless there is physical injury to some other tangible property. *Id* at 1248-1249. If, however, the windows purchased by the homeowner were not defective before installation, but were damaged as a result of defective installation, there would be damage to other tangible property, *i.e.*, the windows, themselves, and coverage would exist for the costs to repair or replace them. *Id*.

(a) "Rip and Tear" Costs

Insurers are increasingly having to pay for the repair of non-covered "property damage" where to do so is necessary to repair covered "property damage". This was another issue addressed in *Carithers v. Mid-Continent Cas. Co*., 782 F.3d at 1251. A balcony was defectively constructed which resulted in covered "property damage" to the garage. In order to repair the garage it was necessary to completely replace the balcony. Even though the damaged balcony was not covered, the insurer became responsible for the rebuild costs as a necessary component to the garage repair. See also, *Pavarini Const. Co. v. Ace Amer. Ins. Co*., 161 F. Supp. 3d 1227, 1233-1234 (S.D. Fla. 2015)(insurer liable for non-covered stabilization repair costs because building stabilization was necessary to repair covered "property damage").

(b) Coverage for Costs to Prevent Further Damage

An emerging trend is whether coverage can lie for the costs to prevent ongoing damage instead of simply repairing existing damage. Thus far, cases can be read for that proposition. In relying on *Carithers v. Mid-Continent Casualty Company*, 782 F.3d 1240 the Court in *Pavarini* held that "J.S.U.B. stands for the proposition that claims for repairing structural damage caused by the defective work of subcontractors may be covered. As a natural corollary, coverage may exist for costs to repair defective work in order to prevent further structural damage and covered loss." Id. at 1233 - 1234.[12]

A recent trial court Order from the United States District Court for the Middle District of Florida has continued the trend of finding coverage. In *Amerisure v. The Auchter Co., et al.*, No: 3:16-cv-00407-BJD-JRK (M.D. Fla. March 27, 2018) the Court examined the ostensible holdings in *Pavarini* and *Carithers* that coverage for "rip and tear" costs would logically extend to repairing the condition causing "ongoing" property damage whether or not it fell within an

[12] The Court is referring to *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871.

insured's work. The Court found that it did. This finding, the Court noted, is consistent with a "logical interpretation" of the property damage coverage afforded by a CGL policy.

(c) Warranty, Non-Disclosure and Economic Loss

There is no coverage for economic loss, consequential damages and in certain circumstances breach of warranty claims. These causes of action are not regarded as arising from "Property damage" caused by an "Occurrence. See, *Mid-Continent Casualty Co. v. Adams Homes of Northwest Fla., Inc.* 2018 WL 834896 (11th Cir. 2018)(no coverage for defective drainage plan allegedly interfering with home owners' free use of their property); *James River Ins. Co. v. Arlington Pebble Creek*, LLC 188 F.Supp. 3d 1246 (N.D. Fla. 2016)(no coverage for developer being sued by condominium association for violation of condominium act, fraudulent non-disclosure, negligent misrepresentation and breach of implied warranties); *Key Custom Homes, Inc. v. Mid-Continent Cas. Co*., 450 F. Supp 2d 1311, 1317 (M.D. Fla. 2006) (CGL policy only applies to tort damage caused by the insured's work or product and does not apply to cover damages that are purely economic in nature); *Pavarini Constr. Co. (SE) v. Ace. Am. Ins. Co*., 161 F. Supp. 3d 1227, 1237 (S.D. Fla. 2015) (claim for consequential damages such as delay costs, overhead expenses, lost profits and diminution of value allegedly flowing from "Property damage" are purely economic in nature and not covered under general liability policy); *Nationwide Mut. Fire Ins. Co. v. Advanced Cooling & Heating, Inc.*, 126 So. 3d 385 (Fla. 4th DCA 2013)(installation of defective component that did not result in physical injury to some other tangible property resulted only in economic loss not covered under a CGL policy); *Fcci Commer. Ins. Co. v. Commercial Plastering*, 2015 Fla. Cir. LEXIS 314 (absent allegations of negligence, breach of express and implied warranty claims not covered under a CGL policy because they are contract actions involving economic damages and do not arise from an "Occurrence").[13]

2. Whether the Policy Has Been "Triggered"

The concept of "trigger" can be confusing primarily because a determination of whether a policy must respond to a claim under the law does not always comport with the language of the policy itself. The Florida Supreme Court has not addressed the appropriate trigger but the clear trend in Federal court is injury-in-fact. *Carithers v. Mid-Continent Casualty Company*, 782 F.3d at 1246-1247; *Trizec Props. Inc. v. Biltmore Constr*. Co. 767 F.2d 810 (11th Cir 1985); *St. Paul Fire & Marine Ins. Co. v. Cypress Fairway Condo. Ass'n*, 114 F.Supp.3d 1231, 1237 (M.D. Fla. 2015).[14]

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[13] This is a State trial court order from the Florida Twelfth Judicial Circuit, Manatee County.

[14] See also, *Axis Surplus Ins. Co. v. Contravest Constr. Co.*, 921 F.Supp.2d 1338, 1348-1349 (M.D. Fla. 2012)(finding duty to defend based on injury-in-fact trigger where the underlying complaint contained allegations that a condominium suffered water intrusion and damage but the construction defects were not readily discoverable); *Voeller Constr., Inc. v. Southern-Owners Ins. Co*., 2014 WL 1779289 at *4 (M.D. Fla.)(finding duty to defend based on injury-in-fact trigger where underlying complaint alleged that the defects and deficiencies were latent but "suggest[ed]" that property damage occurred after the buildings were completed but prior to discovery); *Nautilus Ins. Co. v. Batson-Cook Co*., 2008 U.S. Dist. LEXIS 90909 (M.D. Fla.)(summary judgment granted because there was no evidence of property damage having taken place during the policy period.

In *Ohio Cas. Ins. Co. v. Timber Dev. Co*., 2013 U.S. Dist. LEXIS 196174 (M.D. Fla) a paving contractor was sued for alleged defective paving of a Home Depot parking lot. The construction was completed in 2006 and the period of coverage expired in 2008. The allegation in the complaint was that "In or about 2010 Home Depot began to experience significant and out of the ordinary degradation and failing of the parking lot".

The Court explained that while the "occurrence" need not happen during the policy period, the property damage must. Focusing on the phrase "began to experience" the Court found that coverage was not triggered because it expired before the damage began.

The case of *Trovillion Constr. & Development v. Mid-Continent Cas. Ins. Co.*, 2014 WL 201678 (M.D. Fla.) is also noteworthy. There were a series of consecutive insurance policies with all but one containing the subcontractor exception to the "Your Work" exclusion. The Court found that coverage could only potentially lie during that single policy and dismissed the case because there was no showing of "Property damage" during that period of coverage.

C. Common Policy Exclusions[15]

General liability policies were never intended to provide coverage to a contractor for the repair of its own defective work or product. Accordingly, the policies have a series of exclusions to preclude coverage for such ordinary "business risks" and contractually assumed liability.

1. Contractual Liability Exclusion

CGL policies typically contain an exclusion similar to the following:

> This insurance does not apply to:
>
> **Contractual Liability**
> "Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:
>
> (1) That the insured would have in the absence of the contract or agreement; or
> (2) Assumed in a contract or agreement that is an "insured contract",[16] provided the "bodily injury" or "property damage" occurs

[15] While uncommon, the "owned property" exclusion bears mention. It bars coverage for "Property you Own Rent or Occupy". A typical scenario where this Exclusion may apply is condominium conversions. Coverage will be barred as long as the "Property damage" occurred at the time of ownership after inception of the policy. *Nationwide Mut. Fire Ins. Co. v. Cypress Fairway Condo. Ass'n*, 2015 U.S. Dist. LEXIS 96196 (M.D. Fla.).

[16] Commonly defined, "Insured contract" means "That part of any other contract or agreement pertaining to your business… under which you assume the tort liability of another party to pay for 'bodily injury' or 'property damage' to a third person or organization, provided that the 'bodily injury' or 'property damage' is caused in whole or in part, by you or those acting on your behalf. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement." Another common definition of "Insured contract" eliminates the specific requirement

> subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an "insured contract", reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be damages of "bodily injury" or "property damage", provided:
>
> (a) Liability to such party for, or for the cost of, that party's defense has also been assumed in the same "insured contract", and
>
> (b) Such attorney fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which damages to which this insurance applies are alleged.
>
> * * * *

There are two initial requirements for the contractual liability exclusion to apply. First, there must be a contract or agreement and second, there must be an assumption of liability. The Court in *Amerisure Ins. Co. v. Orange & Blue Constr., Inc., et. al.*, 913 F. Supp. 2d 1363 addressed both of these issues. A property owner hired Epoch as general contractor to build a project known as Portifino at Lakes Laguna. Epoch subcontracted the building shell work to Orange & Blue Construction, Inc. ("O&B"). O&B subcontracted most of its work to CL&B Contracting, Inc. ("CL&B"), who in turn subcontracted the work to Sandi Construction, Inc. ("Sandi"). A worker of Sandi fell and died. The worker's estate filed a lawsuit against Epoch, CL&B and Sandi. O&B was not sued. The complaint asserted claims for negligence and intentional tort against Epoch. Pursuant to Epoch's contract with the owner, Epoch had ultimate responsibility for safety at the site. Epoch's subcontract with O&B made O&B liable for job site injuries. It also required that O&B indemnify the owner and its lender and to name Epoch as an Additional Insured on its policy, which it did.

Epoch made a claim under O&B's policy as an Additional Insured. The insurer argued that the contractual liability exclusion barred the claim. The Court rejected this argument for two reasons. First, there was no provision in Epoch's subcontract with O&B whereby O&B assumed Epoch's liability. Rather, the only indemnified parties were the owner of the project and the owner's lender. Second, Epoch was not being sued based upon liability it assumed in its contract with the owner. Instead, it was being sued for its own liability. *Id*. at 1370 - 1371.

An emerging issue is whether breach warranty claims are barred by this exclusion. The Court in *Fcci Commer. Ins. Co. v. Commercial Plastering*, 2015 Fla. Cir. LEXIS 314 found that breach of warranty claims, express or implied, are founded upon a contract and are therefore excluded.

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that the liability assumed has to arise from the insured's work and says only that the tort liability of another is assumed.

2. Performing Operations / Work-In-Progress Exclusion

CGL policies affording Products/Completed Operations Coverage typically preclude coverage for damage caused during ongoing operations using an exclusion similar to the following:

> This insurance does not apply to:
>
> * * * *
>
> **Damage to Property**
> "Property damage" to:
>
> (5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations; or
>
> (6) That particular part of any property that must be restored, repaired or replaced because "your work"[17] was incorrectly performed on it.
>
> * * * *
>
> Paragraph (6) of this exclusion does not apply to "property damage" included within the "products-completed operations hazard"[18]

Both of these exclusions are limited in their application by both time and scope. They apply only to damage that occurs during ongoing operations, and only to damage to the particular part of the property on which the operations are being performed.

In *American Equity Ins. Co. v. Van Ginhoven*, 788 So.2d 388 (Fla. 5th DCA 2001), a swimming pool popped out of the ground once it was drained causing damage to the pool and various other property such as the pump, heating system, deck, and sprinkler system. The Court found that the pool was the "particular part" of property upon which the insured was performing its work and repair costs were excluded. However, there was coverage for the costs to repair the pump, heating system, sprinklers and deck. *Id*. at 391.

Likewise, in *Amerisure Mut. Ins. Co, v. American Cutting & Drilling Co., Inc*., 2009 WL 700246 (S.D. Fla.), the insured-contractor was engaged to cut concrete and negligently cut

[17] "Your work" is commonly defined as "work or operations performed by you or on your behalf and materials, parts or equipment furnished in connection with such work or operations. Your work includes: warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of 'your work' and the providing or failure to provide warnings or instructions."

[18] "Products completed operation hazard" is commonly defined to include "all 'bodily injury' and 'property damage' occurring away from premises you own or rent arising out of 'your product' or 'your work' except . . . work that has not yet been completed or abandoned".

through embedded post tension cables. The court determined that the area of the floor where the contractor was cutting which included the embedded cables fell within the phrase "[t]hat particular part of [] property". Further, because the damage occurred during ongoing operations, the court found that both exclusions were applicable and granted the insurer's motion for summary judgment. See also, *Wilshire Ins. Co. v. Birch Crest Apartments, Inc.*, 69 So. 3d 975, 976 (Fla. 4th DCA 2011)(exclusion applied where painting contractor damaged windows when removing paint splattered on them during the painting process because the windows were part of the building being worked on and the cleaning was "within the nature and intended scope of work undertaken by the contractor"); *Essex Ins. Co. v. Kart Constr., Inc*. 2015 WL 4730540 (M.D. 2015)(insured's ancillary contracted work on 127 foot cell tower did not serve to limit coverage to the ten foot section damaged as a result of the insured's ongoing welding activities from which the damage arose).

Conversely, the exclusion will not apply where the contractor departs from his contracted work and causes property damage. In *Nova Cas. Co. v. Willis*, 39 So. 3d 434 (Fla. 3d DCA 2010), a contractor was hired to cut mangrove trees on a particular property in accordance with specific requirements of the law and the work permit. The contractor accidentally cut mangrove trees on an adjacent property and improperly cut the mangrove trees on the correct property. The Court held that the exclusion did apply to the faulty work on the correct property but did not apply to the faulty work on the wrong property. It reasoned that the contracted work with the property owner did not involve trimming trees on adjacent property. *Id*. at 437.

3. Damage to Your Product Exclusion

CGL policies commonly include an exclusion that precludes coverage for the replacement of defective products using an exclusion similar to the following:

> This insurance does not apply to:
>
> **Damage to Your Product**
> "Property damage" to "your product" arising out of it and any part of it.

"Your product" is commonly defined to include "[a]ny goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by you or others trading under your name".

Three primary issues have been addressed by the courts in construing this exclusion: 1) whether the "product" qualifies as real property; 2) whether the product was altered from its original state; and, 3) whether the product was defective or instead damaged after it was manufactured.

In *Auto-Owners Ins. Co. v. American Building Materials, Inc.*, 2011 WL 1878236 (M.D. Fla.), the Court found that drywall became "real property," as defined under Florida law once it was installed in the homes. It thus did not fall within the definition of "your product" and the exclusion did not preclude coverage for the repair or replacement of the defective drywall.

The Court in *Liberty Mut. Fire Ins. Co. v. MI Windows & Doors, Inc.*, 2013 WL 4734045 (Fla. 2d DCA 2013), confronted the issue of whether the "your product" exclusion applied where the claimant alleged that the products had been altered from their original state. The insured manufactured windows and doors and sold them to a contractor who installed them in a series of houses. During installation, the contractor installed transoms running atop the doors that it had manufactured. On appeal, the Court held that the "your product" exclusion applied because the addition of the transoms did not fundamentally change the nature and function of the doors.

In *Rad Source Technologies, Inc. v. Colony Nat. Ins. Co.*, 914 So. 2d 1006 (4th DCA 2005), a piece of medical equipment was damaged in transit. The Court held that the "your product" exclusion did not apply because it is intended to apply to defective products and not products that are subsequently damaged.

4. Damage to Your Work Exclusion

CGL policies commonly include an exclusion that bars coverage for the repair or replacement of the insured's defective work similar to the following:

> This insurance does not apply to:
>
> **Damage to Your Work**
> "Property Damage to "your work" arising out of it or any part of it and included in the "products-completed operations hazard".
>
> This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a sub -contractor.[19]

The purpose of this exclusion is to *entirely* preclude coverage for an insured's own faulty workmanship. The exception, however, is coverage to an up-stream contractor for the defective work of a subcontractor when the policy includes the above-referenced "subcontractor exception"

In *Mid-Continent Cas. Co. v. JWN Constr*. 2018 U.S. Dist. LEXIS 20529 (S.D. Fla.) a homeowner hired JWN Construction ("JWN") as the general contractor to build a house. It did no work and instead acted as qualifying agent for Mager Construction ("Mager") who built the house. After discovering water intrusion the homeowner sued JWN. JWN argued that it didn't do any of the work. The Court found that there was no coverage under JWN's policy because the work was done on its behalf and there was no subcontractor exception to the Your Work exclusion.

The same issue was addressed in *J.B.D. Constr., Inc. v. Mid-Continent Cas. Co.*, 571 Fed.Appx. 918 (11th Cir. 2014). J.B.D was hired as the General Contractor to build a fitness center addition to an existing structure. After completed, water intrusion was discovered in and

[19] Many more recent insurance policies have either eliminated this exception from within the exclusion itself or have deleted it by endorsement.

about the addition which resulted in peeling paint, rusting and blistering stucco. The Court found that J.B.D. was not entitled to coverage. Because the entire fitness center was the work of J.B.D and the "Your Work" exclusion did not contain the subcontractor exception, the claim was not covered. It explained that the "Your Work" exclusion without a subcontractor exception eliminates a General Contractor's coverage for damage to a completed project where a sub-contractor's faulty construction on one part of a project caused damage to another part of the project. See also, *Trovillion Constr. V. Mid-Continent Cas. Co*., 2014 U.S. Dist. LEXIS 6265 (addressing coverage under a series of consecutive policies involving "Your Work" exclusions with and without the subcontractor exception).

5. Damage to Impaired Property or Property Not Physically Injured

General liability policies typically include an exclusion that precludes coverage for loss of use claims where property which is *not* damaged cannot be used as a result of defective work to other property. Exclusions similar to the following are common:

> This insurance does not apply to:
>
> **Damage To Impaired Property Or Property Not Physically Injured**.
>
> "Property damage" to "impaired property"[20] or property that has not been physically injured, arising out of:
>
> (1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work", or
>
> (2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.
>
> This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

This exclusion was considered in *Commercial Union Ins. Co. v. R.H. Barto Co.*, 440 So.2d 383 (Fla. 4th DCA 1983). The Court found that no coverage was owed to an HVAC contractor whose negligent installation of an air conditioning system made the building uninhabitable. The loss of use of the building was a loss of use of "tangible property", not physically injured, and was thus within the exclusion. Further, the exception for "sudden and accidental physical injury" did not apply because the underlying complaint alleged frequent and repeated breakdowns of the equipment. *Id*. at 387-388. See also, *Aetna Cas. & Sur. Co. of Amer. v. Deluxe Systems, Inc.*, 711 So. 2d 1293 (Fla. 4th DCA 1998)(exclusion precluded coverage for

[20] "Impaired property" is commonly defined as "tangible property, other than 'your product' or 'your work', that cannot be used or is less useful because: **a**. It incorporates 'your product' or 'your work' that is thought to be defective, deficient, inadequate or dangerous; or **b.** You have failed to fulfill the terms of a contract or agreement; if such property can be restored to use by: **a.** The repair, replacement, adjustment, or removal of 'your product' or 'your work'; or **b.** Your fulfilling the terms of the contract or agreement."

the loss of use of warehouse space during the period when defective shelving was being replaced).

III. NUMBER OF OCCURRENCES

Assuming that coverage is owed under a policy the number of occurrences must be determined to evaluate potential exposure.

Florida follows the "cause" theory in determining the number of occurrences. In general terms, the number of occurrences is the number of precipitating causes irrespective of the number of resulting injuries. In *Koikos v. Travelers Ins. Co.*, 849 So.2d 263 (Fla. 2003), the Florida Supreme Court determined that there were two occurrences where a person fired two separate, but nearly concurrent, gun shots which struck two persons. The Court stated that using the number of shots fired as the basis for the number of occurrences was appropriate because each individual shooting was distinguishable even though they occurred in close proximity in time and space. *Id.* at 272.

In the context of a construction defect coverage claim, the determination of the number of occurrences will depend on the specific nature of the work being formed. In *Southern Intern. Corp. v. Poly-Urethane Industries, Inc*., 353 So. 2d 646 (Fla. 3d DCA 1977), the insured applied a polyurethane sealant to several roofs of a condominium complex. The roof system subsequently began to leak. Without any substantive analysis, the Court concluded that there was only one occurrence.

Southern Intern. Corp. was distinguished in *Mid-Continent Casualty Co. v. Basdeo*, 477 Fed. Appx. 702. There, the contractor committed different acts of negligence on a single structure. It negligently failed to tarp roofs and improperly performed services on sections of the flat roof and mansards. The Court found that there were three (3) occurrences – one for each separate act of negligent work. It explained that in *Southern Intern. Corp.* "the insured … engaged in a single type of … activity several times", whereas in the case before it, the insured "undertook substantially different types of work on different parts of the building." *Id*. at 708-709.

IV. OTHER INSURANCE CLAUSES AND SELF INSURED RETENTIONS

A. Other Insurance Clauses

It is not uncommon for disputes to arise between insurers as to which is to be regarded as affording primary coverage with a duty to defend and which is to be regarded as affording excess coverage with no duty to defend. This determination is based on the specific wording of the competing policies.

In *Certain Underwriters at Lloyds London Subscribing to Policy No. SA 10092-11581 v. Waveblast Watersports, Inc*., 80 F.Supp 3d. 1311 (S.D. Fla. 2015), the Court addressed competing "other insurance" clauses. The case arose from a parasailing accident which resulted in the deaths of two people. The individuals were staying at the Sands Harbor Hotel and Resort ("Sands Harbor") which arranged the excursion through a company called Waveblast. Lloyd's

issued a policy to Waveblast as the Named Insured which also named Sands Harbor as an Additional Insured. Sands Harbor was the Named Insured on a policy issued by Scottsdale Insurance Company. *Id.* at 1314. The estates of the decedents filed suit against both Waveblast and Sands Harbor.

Lloyds filed suit against Sands Harbor and Scottsdale to determine the priority of coverage for Sands Harbor. Lloyds sought a ruling that it and Scottsdale must respond on a co-primary, pro-rata basis because the "other insurance" clause contained within their respective policies are repugnant (cancel each other out). *Id*. at 1320-1321.

In part, both the Lloyds and Scottsdale policies provide that their respective coverage was excess over any other insurance where the loss arose out of the maintenance or use of a watercraft. The Scottsdale policy, however, added an additional clause not contained in the Lloyds policy that makes Scottsdale's insurance excess where there is "valid and collectible insurance available [] under any other policy". *Id*.

Scottsdale argued that even if the watercraft clauses cancelled each other out, its broader "other insurance" provision remained. The Court rejected this argument finding that "other insurance" clauses cannot survive on a piecemeal basis and that Florida does not give effect to this type of "super excess" clause. *Id*. at 1321. Accordingly, the policy coverage must be apportioned on a pro-rata basis determined by the policy limits in relation to the loss. *Id*.

B. Self-Insured Retentions

Some liability policies have a Self-Insured Retention which means that the insurer's obligations do not attach until the insured has incurred the amount of the Retention stated in the policy. If for example a policy contains a $50,000 Self-Insured Retention the insured is solely responsible for funding any settlement below that amount. Some policies also include defense costs within the Self-Insured Retention. In those situations the insurer retains the right to appoint defense counsel but the insured pays those bills directly until the Retention is reached. Insurer responsibility still attaches only above the Retention but that amount can be consumed either by settlement, defense costs, or a combination of both. See, *e.g*., *Intervest of Jax, Inc. v. General Fidelity Ins. Co*., 133 So. 3d 494 (Fla. 2014); *Core Construction Services Southeast, Inc. v. Crum & Forster*, 2016 WL374940 (M.D. Fla).

In *Core*, Core Construction ("Core") was the general contractor for a condominium complex. It hired a subcontractor to install the windows. *Id*. at *1. The subcontractor was insured by Crum & Forster and Core was (purportedly) named as an Additional Insured[21]. The policy had a $250,000 Self-Insured Retention.

The Condominium sued Core for defective construction. Core had itself incurred costs of approximately $100,000 and other insurers had paid over $300,000 in defense costs. In part, Crum argued that it had no obligations because Core had not satisfied the Retention. *Id*. at *4-5.

[21] There was a fact issue over whether the actual defendant sued was the same entity as the Additional Insured identified on the policy.

The issue before the Court was whether the insured had to actually pay the Retention amount or whether it was sufficient for it to be paid by a third-party. The Court rejected Crum's argument and found that the Retention *could* be satisfied by virtue of the third-party payments. But, pursuant to the policy terms the Retention is exhausted only by payments towards covered damages. On the record before it the Court was unable to make that distinction and thus did not rule on whether the Retention had or had not been exhausted. *Id*. at *5-6. See also, *Intervest of Jax, Inc. v. General Fidelity Ins. Co*. at 498; 503, holding that despite policy language that payments must be "made by the insured", third-party payments can be used towards satisfaction of the Retention.

V. CONDITIONS DEFENSES

A. Late Notice

It is extremely difficult to prevail in a coverage action in Florida because an insured breached a Condition of coverage. In addition, as discussed at the outset of this paper "Conditions" defenses are generally waived if an insurer does not strictly comply with the requirements of the Claims Administration Statute. That being said, it is not impossible.

The most common "Conditions" defense is "Late Notice". General liability policies require that the insurer be provided notice of claim or suit as soon as “practicable” or other similar language. Under Florida law, once notice is deemed untimely, a presumption of prejudice arises to the insurer which must be rebutted by the insured. Otherwise, coverage is barred. *Stark v. State Farm Florida Ins. Co.*, 95 So.3d 285 (Fla. 4th DCA 2012).

In *National Trust Ins. Co. v. Graham Bros. Const. Co., Inc*., 916 F. Supp.2d at 1257-1259, the Court held that coverage was precluded where the insured-contractor did not provide notice of claim until three years after it had knowledge of its defective work at the property which gave rise to the claims against it. The Court first found that notice was untimely, as a matter of law. It next found that the insured did not put forth any credible evidence to rebut the presumption of prejudice. The Court explained that “prejudice” is shown where the delay in providing notice disadvantages the insurer’s ability to investigate a claim, defend a claim, or to mitigate its damages through settlement or early repairs. It was undisputed that the insurer had lost the ability to inspect the property prior to remediation and therefore to assess its insured's liability and evaluate its coverage position. Accordingly, the claim was not covered.

B. Voluntary Payments

General liability policies contain a provision that precludes coverage for the voluntary assumption of costs or liability similar to the following:

> d. No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense … without our consent.

In *Zurich Am. Ins. Co. v. Frankel Enters*., 287 Fed. Appx. 775 (11th Cir. 2008) the Court barred coverage for a defective construction claim because the insured had settled it without the insurer's consent. What makes this case interesting and unique is that the settlement occurred at a mediation in which the insurer and its appointed liability defense counsel participated. *Id*. at 777.

The facts are that the insured performed defective work on the claimants' roof. Leaks followed resulting in damage and mold. The homeowners filed suit. The insured timely reported the suit to the insurer who assumed the defense under a reservation of rights and appointed defense counsel. *Id*.

The matter proceeded to mediation. In personal attendance were the insured's representative and its personal counsel, appointed defense counsel, the claimants and the claimants' counsel. The insurer representative participated by telephone. Throughout the mediation the insurer representative only communicated with appointed counsel. *Id*.

The claimants and the insured resolved the suit for $1.8 million and an assignment of the insurance claim to the claimants. The insurer did not expressly consent to the settlement and the appointed defense counsel never voiced any objection on behalf of the insurer. After the mediation the insurer took the position that it was not bound by the settlement. *Id*. at 777-778.

The insured admitted that it did not obtain the insurer's authorization to enter the settlement. It argued that the insurer was bound to the settlement because appointed defense counsel was its agent. The Court rejected this argument finding that as a matter of Florida law appointed defense counsel is an independent contractor. Since the insured admitted that it did not secure prior authorization the Court granted the insurer's motion for summary judgment. *Id*. at 778-779.

PART II
EFFICIENT AND SUCCESSFUL RESOLUTION STRATEGIES

Discussions with claim representatives and mediators have revealed a series of common obstacles that prolong and frustrate the claim resolution process. These are: lack of preparation; lack of organization; and lack of communication. Prompt, efficient and successful claim resolution is contingent on multiple parties and multiple factors. While each party has an independent incentive to resolve claims against an insured as quickly as possible they often do not act in facilitative manner. Proper planning and execution can streamline the resolution process and eliminate unnecessary delays.

I. THE INSURER'S PERSPECTIVE

The insurance claim representative stands between the insured and settlement. An insurer cannot evaluate exposure to its insured or its own coverage obligations until such time as it has sufficient information and time to do so. There is no "shortcut" around this methodical process.

Understanding the claim process is instrumental in prompt and efficient claim resolution. It is not in any insurer's best interest to delay claim resolution and have claims and litigation languish for extended periods of time. That only serves to unnecessarily increase the insurer's expenses. Nor is it in an insurer's best interest to rush through claims without a proper investigation. That could cause mistakes or improper claim decisions resulting in increased exposure and decreased profitably. Insurers thus strive for efficiency, accuracy and fairness in their claim handling processes.

Nevertheless, the insurers are caught in a "Catch 22". If the investigation takes longer than the insured expects and the claim decision is adverse, the insurer gets sued for "bad faith" delay. If the insured gets an adverse claim decision in a relatively short period of time, the insurer gets sued for "bad faith" for not conducting a proper and thorough investigation. Prompt and efficient claim resolution, however, is not exclusively within the control of the insurer. Nor is the process a perfect one. The insurer, retained defense counsel, the insured and coinsurers all have an important role and must work cooperatively throughout the life of the claim.

A. The Role of the Insured

Initially, an insured must provide notice to its insurer as soon as it has reason to believe that a claim *may* be made against it. An insured should not wait until it receives a §558 notice or even worse, a lawsuit. Notice should certainly be given before any destructive testing occurs. Without timely notice an insurer may lose access to crucial claim information. Untimely notice also jeopardizes coverage.

When a claim is first presented, the insurance representative's initial source of information is the insured. The representative will review the information provided and request additional information as necessary. To facilitate this process, the insured must gather its job file and all available insurance information at the beginning of the claim. It should notify all of its insurers immediately upon any belief that a claim may be made against it. Any response from an insurer should be circulated to the other insurers. At that point the insurers can communicate amongst themselves, share information and plan their respective investigations. The speed and efficiency of this initial step is largely dependent on the insured. Presuming that the insured maintained its records, this initial exchange of information should not be a protracted process.

As a matter of good business practice an insured should have a document retention policy for at least basic project documents. Oftentimes, an insured does not obtain or maintain such basic things as contracts or certificates of insurance. Payroll and accounts payable records are also an important resource for identifying who worked on the project and how long it lasted. This information is critical to an insurer's claim investigation.

The bottom line is that if an insurer does not have information it can't make a claim determination. If an insurer has to repeatedly follow-up with an insured to get information or go to other sources because an insured isn't cooperating, the claim will stall. This is often a source of frustration for both the claim professional and the insured. On the one hand, the claim professional can't advance the claim and on the other, the insured becomes increasingly impatient over the length of time the claim is taking. Sometimes an insured will reflexively retain counsel

unnecessarily creating an antagonistic relationship. While experienced insurance counsel can be an invaluable resource in the claim resolution process, inexperienced counsel can hinder the process. The point here is that if an insured feels that legal counsel is necessary, it should select one with the necessary insurance background.

B. The Role of Defense Counsel

If a lawsuit is filed against an insured, the insurer may assign defense counsel to represent it. At this point defense counsel becomes the primary source of information. A lawsuit against an insured does not end the insurer's duty to investigate the claim. Efforts to settle can and should continue throughout the proceeding. It could very well be that information needed by the insurer(s) can be obtained quickly and without formal discovery. Especially at the early stages of litigation it is in everyone's best interest to share information and try to settle the dispute. Far too often, though, the parties get embroiled in "boiler plate" discovery without having any settlement discussions. The lawsuit then drags on for years until the court orders mediation.

If litigation proceeds, defense counsel should still make every effort to streamline the discovery process. He/she must keep both the insurer and the insured abreast of the facts as they develop. He/she can also develop other insurance information and facilitate discussions between all of the insurers. Again, having a dispute languish in court for years does not serve anyone's best interests.

C. The Role of Coinsurers

By the time a matter is in suit, or shortly thereafter, multiple insurers should be involved. However, each may be experiencing their own cooperation and lack of documentation issues. It is imperative that the insurers work cooperatively from the beginning. Experienced claim representatives know the coverage issues and should begin addressing them at the outset. Nothing prevents insurers from exchanging factual information about the claim. In practice, there is much more communication and cooperation between insurers who share a common insured, than there is between insurers of different insureds. That does not have to be the case. It remains necessary for all of the insurers to have a complete coverage picture and a shared knowledge of the facts. Communication is always the key but someone must initiate and advance it.

There is a recurring unfortunate stumbling block in jurisdictions like Florida where there is no right of contribution for defense costs. It is the quintessential "game of chicken". The first insurer that steps up is defending alone. But, it is important to recognize that the defending insurer is under no obligation to share information that is developed by defense counsel. It is far more beneficial for the insurers to join in the defense and learn the facts than it is having one or more insurers remaining "ignorant" of the facts. Settlement cannot occur without common knowledge of all of the facts.

II. THE MEDIATOR'S PERSPECTIVE

Mediation provides an opportunity for the parties to eliminate the uncertainty of a future jury award and to therefore control their exposure. The insurers obviously play a crucial role in whether the matter gets resolved. From a mediator's perspective, construction defect conflicts are among the most difficult matters to resolve. There are numerous parties and insurers all with antagonistic interests. Insurers frequently get claims for the same project by different parties. Insurers also get claims by multiple parties claiming to be insured under the same policy. There may be primary insurance, different levels of excess insurance and different types of insurance. The one and only constant, however, is that prompt and efficient resolution of these cases is contingent on an awareness of the insurance issues and a plan to address them. The lack of preparation and the failure to timely and adequately address insurance coverage and allocation issues will needlessly frustrate the mediation process.

While the parties will typically submit mediation briefs that address the liability and damages issues of the underlying litigation, they often do not address coverage issues or allocation disputes even if known to exist. Too often, the mediator is not advised of an insurance issue until well into the mediation and is then faced with a "mediation within the mediation." At that point, there may be no way to resolve the undeveloped coverage or allocation issues and the mediation fails.

It is the shared responsibility of the parties and the mediator to prepare participants for maximum success in the mediation process. Advance preparation and coordination between the mediator, insurers and assigned defense counsel is crucial. This "seven step program" will greatly enhance the chances of success for all involved:

1. All potentially involved insurers must have been placed on notice. This must happen at the earliest possible opportunity. Many claims trigger more than one policy. Consecutive and excess policies may be implicated; different types of coverage may be implicated such as general liability, professional liability and builders risk; different parties may be making claim under the same policy as an Additional Insured or as a Named Insured. The parties and their insurers must have the complete insurance "picture". This is especially true in Florida given the unsettled law on allocation and the trigger of coverage.

2. Know which insurers are participating and which are not. It is important to reach an agreement with the implicated insurers, particularly those which are defending, that all insurers who should participate will participate. If it is known that some insurers will not participate, agreement must be reached among the participating insurers on if and how settlement can be achieved without them.

3. Everybody must be educated and committed to the process. Insurers are increasingly unwilling to "pay and chase," that is, pay the entire settlement themselves and then pursue other insurers for recovery. A defending insurer may attend a mediation and be well-informed

regarding the case, but refuse to contribute to a global resolution because a coinsurer is either not present, not prepared or is simply unwilling to cooperate. An insurer's primary source of factual information is its retained defense counsel. To evaluate settlement, the insurer needs to understand the risks associated with a trial loss and the potential magnitude of a damages award. If a representative is poorly informed, he or she will likely not have sufficient authority at the mediation to effectively contribute to a global resolution. Accordingly, defense counsel should review prior requests from the insurer and ensure that all requested and necessary information has been provided well in advance of the mediation.

4. Provide written demands in advance of the mediation. Mediation should not occur until the claimant has a realistic picture of its damages claim as well as the availability of coverage and outstanding coverage issues. Neither the parties nor their insurers can adequately analyze exposure without an understanding of their respective expectations. This process takes time. Claimants should not wait until the day before or the day of the mediation to set forth their demands.

5. Resolve insurer allocation issues in advance. While it is sometimes possible for insurers to resolve these issues among themselves, that is uncommon. More often, the mediator facilitates the dialogue and sometimes the insurers participate in a "pre-mediation" insurance mediation. Counsel should not hesitate to get the mediator involved in the insurance aspect of the case prior to the formal mediation session.

6. Educate the mediator on the insurance issues before the mediation. Often there will be insufficient time for the mediator to become fully versed on insurance issues if they have not already been explained in prior submissions. Provide this information sufficiently in advance of the mediation so that the mediator can map a strategy and perhaps begin discussing the issues with the participating insurers.

7. Proper insurance representative availability. The proper representative or representatives must attend or at least be available by telephone. If there are unresolved coverage issues, it is not uncommon for a separate insurer representative to address only those issues with or without separate counsel. If representatives are not physically present, counsel should make sure that they have after-hours access, accounting for any difference in time zones.

Experience has shown that pre-mediation preparation is the key to a prompt, efficient and successful mediation. The above guidelines, if followed, will facilitate just that.

PART III
GOOD FAITH CLAIM HANDLING

I COMMON LAW BAD FAITH LIABILITY

The obligations that an insurer owes to its insured begin with the Insuring Agreement of the applicable policy. The typical CGL Insuring Agreement provides that the insurer has a duty to defend but merely the "discretion" to investigate and settle. It is the manner in which an insurer exercises its defense and claim resolution discretion that gives rise to potential "bad faith" liability.

A. Standards for "Bad Faith" Liability

Florida courts recognize a cause of action for common law "bad faith" within the framework of an implied covenant of good faith and fair dealing between the insured and the insurer. As a result of the insurer's control over the settlement and defense of a suit against its insured, the insurer owes it a fiduciary duty to act fairly, honestly and with due regard for its interests. *Auto Mut. Indem. Co. v. Shaw*, 184 So. 852 (Fla. 1938); *Campbell v. Gov't Employees Ins. Co.*, 306 So.2d 525 (Fla. 1974).

Florida's expectations for "good faith" claim handling are well established. Simply put, "[a]n insurer, in handling the defense of claims against its insured, has a duty to use the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business." *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So. 2d 783, 785 (Fla. 1980). It is incumbent on the insurer to investigate the facts, give fair consideration to a settlement offer that is not unreasonable under the facts, and settle, if possible, where a reasonably prudent person, faced with paying the total recovery, would do so. *Id*.

The standard for "bad faith" does not refer to negligence or mistakes. It does not matter if the insurer's denial was later determined to have been mistaken. *Vest v. Travelers Ins. Co*., 753 So.2d 1270 (Fla. 2000). The question of whether an insurer has acted in "bad faith" in handling claims against an insured is determined under the "totality of the circumstances" standard. However, courts have held that "[b]ecause the duty of good faith involves diligence and care in the investigation and evaluation of the claim against the insured, negligence is relevant to the question of "good faith" and hence is one factor to be considered. *Boston Old Colony Ins. Co.*, 386 So. 2d at 785; *Auto Mut. Indem. Co. v. Shaw*, 184 So. at 859; *State Farm Mut. Auto. Ins. Co. v. Laforet*, 658 So.2d 55 (Fla.1995).

1. General Duties Owed by the Insurer

Irrespective of the type of claim, an insurer owes the very same good faith obligations to its insured. These are as follows:

(1) To diligently and thoroughly investigate the claim;
(2) To give fair consideration to settlement offers;
(3) To promptly advise the insured of settlement opportunities;

(4) To advise the insured of the probable outcome of the litigation;
(5) To warn the insured of the possibility of an excess judgment;
(6) To advise the insured of any steps that it may take to avoid an excess judgment; and,
(7) To settle a claim where a reasonably prudent person, faced with the prospect of paying the total recovery would do so.

See, *e.g.*, *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So. 2d 783; *Campbell v. Gov't Employees Ins. Co.*, 306 So.2d 525; *Auto Mut. Indem. Co. v. Shaw*, 184 So. 852.

The "duty to settle" is arguably the most important duty of an insurer. An insurer has an affirmative duty to initiate settlement discussions where liability is clear and an excess judgment is likely. The lack of a formal offer to settle does not preclude a finding of bad faith. Rather, it is one factor to be considered. *Powell v. Prudential Prop. & Cas. Ins. Co.*, 584 So. 2d 12, 14 (Fla. 3d DCA 1991). An insurer's ultimate tender of the policy limits does not automatically insulate it from liability for bad faith. *Id*. at 15.

(a) Representative Cases

***Berges v. Infinity Ins. Co.*, 896 So. 2d 665 (Fla. 2004)**

A driver insured by Infinity caused the death of the driver of another vehicle and severely injured the deceased's child. Infinity's investigation confirmed that its insured was 100% at fault for the accident. The decedent's husband sent Infinity a handwritten offer to settle the claim for the policy limits of $10,000 and gave Infinity twenty-five days to accept. He told Infinity that he needed the money to help with medical bills and to replace his lost income caused by the death of his wife. Although the petition to appoint a personal representative was filed, none had been appointed. Infinity failed to pay the policy limits within the time allowed by the claimant even though it had concluded its investigation before the demand was made. The claimant filed a wrongful death suit.

The Court held that the insurer was not absolved of its duty to settle the claim (and thereby protect its insured) simply because no personal representative had been appointed. The question of whether Infinity acted in "bad faith" was deemed one for the jury to decide after examining the totality of the circumstances. The Supreme Court ultimately affirmed a finding of "bad faith". Stated simply, Infinity failed to take reasonable steps to effectuate and complete the settlement, request an extension of time to do so, or communicate with the insured or the claimant. The insurer was therefore liable for the full amount of the judgment against its insured.

***Macola v. Gov't Emps. Ins. Co.*, 953 So. 2d 451 (Fla. 2006)**

A claimant filed suit against GEICO's insured. During the litigation but before trial, the insured filed a Civil Remedy Notice of Insurer Violation which afforded GEICO sixty days to pay the claim. GEICO tendered the policy limits to the insured (not the claimant) within the sixty-day period. At the time that GEICO tendered its policy limits, the third-party claimant's offer to settle

had long since expired. The claimant eventually obtained a judgment against the insured in excess of the policy limits.

In the subsequent "bad faith" action, GEICO claimed that it "cured" the "bad faith" by paying the insured, even though the insured could not settle the claim for the policy limits. Relying on *Talat Enters., Inc. v. Aetna Cas. & Sur. Co.*, 753 So. 2d 1278 (Fla. 2000), the trial court agreed that GEICO's payment within the sixty day time period extinguished any "bad faith" liability.

On appeal, the Florida Supreme Court reversed. It found that an insurer's payment of the policy limits to *an insured* in response to the filing of a Civil Remedy Notice after the lawsuit was filed does not preclude a "bad faith" action. *Macola*, 953 So. 2d at 457. The Court explained that "the essence of a third party 'bad faith' cause of action is to remedy a situation in which an insured is exposed to an excess judgment because of the insurer's failure to properly or promptly defend the claim." *Id*.

***Goheagan v. Am. Vehicle Ins. Co.*, 107 So. 3d 433 (Fla. 4th DCA 2012)**

American Vehicle's policyholder John Perkins rear-ended Molly Swaby's vehicle while speeding. Swaby remained in a coma until she passed away five months later. The claim was reported to American Vehicle two days after the accident. It immediately decided that Perkins was solely liable for the accident and that Swaby's injuries were far in excess of the $10,000 per-claim $20,000 per-accident policy limits. Within the next month, American Vehicle's claim adjuster attempted to contact Swaby's family by telephone but was referred to an unidentified attorney retained by Goheagan, the personal representative of the estate. Despite six or seven calls, the claim adjuster was never able to obtain the name of the attorney. The adjuster ultimately learned that Goheagan had filed a lawsuit against Perkins for wrongful death. American Vehicle subsequently tendered its policy limits, which were rejected by Goheagan. A jury found against Perkins for $2.8 million.

Goheagan, as assignee of Perkins, filed suit against American Vehicle for "bad faith" alleging that it failed to 1) initiate settlement negotiations with Swaby; 2) tender the policy limits in a timely manner; and, 3) warn Perkins of a possible excess judgment. American Vehicle moved for summary judgment on two grounds. First, it argued that Swaby was in a coma and there was no one to make the offer to; and second, because American Vehicle had been made aware that a lawyer was involved, it was prohibited from communicating or negotiating a settlement with Swaby or Goheagan.

On rehearing, after appeal, the Court reversed now finding that the issue of "bad faith" was for the jury to determine. The Court found several facts to be important. First, the American Vehicle adjuster never made an offer to the family members or represented that the purpose of her telephone call was to make an offer. Second, American Vehicle failed to send a written settlement offer prior to the initiation of the wrongful death lawsuit. Lastly, while the presence of an attorney may have precluded settlement it should not have been an impediment to communicating an offer.

2. Claims by Multiple Claimants

An insurer faces a more difficult challenge where there are multiple claimants and limited policy limits. In such cases, the insurer must act in the manner which best serves to minimize exposure to its insured even if that means resolving some claims to the exclusion of others. *Farinas v. Florida Farm Bureau General Ins. Co.*, 850 So.2d 555 (Fla. 4th DCA 2003).

In *Farinas* an insured driver caused an automobile accident, killing five young people and injuring six others besides himself. One of the victims, Farinas, was rendered a quadriplegic. The insured's automobile policy had limits of $100,000 per-claim and $300,000 per-accident. Florida Farm Bureau promptly settled for the limits with the badly injured driver of the other car and the estates of two individuals who were killed in the accident. The value of each of these settled claims unquestionably exceeded the policy limits of $100,000 per claim.

Florida Farm Bureau then filed a declaratory judgment action to determine whether it had any further duty to defend its insured against other claims after the exhaustion of the policy limits. Accident victims, or their survivors, intervened and filed a third-party "bad faith" action alleging that the insurer's hasty settlement of the three claims was without regard to the interests of its insured thereby exposing him to multiple excess judgments. The trial court entered summary judgment in favor Florida Farm Bureau.

On appeal, the Court articulated three duties of an insurer in addressing multi-claimant situations. First, the insurer is required to "fully investigate all the claims at hand to determine how to best limit the insured's liability." While an insurer has some "discretion in how it elects to settle claims, and may even choose to settle certain claims to the exclusion of others," the decision must be reasonable and in keeping with its good faith duty. Second, the insurer should seek "to settle as many claims as possible within the policy limits." Lastly, the insurer has a "duty to avoid indiscriminately settling selected claims and leaving the insured at risk of excess judgments that could have been minimized by wiser settlement practice." Whether these duties have been breached is a question of fact for the jury.

As long as an insurer exercises its discretion reasonably and with reason no bad faith liability will lie. *Id.*; *General Sec. Nat'l Ins. Co. v. Marsh*, 303 F. Supp. 2d 1321, 1325-1326 (M.D. Fla. 2004).

3. Claims Involving Multiple Insureds

Contreras v. U.S. Sec. Ins. Co., 927 So. 2d 16 (Fla. 4th DCA 2006) is the leading case setting forth an insurer's good faith responsibilities in situations involving multiple insureds. The case involved a permissive user of an automobile (an Additional Insured under the policy) who killed the claimant's daughter while driving intoxicated at a high rate of speed. The claimant made a demand for policy limits and in response, the insurer tendered its policy limits along with a release. The claimant did not accept the policy limits because the accompanying release was too broad – it also included the driver. The claimant's attorney sent the insurer a release only as to the owner and the insurer, but the insurer refused to sign it because it contended that it also owed a

duty of good faith to the driver as an Additional Insured under the policy. The claimant filed a wrongful death suit and won an excess judgment and punitive damages.

The insurer was granted a directed verdict in the subsequent "bad faith" suit on grounds that it was obligated to act in good faith to both the owner and the driver and could not enter into a settlement agreement which operated to exonerate one but not the other. On appeal, the claimant argued that the issue was really whether an insurer acts in "bad faith" in refusing to pay a reasonable settlement demand in order to obtain a release of one of its two insureds, where the claimant refuses to settle with the other insured.

The appellate court agreed and explained that after the insurer had attempted to secure a release for the permissive driver without success, it had done all it could to avoid excess exposure to the driver. The insurer was then obligated to “take the necessary steps” to protect the owner. It also explained that the focus in a "bad faith" suit must remain on the actions of the insurer in fulfilling its obligation to the insured, not on the claimant’s actions.

CONCLUSION

There is no bright-line test for whether an insurer has acted in "bad faith". The insurer must put itself in the place of the insured and act at all times to minimize its insured's liability. An insurer can make a mistake and not automatically be in "bad faith". It cannot act in its own best interests or engage in other conduct that wrongfully compromises the well-being of its insured.

Section 15.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

South Ballroom

Friday, May 18th 2018
9:30 AM – 10:30 AM

Course Title:
An Update on California's Right to Repair Act, featuring McMillin Albany et al. v. Superior Court

Andrew Morgan, Esq., Jill J. Lifter, Esq., Susan Benson, Esq. and Mayo Makarczyk, Esq.

Filed 1/18/18

IN THE SUPREME COURT OF CALIFORNIA

MCMILLIN ALBANY LLC et al.,	
Petitioners,	S229762
v.	Ct.App. 5 F069370
THE SUPERIOR COURT OF KERN COUNTY,	
Respondent;	Kern County Super. Ct. No. S-1500-CV-279141
CARL VAN TASSEL et al.,	
Real Parties in Interest.	

In *Aas v. Superior Court* (2000) 24 Cal.4th 627, 632 (*Aas*), this court held that the economic loss rule bars homeowners suing in negligence for construction defects from recovering damages where there is no showing of actual property damage or personal injury. We explained that requiring a showing of more than economic loss was necessary to preserve the boundary between tort and contract theories of recovery, and to prevent tort law from expanding contractual warranties beyond what home builders had agreed to provide. (*Id.* at pp. 635–636; see *Seely v. White Motor Co.* (1965) 63 Cal.2d 9, 18.) We emphasized that the Legislature was free to alter these limits on recovery and to add whatever additional homeowner protections it deemed appropriate. (*Aas*, at pp. 650, 653.)

Two years later, spurred by *Aas* and by lobbying from homeowner and construction interest groups, the Legislature passed comprehensive construction defect litigation reform. (Stats. 2002, ch. 722, principally codified at Civ. Code, §§ 895–945.5 (commonly known as the Right to Repair Act, hereafter the Act); all further unlabeled statutory references are to the Civil Code.) The Act sets forth detailed statewide standards that the components of a dwelling must satisfy. It also establishes a prelitigation dispute resolution process that affords builders notice of alleged construction defects and the opportunity to cure such defects, while granting homeowners the right to sue for deficiencies even in the absence of property damage or personal injury.

We are asked to decide whether the lawsuit here, a common law action alleging construction defects resulting in both economic loss and property damage, is subject to the Act's prelitigation notice and cure procedures. The answer depends on the extent to which the Act was intended to alter the common law — specifically, whether it was designed only to abrogate *Aas*, supplementing common law remedies with a statutory claim for purely economic loss, or to go further and supplant the common law with new rules governing the method of recovery in actions alleging property damage. Based on an examination of the text and legislative history of the Act, we conclude the Legislature intended the broader displacement. Although the Legislature preserved common law claims for personal injury, it made the Act the virtually exclusive remedy not just for economic loss but also for property damage arising from construction defects. The present suit for property damage is therefore subject to the Act's prelitigation procedures, and the Court of Appeal was correct to order a stay until those procedures have been followed.

I.

Plaintiffs Carl and Sandra Van Tassel and several dozen other homeowners (collectively the Van Tassels) purchased 37 new single-family homes from developer and general contractor McMillin Albany LLC (McMillin) at various times after January 2003. In 2013, the Van Tassels sued McMillin, alleging the homes were defective in nearly every aspect of their construction, including the foundations, plumbing, electrical systems, roofs, windows, floors, and chimneys. The operative first amended complaint included common law claims for negligence, strict product liability, breach of contract, and breach of warranty, and a statutory claim for violation of the construction standards set forth in section 896. The complaint alleged the defects had caused property damage to the homes and economic loss due to the cost of repairs and reduction in property values.

McMillin approached the Van Tassels seeking a stipulation to stay the litigation so the parties could proceed through the informal process contemplated by the Act. (§§ 910–938.) That process begins with written notice from the homeowner to the builder of allegations that the builder's construction falls short of the standards prescribed by the Act. (§ 910.) The builder must acknowledge receipt (§ 913) and thereafter has a right to inspect and test any alleged defect (§ 916). Following any inspection and testing, the builder may offer to repair the defect (§ 917) or pay compensation in lieu of a repair (§ 929). The Act regulates the procedures for any repair, authorizes mediation, and preserves the homeowner's right to sue in the event the repair is unsatisfactory and no settlement can be reached. (§§ 917–930.)

The Van Tassels elected not to stipulate to a stay and instead dismissed their section 896 claim. McMillin moved for a court-ordered stay. (§ 930, subd. (b) ["If the claimant does not conform with the requirements of this chapter, the builder may bring a motion to stay any subsequent court action or other

proceeding until the requirements of this chapter have been satisfied."].) In response, the Van Tassels argued that because the complaint now omitted any claim under the Act, the Act's informal prelitigation process did not apply. The Van Tassels cited *Liberty Mutual Ins. Co. v. Brookfield Crystal Cove LLC* (2013) 219 Cal.App.4th 98, 101 (*Liberty Mutual*), which held that the Act was adopted to provide a remedy for construction defects causing only economic loss and did not alter preexisting common law remedies in cases where actual property damage or personal injuries resulted.

The trial court denied the motion for a stay. It observed that the issues decided in *Liberty Mutual* might be the subject of further appellate inquiry, but concluded it was bound to follow the case. Recognizing that the question was not free from doubt, the trial court certified the issue as one worthy of immediate review. (Code Civ. Proc., § 166.1.) McMillin sought writ relief.

The Court of Appeal granted the petition and issued the writ, disagreeing with *Liberty Mutual* and another case that had followed it, *Burch v. Superior Court* (2014) 223 Cal.App.4th 1411. The court examined the text and history of the Act and concluded that the Act was meant to at least partially supplant common law remedies in cases where property damage had occurred. In the Court of Appeal's view, "the Legislature intended that all claims arising out of defects in residential construction" involving post-2003 sales of new houses "be subject to the standards and the requirements of the Act." Accordingly, the Court of Appeal held the Act's prelitigation resolution process applied here even though the Van Tassels had dismissed their statutory claim under the Act. The court concluded that McMillin is entitled to a stay pending completion of the prelitigation process.

We granted review.

II.

In deciding whether a statutory scheme alters or displaces the common law, we begin with a presumption that the Legislature did not so intend. (*Fahlen v. Sutter Central Valley Hospitals* (2014) 58 Cal.4th 655, 669 (*Fahlen*); *California Assn. of Health Facilities v. Department of Health Services* (1997) 16 Cal.4th 284, 297 (*Health Facilities*).) To the extent possible, we construe statutory enactments as consonant with existing common law and reconcile the two bodies of law. (*Verdugo v. Target Corp.* (2014) 59 Cal.4th 312, 326; *People v. Ceja* (2010) 49 Cal.4th 1, 10.) Only " 'where there is no rational basis for harmonizing' " a statute with the common law will we conclude that settled common law principles must yield. (*Health Facilities*, at p. 297.)

Although the presumption against displacement of the common law is strong, abrogation of the common law does not require an express declaration; it is enough that "the language or evident purpose of the statute manifest a legislative intent to repeal" a common law rule. (*Health Facilities*, *supra*, 16 Cal.4th at p. 297; see *Fahlen*, *supra*, 58 Cal.4th at p. 669 [abrogation may be found " ' "by express declaration or by necessary implication" ' "].) In *Martinez v. Combs* (2010) 49 Cal.4th 35, for example, we canvassed the "full historical and statutory context" surrounding enactment of statutory minimum wage protections and concluded that it "show[ed] unmistakably" that the Legislature intended Industrial Welfare Commission definitions of the employment relationship to control, even when those definitions might depart from the common law. (*Id.* at p. 64; see *Verdugo v. Target Corp.*, *supra*, 59 Cal.4th at pp. 326–327 [giving other examples where the Legislature clearly but implicitly abrogated the common law].)

As explained below, the statute here leaves the common law undisturbed in some areas, expressly preserving actions for breach of contract, fraud, and personal injury. (§ 943, subd. (a).) In other areas, however, the Legislature's

intent to reshape the rules governing construction defect actions is patent. Where common law principles had foreclosed recovery for defects in the absence of property damage or personal injury (*Aas, supra*, 24 Cal.4th at p. 632), the Act supplies a new statutory cause of action for purely economic loss (§§ 896–897, 942–944). And, of direct relevance here, even in some areas where the common law had supplied a remedy for construction defects resulting in property damage but not personal injury, the text and legislative history reflect a clear and unequivocal intent to supplant common law negligence and strict product liability actions with a statutory claim under the Act.

A.

We begin with the text of the Act, which "comprehensively revises the law applicable to construction defect litigation for individual residential units" within its coverage. (*Lantzy v. Centex Homes* (2003) 31 Cal.4th 363, 382, fn. 16.) The Act adds title 7 to division 2, part 2 of the Civil Code. (§§ 895–945.5.) That title consists of five chapters. Chapter 1 establishes definitions applicable to the entire title. (§ 895.) Chapter 2 defines standards for building construction. (§§ 896–897.) Chapter 3 governs various builder obligations, including the warranties a builder must provide. (§§ 900–907.) Chapter 4 creates a prelitigation dispute resolution process. (§§ 910–938.) Chapter 5 describes the procedures for lawsuits under the Act. (§§ 941–945.5.)

Section 896, which codifies a lengthy set of standards for the construction of individual dwellings, begins with a preamble describing the intended effect of those standards. As relevant here, the preamble says: "In any action seeking recovery of damages arising out of, or related to deficiencies in, the residential construction, design, specifications, surveying, planning, supervision, testing, or observation of construction, a builder . . . shall, except as specifically set forth in

this title, be liable for, and the claimant's claims or causes of action shall be limited to violation of, the following standards, except as specifically set forth in this title. This title applies to original construction intended to be sold as an individual dwelling unit. As to condominium conversions, this title does not apply to or does not supersede any other statutory or common law." (§ 896.)

Three aspects of this text are instructive. First, the provision applies to "any action" seeking damages for a construction defect, not just any action under the title. (§ 896.) This suggests an intent to create not merely *a* remedy for construction defects but *the* remedy. Second, "the claimant's claims or causes of action shall be limited to violation of[] the following standards, except as specifically set forth in this title." (*Ibid.*) This express language of limitation means that a party seeking damages for a construction defect may sue for violation of these standards, and *only* violation of these standards, unless the Act provides an exception. This clause evinces a clear intent to displace, in whole or in part, existing remedies for construction defects. Third, "[t]his title applies to original construction intended to be sold as an individual dwelling unit," but "[a]s to condominium conversions, this title does not apply to or does not supersede any other statutory or common law." (*Ibid.*) The Act governs claims concerning stand-alone homes; for such disputes, the Act's provisions do "supersede any other statutory or common law" except as elsewhere provided.

The Van Tassels argue that section 896 should be read to refer and apply only to claims concerning defects that have yet to cause damage. But no such limitation appears in the text, which says the Act applies to "any action seeking recovery of damages arising out of" construction defects. (§ 896.) The Van Tassels also object that if section 896 is read to apply broadly, the shorter limitations periods it imposes for certain types of defects (e.g., § 896, subds. (e)–(g)) may limit homeowners' ability to recover. But there is nothing absurd about

accepting these limitations periods at face value, and they supply no special reason to disregard the import of the remainder of the statute.

We turn next to chapter 5 (§§ 941–945.5), which contains key provisions governing the damages recoverable in an action under the Act and the extent to which the Act provides the exclusive vehicle for recovery of such damages. The Legislature was well aware of the main categories of damages involved in construction defect actions (economic loss, property loss, death or personal injury) and their treatment under existing law. The major stakeholders on all sides of construction defect litigation participated in developing the Act. (See Sen. Com. on Judiciary, Analysis of Sen. Bill No. 800 (2001–2002 Reg. Sess.) as amended Aug. 28, 2002, pp. 3, 8.) The Legislature also expressly considered *Aas* and its rule requiring property damage or personal injury, not just economic loss, for any tort suit alleging a construction defect. (Assem. Com. on Judiciary, Analysis of Sen. Bill No. 800 (2001–2002 Reg. Sess.) as amended Aug. 26, 2002, pp. 2–3; Sen. Com. on Judiciary, Analysis of Sen. Bill No. 800 (2001–2002 Reg. Sess.) as amended Aug. 28, 2002, pp. 1–4.) Informed by the various stakeholders' concerns, the Legislature enacted provisions that reflect a conscious effort to address how and when various categories of damages would be recoverable going forward.

The provisions of chapter 5 make explicit the intended avenues for recouping economic losses, property damages, and personal injury damages. Section 944 defines the universe of damages that are recoverable in an action under the Act. (§ 944 ["If a claim for damages is made under this title, the homeowner is only entitled to damages for" a series of specified types of losses].) In turn, section 943 makes an action under the Act the exclusive means of recovery for damages identified in section 944 absent an express exception: "Except as provided in this title, no other cause of action for a claim covered by

this title or for damages recoverable under Section 944 is allowed." (§ 943, subd. (a).) In other words, section 944 identifies what damages *may* be recovered in an action under the Act, and section 943 establishes that such damages *may only* be recovered in an action under the Act, absent an express exception.

The list of recoverable damages in section 944 and the list of exceptions in section 943 have different consequences for recovery of economic losses, personal injury damages, and property damages:

Economic Loss. As noted, before the Act, tort recovery of purely economic losses occasioned by construction defects was forbidden by this court's decision in *Aas*. (*Aas, supra,* 24 Cal.4th at p. 632.) Section 944 now specifies that various forms of economic loss are recoverable in an action under the Act. (§ 944 [listing among recoverable damages "the reasonable value of repairing any violation of the standards set forth in this title, the reasonable cost of repairing any damages caused by the repair efforts, . . . the reasonable cost of removing and replacing any improper repair by the builder, reasonable relocation and storage expenses, lost business income if the home was used as a principal place of a business licensed to be operated from the home, [and] reasonable investigative costs for each established violation . . . ."].) Consequently, a party suffering economic loss from defective construction may now bring an action to recover these damages under the Act without having to wait until the defect has caused property damage or personal injury. Were there any doubt, section 942 makes clear that "[i]n order to make a claim for violation of the" Act's standards, "[n]o further showing of causation or damages is required to meet the burden of proof regarding a violation of a standard."

Personal Injury. In contrast, personal injury damages are not listed as a category recoverable under the Act. (§ 944.) This omission places personal injury claims outside the scope of section 943, subdivision (a), which makes an action

under the Act the exclusive remedy for those damages listed in section 944. To make the point even clearer, the Legislature also included personal injury claims in a list of claims that are exempt from the exclusivity of the Act. (§§ 931 [listing any action for "personal injuries" among the causes of action not covered by the Act], 943, subd. (a) ["this title does not apply to . . . any action for . . . personal injury . . ."].) Thus, common law tort claims for personal injury are preserved.

Property Damage. As with economic losses, the Act expressly includes property damages resulting from construction defects among the categories of damages recoverable under the Act. (§ 944 [a homeowner may recover "the reasonable cost of repairing and rectifying any damages resulting from the failure of the home to meet the standards"]; see § 896 [the Act applies to "recovery of damages arising out of, or related to" construction defects].) This places claims involving property damages within the purview of section 943, subdivision (a), which makes a claim under the Act the exclusive way to recover such damages. And unlike personal injury claims, negligence and strict liability claims for property damages are not among the few types of claims expressly excepted from section 943's exclusivity. (§ 943, subd. (a); see § 931 [noting claims for personal injury, but not property damage, fall outside the Act's coverage].)

To sum up this portion of the statutory scheme: For economic losses, the Legislature intended to supersede *Aas* and provide a statutory basis for recovery. For personal injuries, the Legislature preserved the status quo, retaining the common law as an avenue for recovery. And for property damage, the Legislature replaced the common law methods of recovery with the new statutory scheme. The Act, in effect, provides that construction defect claims not involving personal injury will be treated the same procedurally going forward whether or not the underlying defects gave rise to any property damage.

As with section 896, the Van Tassels argue that section 943, subdivision (a) should be read to make the Act the exclusive remedy only for claims concerning defects that have yet to cause damage. But this view cannot be reconciled with the portion of section 943, subdivision (a) making the Act the exclusive means of recovering any of the categories of damages listed in section 944 — categories that, as noted, include resulting damages from construction defects, not just economic loss. Moreover, if the only purpose of the Act's creation of a statutory claim was to abrogate the *Aas* rule for negligence claims and provide for recovery of economic losses, the Act's provisions would have had no effect on actions for breach of contract, fraud, or personal injury. Had that been the limit of the Legislature's intent, the inclusion of an exception expressly preserving such claims would have been unnecessary. (§ 943, subd. (a) ["this title does not apply to any action by a claimant to enforce a contract or express contractual provision, or any action for fraud, personal injury, or violation of a statute"].)

Section 897, which applies to elements of construction not otherwise addressed in section 896, is also relevant. Although section 896 was intended to be comprehensive, section 897 provides a supplemental standard for any building components that section 896 may have overlooked: Any part not otherwise covered is defective and "actionable if it causes damage." This use of damage to measure defectiveness is not unusual; many of the more specific standards in section 896 likewise use the causation of damage as part of the test for whether a given part is defective. (§ 896, subds. (a)(3), (6), (7), (9), (11), (12), (18), (c)(1).) Thus, a claim under the Act, whether predicated on a violation of section 896 or section 897, often may involve circumstances where an alleged defect has resulted in property damage.

The Van Tassels read section 897 as providing that any defect covered by that section can form the basis of a suit under the common law rather than under

the Act. Again, the statutory text and context do not support this reading. First, when the Legislature intended to preserve common law claims as a complement to claims under the Act, it did so expressly. (§§ 931, 943, subd. (a); see *Gillotti v. Stewart* (2017) 11 Cal.App.5th 875, 894.) No similar language appears in section 897 to suggest violations of its catchall standard may be pursued in a common law negligence or strict liability action outside the parameters of the Act. Second, other parts of the Act treat sections 896 and 897 as a unified and connected whole. (See §§ 910 [requiring exhaustion of prelitigation procedures in all cases where "a violation of the standards set forth in Chapter 2 [§§ 896–897]" is alleged], 942 [establishing rules for "a claim for violation of the standards set forth in Chapter 2 [§§ 896–897]"].) Such treatment is at odds with the Van Tassels' proposal that section 897, unlike section 896, may be enforced at common law. Were we to agree with the Van Tassels that a defect standard based on damage causation reflects a legislative intent to preserve a common law claim for such defects, this would create difficulties in applying section 896. That section measures defectiveness for some but not all building components by whether damage was caused and, under the Van Tassels' reading, would support a common law claim for some but not all standard violations. (Compare § 896, subds. (a)(3), (6), (7), (11), (12), (18), (c)(1) [setting out standards for various components that depend on damage] with *id.*, subds. (a)(4), (14)–(17), (b)(1)–(4), (d)–(f) [setting out standards for other components that do not depend on damage].) Had the Legislature intended such a selective preservation of common law remedies, we think it would have said so, as it did elsewhere.

Against these textual inferences, the Van Tassels point to other portions of the Act that purportedly preserve common law claims and confine the Act's prelitigation procedures to statutory claims under the Act. (See §§ 910, 914, subd. (a), 942.) Central to their argument is section 910, which says: "Prior to

filing an action against any party alleged to have contributed to a violation of the standards set forth in Chapter 2 (commencing with Section 896), the claimant shall initiate the following prelitigation procedures . . . ." The Van Tassels contend that this passage limits the applicability of the Act's prelitigation procedures to cases where the complaint formally "allege[s]" the defendant has "contributed to a violation of the standards" set forth in the Act. A common law claim for property damage that does not contain such formal allegations, they argue, is exempt from the Act's prelitigation procedures. But this reading of the statute is difficult to reconcile with section 943, subdivision (a), which says: "Except as provided in this title, no other cause of action for a claim covered by this title or for damages recoverable under Section 944 is allowed." In other words, section 943 disallows claims other than those predicated on the Act's standards, with exceptions not applicable here. And if a claim for property damage alleges a violation of section 896 or section 897, then section 910 by its terms subjects the claim to the Act's prelitigation procedures.

Finally, the Van Tassels argue that the presumption against abrogation of the common law requires an express statement that the Legislature intended to displace existing remedies. It does not. (*Ante*, at p. 5.) Moreover, both sides agree that the Legislature in passing the Act sought to abrogate the common law, even though the text contains no express statement of that intent. They differ only in degree: The Van Tassels contend that the Legislature sought only to overrule the common law limits on recovery identified in *Aas*, whereas McMillin contends that the Legislature went further in supplanting certain common law claims with statutory ones. As explained above, we agree with McMillin's reading of the Act.

B.

The legislative history of the Act confirms that displacement of parts of the existing remedial scheme was no accident, but rather a considered choice to reform construction defect litigation.

First, language in the Legislature's analyses of the Act's effects reflects an intent that the Act would govern not only no damage cases, but cases where property damage had resulted. The Act's standards were designed so that "except where explicitly specified otherwise, liability would accrue under the standards regardless of whether the violation of the standard had resulted in actual damage or injury." (Sen. Com. on Judiciary, Analysis of Sen. Bill No. 800 (2001–2002 Reg. Sess.) as amended Aug. 28, 2002, p. 4.) Both halves of this intended application are significant: Liability under the standards would attach even in the absence of actual damage, thus effectively abrogating *Aas*. And liability under the standards would also attach in cases of actual damage; in other words, the Legislature anticipated that passage of the Act would result in standards that governed liability even when violation of the standards *had* resulted in property damage. The Legislature thus recognized and intended that claims under the Act would cover territory previously in the domain of the common law.

Second, the Act "establishes a mandatory process prior to the filing of a construction defect action," with the "major component of this process" being "the builder's absolute right to attempt a repair prior to a homeowner filing an action in court." (Sen. Com. on Judiciary, Analysis of Sen. Bill No. 800 (2001–2002 Reg. Sess.) as amended Aug. 28, 2002, p. 5.) These purposes, the creation of a mandatory prelitigation process and the granting of a right to repair, would be thwarted if we were to read the Act to permit homeowners to continue to sue as before at common law, without abiding by the procedural requirements of the Act, for construction defect claims involving damages other than economic loss.

Third, although there is no doubt that the Act had the intended effect of overriding *Aas*'s limits on construction defect actions, that effect was treated in both the Assembly and Senate as one consequence of the overall reform package, not as the principal goal of the Act. The Assembly Committee on the Judiciary described as a "principal feature of the bill" the establishment of construction defect standards and then observed that one consequence of the "standards [is to] effectively end the debate over the controversial decision in the *Aas* case." (Assem. Com. on Judiciary, Analysis of Sen. Bill No. 800 (2001–2002 Reg. Sess.) as amended Aug. 26, 2002, p. 3; accord, Sen. Rules Com., Off. of Sen. Floor Analyses, analysis of Sen. Bill No. 800 (2001–2002 Reg. Sess.) as amended Aug. 28, 2002, p. 3.) In a similar vein, the Senate Committee on the Judiciary described the Act as creating standards that would "govern any action seeking recovery of damages arising out of or related to construction defects" and then noted that "[i]n addition" the rules for liability under the standards would "essentially overrule the *Aas* decision and, for most defects, eliminate that decision's holding that construction defects must cause actual damage or injury prior to being actionable." (Sen. Com. on Judiciary, Analysis of Sen. Bill No. 800 (2001–2002 Reg. Sess.) as amended Aug. 28, 2002, p. 4.) If the Van Tassels' interpretation of the Act were correct, then the legislative analyses certainly bury the lede.

In sum, the legislative history confirms what the statutory text reflects: the Act was designed as a broad reform package that would substantially change existing law by displacing some common law claims and substituting in their stead a statutory cause of action with a mandatory prelitigation process.

III.

Echoing an argument made by the Court of Appeal in *Liberty Mutual*, *supra*, 219 Cal.App.4th 98, the Van Tassels contend that the detailed prelitigation

procedures and timelines set out in chapter 4 (§§ 910–938) cannot rationally be applied to defects that create a sudden loss requiring emergency repairs. From this, they infer that the Act and its procedures were never intended to extend to claims for defects resulting in actual damage. We are not presented with a case in which any party had to take emergency action. But the emergency scenario does not give us reason to doubt that the Act applies to property damage cases.

The Act requires a homeowner, before suing, to provide a builder with written notice and a general description of an alleged construction defect. (§ 910, subd. (a).) The Act then subjects the builder to a series of deadlines by which it must acknowledge receipt, supply relevant records, and, if it chooses, inspect, offer to repair the defect, and commence repairs. (§§ 912–913, 916–917, 921.) In nonemergency cases, there is no tension between these provisions and the portions of the Act that extend its application to cases involving property damage. In the absence of delay risking a worsening of any damage, a homeowner will have time to give the requisite notice and await the builder's response. If the builder drags its feet in a way that exacerbates damage, the Act protects the homeowner. (See § 944 [builder is liable for "the reasonable cost of repairing and rectifying any damages resulting from the failure of the home to meet the standards"]; *KB Home Greater Los Angeles, Inc. v. Superior Court* (2014) 223 Cal.App.4th 1471, 1478 (*KB Home*) ["Since the builder is required to compensate the homeowner for consequential damages, including the cost of repair of actual property damage caused by a construction defect, any delay up to the statutory maximum risks increasing the builder's liability."].)

Defects that trigger sudden ongoing, escalating damage present a more difficult problem. The Act does not expressly address how its operation might change in such unusual circumstances. The minimal requirements of formal written notice and awaiting a builder response could be onerous in cases where a

construction failure creates a need for emergency action by a homeowner or the homeowner's insurer. But we need not read the notice requirement in isolation. The Act also imposes on homeowners a general duty to act reasonably in order to mitigate losses. (See § 945.5, subd. (b) [affording builders an affirmative defense where losses are the result of "a homeowner's unreasonable failure to minimize or prevent those damages in a timely manner"].) A failure to give formal written notice before taking any other action might well be excused in circumstances where a homeowner has acted reasonably to mitigate losses and has provided informal notice, and subsequent written notice, in a manner that is as timely and effective as reasonably practicable under the circumstances. (See *Lewis v. Superior Court* (1985) 175 Cal.App.3d 366, 378 [construing statute of limitations for filing of complaint to permit an exception "based upon impossibility where catastrophic fire or earthquake or other events might render it physically impossible" to comply]; cf. *KB Home, supra*, 223 Cal.App.4th 1471 [notice requirement not excused where homeowner alerted insurer, but not builder, and insurer completed repairs three months later before finally notifying builder].)

A similar principle of reasonableness must be applied to the interpretation of the builder's rights and obligations. Although the Act establishes various maximum time periods in which the builder may respond, inspect, offer to repair, and commence repairs (§§ 913, 916–917, 921), the builder avails itself of the full time allowed by the Act at its peril. The builder is liable for the damages its construction defects cause, and even when a homeowner has acted unreasonably in failing to limit losses, the builder remains liable for "damages due to the untimely or inadequate response of a builder to the homeowner's claim." (§ 945.5, subd. (b).) What constitutes a timely response will vary according to the circumstances, and the maximum response periods set forth by the Act do not necessarily insulate a builder from damages when the builder has failed to take

remedial action as promptly as is reasonable under the circumstances. The Act's liability provisions thus supply builders and homeowners clear incentives to move quickly to minimize damages when alerted to emergencies. (*KB Home*, *supra*, 223 Cal.App.4th at p. 1478.)

The Van Tassels highlight section 930, subdivision (a), which requires "[t]he time periods . . . in this chapter . . . to be strictly construed, . . . unless extended by the mutual agreement of the parties." But this directive simply ensures that the time periods are followed when the parties have not agreed otherwise. It does not mean that the parties are necessarily immune from liability for failing to take swifter action when circumstances dictate.

Because this case does not involve a catastrophic occurrence or emergency repairs, we need not decide definitively how the Act would apply on such facts. But our review of the Act's provisions reveals enough play in the joints to suggest that the Act can be adapted well enough to extreme circumstances. The tension between the Act's timelines and the occasional need for expeditious action in exigent circumstances does not provide a sufficiently compelling reason to disregard the numerous indications in the Act's text and history that the Legislature clearly intended it to govern cases involving actual property damage. We disapprove *Liberty Mutual Ins. Co. v. Brookfield Crystal Cove LLC*, *supra*, 219 Cal.App.4th 98, and *Burch v. Superior Court*, *supra*, 223 Cal.App.4th 1411, to the extent they are inconsistent with the views expressed in this opinion.

IV.

The Van Tassels voluntarily dismissed without prejudice their cause of action for violation of section 896's standards. Even so, the operative complaint includes claims resting on allegations that McMillin defectively constructed the foundations, plumbing, roofs, electrical conduits, framing, flooring, and walls of the plaintiffs' homes. This suit remains an "action seeking recovery of damages

arising out of, or related to deficiencies in, the residential construction" of the plaintiffs' homes (§ 896), and McMillin's liability under the Van Tassels' negligence and strict liability claims depends on the extent to which it violated the standards of sections 896 and 897. Thus, the Van Tassels were required to initiate the prelitigation procedures provided for in the Act. (See *Elliott Homes, Inc. v. Superior Court* (2016) 6 Cal.App.5th 333, 341 ["[W]here the complaint alleges deficiencies in construction that constitute violations of the standards set out in chapter 2 of the Act, the claims are subject to the Act, and the homeowner must comply with the prelitigation procedure, regardless of the theory of liability asserted in the complaint."].)

In holding that claims seeking recovery for construction defect damages are subject to the Act's prelitigation procedures regardless of how they are pleaded, we have no occasion to address the extent to which a party might rely upon common law principles in pursuing liability under the Act. Nor does our holding embrace claims such as those for breach of contract, fraud, or personal injury that are expressly placed outside the reach of the Act's exclusivity. (§ 943, subd. (a).) That limit does not help the Van Tassels' position here, for while the complaint includes breach of contract and breach of warranty claims, it also includes claims for strict liability and negligent failure to construct defect-free homes, to which no statutory exception applies. Accordingly, the Van Tassels must comply with the Act's prelitigation procedures before their suit may proceed. Because the Van Tassels have not yet done so, McMillin is entitled to a stay. (§ 930, subd. (b).)

CONCLUSION

We affirm the judgment of the Court of Appeal and remand for further proceedings not inconsistent with this opinion.

LIU, J.

WE CONCUR:

CANTIL-SAKAUYE, C. J.
CHIN, J.
CORRIGAN, J.
CUÉLLAR, J.
KRUGER, J.
LUI, J.[*]

[*] Presiding Justice of the Court of Appeal, Second Appellate District, Division Two, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

See last page for addresses and telephone numbers for counsel who argued in Supreme Court.

Name of Opinion McMillin Albany LLC v. Superior Court

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Counsel:

Borton Petrini, Calvin R. Stead and Andrew M. Morgan for Petitioners.

Ulich Ganion Balmuth Fisher & Feld and Donald W. Fisher as Amici Curiae on behalf of Petitioners.

Donahue Fitzgerald, Kathleen F. Carpenter, Amy R. Gowan; Ware Law and Dee A. Ware for California Building Industry Association, Building Industry Legal Defense Foundation and California Infill Federation as Amici Curiae on behalf of Petitioners.

Ryan & Lifter, Jill J. Lifter; Chapman, Glucksman Dean Roeb & Barger and Glenn T. Barger for Association of Defense Counsel of Northern California and Nevada and Association of Southern California Defense Counsel as Amici Curiae on behalf of Petitioners.

Hirsch Closson, Robert V. Closson and Jodi E. Lambert for California Professional Association of Specialty Contractors as Amicus Curiae on behalf of Petitioners.

Newmeyer & Dillion, Alan H. Packer, J. Nathan Owens, Paul L. Tetzloff and Jeffrey R. Brower for Leading Builders of America as Amicus Curiae on behalf of Petitioners.

Epstein Grinnell & Howell, Anne L. Rauch; Berding & Weil and Tyler P. Berding for Consumer Attorneys of California as Amicus Curiae on behalf of Petitioners.

No appearance for Respondent.

Milstein Adelman, Milstein Adelman Jackson Fairchild & Wade, Mark A. Milstein, Fred M. Adelman and Mayo L. Makarcyzk for Real Parties in Interest.

Benson Legal, Susan M. Benson; Williams | Palecek Law Group and Jason P. Williams for The National Association of Subrogation Professionals as Amicus Curiae on behalf of Real Parties in Interest.

Counsel:

Law Offices of Brian J. Ferber, Brian J. Ferber; Benedon & Serlin, Gerald M. Serlin and Wendy S. Albers as Amici Curiae on behalf of Real Parties in Interest.

Horvitz & Levy, H. Thomas Watson and Daniel J. Gonzalez for MWI, Inc., as Amicus Curiae on behalf of Real Parties in Interest.

Kasdan Lippsmith Weber Turner, Kenneth S. Kasdan, Michael D. Tuner, Bryan M. Zuetel and Derek J. Scott as Amici Curiae on behalf of Real Parties in Interest.

Counsel who argued in Supreme Court (not intended for publication with opinion):

Andrew M. Morgan
Borton Petrini
5060 California Avenue, Suite 700
Bakersfield, CA 93309
(661) 322-3051

Mayo L. Makarcyzk
Milstein Adelman Jackson Fairchild & Wade
10250 Constellation Boulevard, Suite 1400
Los Angeles, CA 90067
(310) 396-9600

Wendy S. Albers
Benedon & Serlin
22708 Mariano Street
Woodland Hills, CA 91367
(818) 340-1950

TITLE 7

REQUIREMENTS FOR ACTIONS FOR CONSTRUCTION DEFECTS

Chapter 1. DEFINITIONS

Section
895. Definitions

§ 895. Definitions

(a) “Structure” means any residential dwelling, other building, or improvement located upon a lot or within a common area.

(b) “Designed moisture barrier” means an installed moisture barrier specified in the plans and specifications, contract documents, or manufacturer's recommendations.

(c) “Actual moisture barrier” means any component or material, actually installed, that serves to any degree as a barrier against moisture, whether or not intended as a barrier against moisture.

(d) “Unintended water” means water that passes beyond, around, or through a component or the material that is designed to prevent that passage.

(e) “Close of escrow” means the date of the close of escrow between the builder and the original homeowner. With respect to claims by an association, as defined in Section 4080, “close of escrow” means the date of substantial completion, as defined in Section 337.15 of the Code of Civil Procedure, or the date the builder relinquishes control over the association's ability to decide whether to initiate a claim under this title, whichever is later.

(f) “Claimant” or “homeowner” includes the individual owners of single-family homes, individual unit owners of attached dwellings and, in the case of a common interest development, any association as defined in Section 4080.

Chapter 2. ACTIONABLE DEFECTS

Section

§ 896. Building standards for original construction intended to be sold as an individual dwelling unit

In any action seeking recovery of damages arising out of, or related to deficiencies in, the residential construction, design, specifications, surveying, planning, supervision, testing, or observation of construction, a builder, and to the extent set forth in Chapter 4 (commencing with Section 910), a general contractor, subcontractor, material supplier, individual product manufacturer, or design professional, shall, except as specifically set forth in this title, be liable for, and the claimant's claims or causes of action shall be limited to violation of, the following standards, except as specifically set forth in this title. This title applies to original construction intended to be sold as an individual dwelling unit. As to condominium conversions, this title does not apply to or does not supersede any other statutory or common law.

(a) With respect to water issues:

(1) A door shall not allow unintended water to pass beyond, around, or through the door or its designed or actual moisture barriers, if any.

(2) Windows, patio doors, deck doors, and their systems shall not allow water to pass beyond, around, or through the window, patio door, or deck door or its designed or actual moisture barriers, including, without limitation, internal barriers within the systems themselves. For purposes of this paragraph, “systems” include, without limitation, windows, window assemblies, framing, substrate, flashings, and trim, if any.

(3) Windows, patio doors, deck doors, and their systems shall not allow excessive condensation to enter the structure and cause damage to another component. For purposes of this paragraph, “systems” include, without limitation, windows, window assemblies, framing, substrate, flashings, and trim, if any.

(4) Roofs, roofing systems, chimney caps, and ventilation components shall not allow water to enter the structure or to pass beyond, around, or through the designed or actual moisture barriers, including, without limitation, internal barriers located within the systems themselves. For purposes of this paragraph, “systems” include, without limitation, framing, substrate, and sheathing, if any.

(5) Decks, deck systems, balconies, balcony systems, exterior stairs, and stair systems shall not allow water to pass into the adjacent structure. For purposes of this paragraph, “systems” include, without limitation, framing, substrate, flashing, and sheathing, if any.

(6) Decks, deck systems, balconies, balcony systems, exterior stairs, and stair systems shall not allow unintended water to pass within the systems themselves and cause damage to the systems. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashing, and sheathing, if any.

(7) Foundation systems and slabs shall not allow water or vapor to enter into the structure so as to cause damage to another building component.

(8) Foundation systems and slabs shall not allow water or vapor to enter into the structure so as to limit the installation of the type of flooring materials typically used for the particular application.

(9) Hardscape, including paths and patios, irrigation systems, landscaping systems, and drainage systems, that are installed as part of the original construction, shall not be installed in such a way as to cause water or soil erosion to enter into or come in contact with the structure so as to cause damage to another building component.

(10) Stucco, exterior siding, exterior walls, including, without limitation, exterior framing, and other exterior wall finishes and fixtures and the systems of those components and fixtures, including, but not limited to, pot shelves, horizontal surfaces, columns, and plant-ons, shall be installed in such a way so as not to allow unintended water to pass into the structure or to pass beyond, around, or through the designed or actual moisture barriers of the system, including any internal barriers located within the system itself. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashings, trim, wall assemblies, and internal wall cavities, if any.

(11) Stucco, exterior siding, and exterior walls shall not allow excessive condensation to enter the structure and cause damage to another component. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashings, trim, wall assemblies, and internal wall cavities, if any.

(12) Retaining and site walls and their associated drainage systems shall not allow unintended water to pass beyond, around, or through its designed or actual moisture barriers including, without limitation, any internal barriers, so as to cause damage. This standard does not apply to those portions of any wall or drainage system that are designed to have water flow beyond, around, or through them.

(13) Retaining walls and site walls, and their associated drainage systems, shall only allow water to flow beyond, around, or through the areas designated by design.

(14) The lines and components of the plumbing system, sewer system, and utility systems shall not leak.

(15) Plumbing lines, sewer lines, and utility lines shall not corrode so as to impede the useful life of the systems.

(16) Sewer systems shall be installed in such a way as to allow the designated amount of sewage to flow through the system.

(17) Showers, baths, and related waterproofing systems shall not leak water into the interior of walls, flooring systems, or the interior of other components.

(18) The waterproofing system behind or under ceramic tile and tile countertops shall not allow water into the interior of walls, flooring systems, or other components so as to cause damage. Ceramic tile systems shall be designed and installed so as to deflect intended water to the waterproofing system.

(b) With respect to structural issues:

(1) Foundations, load bearing components, and slabs, shall not contain significant cracks or significant vertical displacement.

(2) Foundations, load bearing components, and slabs shall not cause the structure, in whole or in part, to be structurally unsafe.

(3) Foundations, load bearing components, and slabs, and underlying soils shall be constructed so as to materially comply with the design criteria set by applicable government building codes, regulations, and ordinances for chemical deterioration or corrosion resistance in effect at the time of original construction.

(4) A structure shall be constructed so as to materially comply with the design criteria for earthquake and wind load resistance, as set forth in the applicable government building codes, regulations, and ordinances in effect at the time of original construction.

(c) With respect to soil issues:

(1) Soils and engineered retaining walls shall not cause, in whole or in part, damage to the structure built upon the soil or engineered retaining wall.

(2) Soils and engineered retaining walls shall not cause, in whole or in part, the structure to be structurally unsafe.

(3) Soils shall not cause, in whole or in part, the land upon which no structure is built to become unusable for the purpose represented at the time of original sale by the builder or for the purpose for which that land is commonly used.

(d) With respect to fire protection issues:

(1) A structure shall be constructed so as to materially comply with the design criteria of the applicable government building codes, regulations, and ordinances for fire protection of the occupants in effect at the time of the original construction.

(2) Fireplaces, chimneys, chimney structures, and chimney termination caps shall be constructed and installed in such a way so as not to cause an unreasonable risk of fire outside the fireplace enclosure or chimney.

(3) Electrical and mechanical systems shall be constructed and installed in such a way so as not to cause an unreasonable risk of fire.

(e) With respect to plumbing and sewer issues:

Plumbing and sewer systems shall be installed to operate properly and shall not materially impair the use of the structure by its inhabitants. However, no action may be brought for a violation of this subdivision more than four years after close of escrow.

(f) With respect to electrical system issues:

Electrical systems shall operate properly and shall not materially impair the use of the structure by its inhabitants. However, no action shall be brought pursuant to this subdivision more than four years from close of escrow.

(g) With respect to issues regarding other areas of construction:

(1) Exterior pathways, driveways, hardscape, sidewalls, sidewalks, and patios installed by the original builder shall not contain cracks that display significant vertical displacement or that are excessive. However, no action shall be brought upon a violation of this paragraph more than four years from close of escrow.

(2) Stucco, exterior siding, and other exterior wall finishes and fixtures, including, but not limited to, pot shelves, horizontal surfaces, columns, and plant-ons, shall not contain significant cracks or separations.

(3)(A) To the extent not otherwise covered by these standards, manufactured products, including, but not limited to, windows, doors, roofs, plumbing products and fixtures, fireplaces, electrical fixtures, HVAC units, countertops, cabinets, paint, and appliances shall be installed so as not to interfere with the products' useful life, if any.

(B) For purposes of this paragraph, “useful life” means a representation of how long a product is warranted or represented, through its limited warranty or any written representations, to last by its manufacturer, including recommended or required maintenance. If there is no representation by a manufacturer, a builder shall install manufactured products so as not to interfere with the product's utility.

(C) For purposes of this paragraph, “manufactured product” means a product that is completely manufactured offsite.

(D) If no useful life representation is made, or if the representation is less than one year, the period shall be no less than one year. If a manufactured product is damaged as a result of a

violation of these standards, damage to the product is a recoverable element of damages. This subparagraph does not limit recovery if there has been damage to another building component caused by a manufactured product during the manufactured product's useful life.

(E) This title does not apply in any action seeking recovery solely for a defect in a manufactured product located within or adjacent to a structure.

(4) Heating shall be installed so as to be capable of maintaining a room temperature of 70 degrees Fahrenheit at a point three feet above the floor in any living space if the heating was installed pursuant to a building permit application submitted prior to January 1, 2008, or capable of maintaining a room temperature of 68 degrees Fahrenheit at a point three feet above the floor and two feet from exterior walls in all habitable rooms at the design temperature if the heating was installed pursuant to a building permit application submitted on or before January 1, 2008.

(5) Living space air-conditioning, if any, shall be provided in a manner consistent with the size and efficiency design criteria specified in Title 24 of the California Code of Regulations or its successor.

(6) Attached structures shall be constructed to comply with interunit noise transmission standards set by the applicable government building codes, ordinances, or regulations in effect at the time of the original construction. If there is no applicable code, ordinance, or regulation, this paragraph does not apply. However, no action shall be brought pursuant to this paragraph more than one year from the original occupancy of the adjacent unit.

(7) Irrigation systems and drainage shall operate properly so as not to damage landscaping or other external improvements. However, no action shall be brought pursuant to this paragraph more than one year from close of escrow.

(8) Untreated wood posts shall not be installed in contact with soil so as to cause unreasonable decay to the wood based upon the finish grade at the time of original construction. However, no action shall be brought pursuant to this paragraph more than two years from close of escrow.

(9) Untreated steel fences and adjacent components shall be installed so as to prevent unreasonable corrosion. However, no action shall be brought pursuant to this paragraph more than four years from close of escrow.

(10) Paint and stains shall be applied in such a manner so as not to cause deterioration of the building surfaces for the length of time specified by the paint or stain manufacturers' representations, if any. However, no action shall be brought pursuant to this paragraph more than five years from close of escrow.

(11) Roofing materials shall be installed so as to avoid materials falling from the roof.

(12) The landscaping systems shall be installed in such a manner so as to survive for not less than one year. However, no action shall be brought pursuant to this paragraph more than two years from close of escrow.

(13) Ceramic tile and tile backing shall be installed in such a manner that the tile does not detach.

(14) Dryer ducts shall be installed and terminated pursuant to manufacturer installation requirements. However, no action shall be brought pursuant to this paragraph more than two years from close of escrow.

(15) Structures shall be constructed in such a manner so as not to impair the occupants' safety because they contain public health hazards as determined by a duly authorized public health official, health agency, or governmental entity having jurisdiction. This paragraph does not limit recovery for any damages caused by a violation of any other paragraph of this section on the grounds that the damages do not constitute a health hazard.

§ 897. Function or component of a structure; scope of standards within chapter

The standards set forth in this chapter are intended to address every function or component of a structure. To the extent that a function or component of a structure is not addressed by these standards, it shall be actionable if it causes damage.

Chapter 3. OBLIGATIONS

Section

§ 900. Fit and finish; limited warranty; scope

As to fit and finish items, a builder shall provide a homebuyer with a minimum one-year express written limited warranty covering the fit and finish of the following building components. Except as otherwise provided by the standards specified in Chapter 2 (commencing with Section 896), this warranty shall cover the fit and finish of cabinets, mirrors, flooring, interior and exterior walls, countertops, paint finishes, and trim, but shall not apply to damage to those components caused by defects in other components governed by the other provisions of this title. Any fit and finish matters covered by this warranty are not subject to the

provisions of this title. If a builder fails to provide the express warranty required by this section, the warranty for these items shall be for a period of one year.

§ 901. Enhanced protection agreement; length of time; minimum standards

A builder may, but is not required to, offer greater protection or protection for longer time periods in its express contract with the homeowner than that set forth in Chapter 2 (commencing with Section 896). A builder may not limit the application of Chapter 2 (commencing with Section 896) or lower its protection through the express contract with the homeowner. This type of express contract constitutes an "enhanced protection agreement."

§ 902. Enhanced protection agreement; determination of enforceability

If a builder offers an enhanced protection agreement, the builder may choose to be subject to its own express contractual provisions in place of the provisions set forth in Chapter 2 (commencing with Section 896). If an enhanced protection agreement is in place, Chapter 2 (commencing with Section 896) no longer applies other than to set forth minimum provisions by which to judge the enforceability of the particular provisions of the enhanced protection agreement.

§ 903. Enhanced protection agreement; time to elect agreement; standards where provisions are unenforceable

If a builder offers an enhanced protection agreement in place of the provisions set forth in Chapter 2 (commencing with Section 896), the election to do so shall be made in writing with the homeowner no later than the close of escrow. The builder shall provide the homeowner with a complete copy of Chapter 2 (commencing with Section 896) and advise the homeowner that the builder has elected not to be subject to its provisions. If any provision of an enhanced protection agreement is later found to be unenforceable as not meeting the minimum standards of Chapter 2 (commencing with Section 896), a builder may use this chapter in lieu of those provisions found to be unenforceable.

§ 904. Enhanced protection agreement; disputed terms; notice of claim against builder

If a builder has elected to use an enhanced protection agreement, and a homeowner disputes that the particular provision or time periods of the enhanced protection agreement are not greater than, or equal to, the provisions of Chapter 2 (commencing with Section 896) as they apply to the particular deficiency alleged by the homeowner, the homeowner may seek to enforce the application of the standards set forth in this chapter as to those claimed deficiencies. If a homeowner seeks to enforce a particular standard in lieu of a provision of the enhanced protection agreement, the homeowner shall give the builder written notice of that intent at the time the homeowner files a notice of claim pursuant to Chapter 4 (commencing with Section 910).

§ 905. Enhanced protection agreement; binding determination of applicable building standards; waiver; privity with nonoriginal homeowners

If a homeowner seeks to enforce Chapter 2 (commencing with Section 896), in lieu of the enhanced protection agreement in a subsequent litigation or other legal action, the builder shall have the right to have the matter bifurcated, and to have an immediately binding determination of his or her responsive pleading within 60 days after the filing of that pleading, but in no event after the commencement of discovery, as to the application of either Chapter 2 (commencing with Section 896) or the enhanced protection agreement as to the deficiencies claimed by the homeowner. If the builder fails to seek that determination in the timeframe specified, the builder waives the right to do so and the standards set forth in this title shall apply. As to any nonoriginal homeowner, that homeowner shall be deemed in privity for purposes of an enhanced protection agreement only to the extent that the builder has recorded the enhanced protection agreement on title or provided actual notice to the nonoriginal homeowner of the enhanced protection agreement. If the enhanced protection agreement is not recorded on title or no actual notice has been provided, the standards set forth in this title apply to any nonoriginal homeowners' claims.

§ 906. Prelitigation procedures; governing law

A builder's election to use an enhanced protection agreement addresses only the issues set forth in Chapter 2 (commencing with Section 896) and does not constitute an election to use or not use the provisions of Chapter 4 (commencing with Section 910). The decision to use or not use Chapter 4 (commencing with Section 910) is governed by the provisions of that chapter.

§ 907. Homeowner maintenance obligations, schedules and practices

A homeowner is obligated to follow all reasonable maintenance obligations and schedules communicated in writing to the homeowner by the builder and product manufacturers, as well as commonly accepted maintenance practices. A failure by a homeowner to follow these obligations, schedules, and practices may subject the homeowner to the affirmative defenses contained in Section 944.

Chapter 4. PRELIGATION PROCEDURE

Section

§ 910. Written notice of claim

Prior to filing an action against any party alleged to have contributed to a violation of the standards set forth in Chapter 2 (commencing with Section 896), the claimant shall initiate the following prelitigation procedures:

(a) The claimant or his or her legal representative shall provide written notice via certified mail, overnight mail, or personal delivery to the builder, in the manner prescribed in this section, of the claimant's claim that the construction of his or her residence violates any of the standards set forth in Chapter 2 (commencing with Section 896). That notice shall provide the claimant's name, address, and preferred method of contact, and shall state that the claimant alleges a violation pursuant to this part against the builder, and shall describe the claim in reasonable detail sufficient to determine the nature and location, to the extent known, of the claimed violation. In the case of a group of homeowners or an association, the notice may identify the claimants solely by address or other description sufficient to apprise the builder of the locations of the subject residences. That document shall have the same force and effect as a notice of commencement of a legal proceeding.

(b) The notice requirements of this section do not preclude a homeowner from seeking redress through any applicable normal customer service procedure as set forth in any contractual,

warranty, or other builder-generated document; and, if a homeowner seeks to do so, that request shall not satisfy the notice requirements of this section.

§ 911. "Builder" defined

(a) For purposes of this title, except as provided in subdivision (b), "builder" means any entity or individual, including, but not limited to a builder, developer, general contractor, contractor, or original seller, who, at the time of sale, was also in the business of selling residential units to the public for the property that is the subject of the homeowner's claim or was in the business of building, developing, or constructing residential units for public purchase for the property that is the subject of the homeowner's claim.

(b) For the purposes of this title, "builder" does not include any entity or individual whose involvement with a residential unit that is the subject of the homeowner's claim is limited to his or her capacity as general contractor or contractor and who is not a partner, member of, subsidiary of, or otherwise similarly affiliated with the builder. For purposes of this title, these nonaffiliated general contractors and nonaffiliated contractors shall be treated the same as subcontractors, material suppliers, individual product manufacturers, and design professionals.

§ 912. Document disclosure by builder; designated agent to accept claims and act on builder's behalf; notice to homeowners and purchasers

A builder shall do all of the following:

(a) Within 30 days of a written request by a homeowner or his or her legal representative, the builder shall provide copies of all relevant plans, specifications, mass or rough grading plans, final soils reports, Bureau of Real Estate public reports, and available engineering calculations, that pertain to a homeowner's residence specifically or as part of a larger development tract. The request shall be honored if it states that it is made relative to structural, fire safety, or soils provisions of this title. However, a builder is not obligated to provide a copying service, and reasonable copying costs shall be borne by the requesting party. A builder may require that the documents be copied onsite by the requesting party, except that the homeowner may, at his or her option, use his or her own copying service, which may include an offsite copy facility that is bonded and insured. If a builder can show that the builder maintained the documents, but that they later became unavailable due to loss or destruction that was not the fault of the builder, the builder may be excused from the requirements of this subdivision, in which case the builder shall act with reasonable diligence to assist the homeowner in obtaining those documents from any applicable government authority or from the source that generated the document. However, in that case, the time limits specified by this section do not apply.

(b) At the expense of the homeowner, who may opt to use an offsite copy facility that is bonded and insured, the builder shall provide to the homeowner or his or her legal representative copies of all maintenance and preventative maintenance recommendations that pertain to his or her residence within 30 days of service of a written request for those documents. Those

documents shall also be provided to the homeowner in conjunction with the initial sale of the residence.

(c) At the expense of the homeowner, who may opt to use an offsite copy facility that is bonded and insured, a builder shall provide to the homeowner or his or her legal representative copies of all manufactured products maintenance, preventive maintenance, and limited warranty information within 30 days of a written request for those documents. These documents shall also be provided to the homeowner in conjunction with the initial sale of the residence.

(d) At the expense of the homeowner, who may opt to use an offsite copy facility that is bonded and insured, a builder shall provide to the homeowner or his or her legal representative copies of all of the builder's limited contractual warranties in accordance with this part in effect at the time of the original sale of the residence within 30 days of a written request for those documents. Those documents shall also be provided to the homeowner in conjunction with the initial sale of the residence.

(e) A builder shall maintain the name and address of an agent for notice pursuant to this chapter with the Secretary of State or, alternatively, elect to use a third party for that notice if the builder has notified the homeowner in writing of the third party's name and address, to whom claims and requests for information under this section may be mailed. The name and address of the agent for notice or third party shall be included with the original sales documentation and shall be initialed and acknowledged by the purchaser and the builder's sales representative.

This subdivision applies to instances in which a builder contracts with a third party to accept claims and act on the builder's behalf. A builder shall give actual notice to the homeowner that the builder has made such an election, and shall include the name and address of the third party.

(f) A builder shall record on title a notice of the existence of these procedures and a notice that these procedures impact the legal rights of the homeowner. This information shall also be included with the original sales documentation and shall be initialed and acknowledged by the purchaser and the builder's sales representative.

(g) A builder shall provide, with the original sales documentation, a written copy of this title, which shall be initialed and acknowledged by the purchaser and the builder's sales representative.

(h) As to any documents provided in conjunction with the original sale, the builder shall instruct the original purchaser to provide those documents to any subsequent purchaser.

(i) Any builder who fails to comply with any of these requirements within the time specified is not entitled to the protection of this chapter, and the homeowner is released from the requirements of this chapter and may proceed with the filing of an action, in which case the remaining chapters of this part shall continue to apply to the action.

§ 913. Written acknowledgment of claim; time to respond; contents

A builder or his or her representative shall acknowledge, in writing, receipt of the notice of the claim within 14 days after receipt of the notice of the claim. If the notice of the claim is served by the claimant's legal representative, or if the builder receives a written representation letter from a homeowner's attorney, the builder shall include the attorney in all subsequent substantive communications, including, without limitation, all written communications occurring pursuant to this chapter, and all substantive and procedural communications, including all written communications, following the commencement of any subsequent complaint or other legal action, except that if the builder has retained or involved legal counsel to assist the builder in this process, all communications by the builder's counsel shall only be with the claimant's legal representative, if any.

§ 914. Election to pursue other nonadversarial contractual procedures; affect of Title 7 upon exiting statutory or decisional law

(a) This chapter establishes a nonadversarial procedure, including the remedies available under this chapter which, if the procedure does not resolve the dispute between the parties, may result in a subsequent action to enforce the other chapters of this title. A builder may attempt to commence nonadversarial contractual provisions other than the nonadversarial procedures and remedies set forth in this chapter, but may not, in addition to its own nonadversarial contractual provisions, require adherence to the nonadversarial procedures and remedies set forth in this chapter, regardless of whether the builder's own alternative nonadversarial contractual provisions are successful in resolving the dispute or ultimately deemed enforceable.

At the time the sales agreement is executed, the builder shall notify the homeowner whether the builder intends to engage in the nonadversarial procedure of this section or attempt to enforce alternative nonadversarial contractual provisions. If the builder elects to use alternative nonadversarial contractual provisions in lieu of this chapter, the election is binding, regardless of whether the builder's alternative nonadversarial contractual provisions are successful in resolving the ultimate dispute or are ultimately deemed enforceable.

(b) Nothing in this title is intended to affect existing statutory or decisional law pertaining to the applicability, viability, or enforceability of alternative dispute resolution methods, alternative remedies, or contractual arbitration, judicial reference, or similar procedures requiring a binding resolution to enforce the other chapters of this title or any other disputes between homeowners and builders. Nothing in this title is intended to affect the applicability, viability, or enforceability, if any, of contractual arbitration or judicial reference after a nonadversarial procedure or provision has been completed.

§ 915. Application of prelitigation provisions upon certain failures to act by builder

If a builder fails to acknowledge receipt of the notice of a claim within the time specified, elects not to go through the process set forth in this chapter, or fails to request an inspection within the time specified, or at the conclusion or cessation of an alternative nonadversarial proceeding, this chapter does not apply and the homeowner is released from the requirements of

this chapter and may proceed with the filing of an action. However, the standards set forth in the other chapters of this title shall continue to apply to the action.

§ 916. Builder election to inspect

(a) If a builder elects to inspect the claimed unmet standards, the builder shall complete the initial inspection and testing within 14 days after acknowledgment of receipt of the notice of the claim, at a mutually convenient date and time. If the homeowner has retained legal representation, the inspection shall be scheduled with the legal representative's office at a mutually convenient date and time, unless the legal representative is unavailable during the relevant time periods. All costs of builder inspection and testing, including any damage caused by the builder inspection, shall be borne by the builder. The builder shall also provide written proof that the builder has liability insurance to cover any damages or injuries occurring during inspection and testing. The builder shall restore the property to its pretesting condition within 48 hours of the testing. The builder shall, upon request, allow the inspections to be observed and electronically recorded, video recorded, or photographed by the claimant or his or her legal representative.

(b) Nothing that occurs during a builder's or claimant's inspection or testing may be used or introduced as evidence to support a spoliation defense by any potential party in any subsequent litigation.

(c) If a builder deems a second inspection or testing reasonably necessary, and specifies the reasons therefor in writing within three days following the initial inspection, the builder may conduct a second inspection or testing. A second inspection or testing shall be completed within 40 days of the initial inspection or testing. All requirements concerning the initial inspection or testing shall also apply to the second inspection or testing.

(d) If the builder fails to inspect or test the property within the time specified, the claimant is released from the requirements of this section and may proceed with the filing of an action. However, the standards set forth in the other chapters of this title shall continue to apply to the action.

(e) If a builder intends to hold a subcontractor, design professional, individual product manufacturer, or material supplier, including an insurance carrier, warranty company, or service company, responsible for its contribution to the unmet standard, the builder shall provide notice to that person or entity sufficiently in advance to allow them to attend the initial, or if requested, second inspection of any alleged unmet standard and to participate in the repair process. The claimant and his or her legal representative, if any, shall be advised in a reasonable time prior to the inspection as to the identity of all persons or entities invited to attend. This subdivision does not apply to the builder's insurance company. Except with respect to any claims involving a repair actually conducted under this chapter, nothing in this subdivision shall be construed to relieve a subcontractor, design professional, individual product manufacturer, or material supplier of any liability under an action brought by a claimant.

§ 917. Written offer to repair

Within 30 days of the initial or, if requested, second inspection or testing, the builder may offer in writing to repair the violation. The offer to repair shall also compensate the homeowner for all applicable damages recoverable under Section 944, within the timeframe for the repair set forth in this chapter. Any such offer shall be accompanied by a detailed, specific, step-by-step statement identifying the particular violation that is being repaired, explaining the nature, scope, and location of the repair, and setting a reasonable completion date for the repair. The offer shall also include the names, addresses, telephone numbers, and license numbers of the contractors whom the builder intends to have perform the repair. Those contractors shall be fully insured for, and shall be responsible for, all damages or injuries that they may cause to occur during the repair, and evidence of that insurance shall be provided to the homeowner upon request. Upon written request by the homeowner or his or her legal representative, and within the timeframes set forth in this chapter, the builder shall also provide any available technical documentation, including, without limitation, plans and specifications, pertaining to the claimed violation within the particular home or development tract. The offer shall also advise the homeowner in writing of his or her right to request up to three additional contractors from which to select to do the repair pursuant to this chapter.

§ 918. Homeowner response to repair offer

Upon receipt of the offer to repair, the homeowner shall have 30 days to authorize the builder to proceed with the repair. The homeowner may alternatively request, at the homeowner's sole option and discretion, that the builder provide the names, addresses, telephone numbers, and license numbers for up to three alternative contractors who are not owned or financially controlled by the builder and who regularly conduct business in the county where the structure is located. If the homeowner so elects, the builder is entitled to an additional noninvasive inspection, to occur at a mutually convenient date and time within 20 days of the election, so as to permit the other proposed contractors to review the proposed site of the repair. Within 35 days after the request of the homeowner for alternative contractors, the builder shall present the homeowner with a choice of contractors. Within 20 days after that presentation, the homeowner shall authorize the builder or one of the alternative contractors to perform the repair.

§ 919. Mediation by mutual agreement; unresolved disputes; repairs

The offer to repair shall also be accompanied by an offer to mediate the dispute if the homeowner so chooses. The mediation shall be limited to a four-hour mediation, except as otherwise mutually agreed before a nonaffiliated mediator selected and paid for by the builder. At the homeowner's sole option, the homeowner may agree to split the cost of the mediator, and if he or she does so, the mediator shall be selected jointly. The mediator shall have sufficient availability such that the mediation occurs within 15 days after the request to mediate is received and occurs at a mutually convenient location within the county where the action is pending. If a builder has made an offer to repair a violation, and the mediation has failed to resolve the dispute, the homeowner shall allow the repair to be performed either by the builder, its contractor, or the selected contractor.

§ 920. Claimant right to file action

If the builder fails to make an offer to repair or otherwise strictly comply with this chapter within the times specified, the claimant is released from the requirements of this chapter and may proceed with the filing of an action. If the contractor performing the repair does not complete the repair in the time or manner specified, the claimant may file an action. If this occurs, the standards set forth in the other chapters of this part shall continue to apply to the action.

§ 921. Repair work; time and date scheduled; completion date

(a) In the event that a resolution under this chapter involves a repair by the builder, the builder shall make an appointment with the claimant, make all appropriate arrangements to effectuate a repair of the claimed unmet standards, and compensate the homeowner for all damages resulting therefrom free of charge to the claimant. The repair shall be scheduled through the claimant's legal representative, if any, unless he or she is unavailable during the relevant time periods. The repair shall be commenced on a mutually convenient date within 14 days of acceptance or, if an alternative contractor is selected by the homeowner, within 14 days of the selection, or, if a mediation occurs, within seven days of the mediation, or within five days after a permit is obtained if one is required. The builder shall act with reasonable diligence in obtaining any such permit.

(b) The builder shall ensure that work done on the repairs is done with the utmost diligence, and that the repairs are completed as soon as reasonably possible, subject to the nature of the repair or some unforeseen event not caused by the builder or the contractor performing the repair. Every effort shall be made to complete the repair within 120 days.

§ 922. Electronic recordation, video recordation, or photographs during repair work

The builder shall, upon request, allow the repair to be observed and electronically recorded, video recorded, or photographed by the claimant or his or her legal representative. Nothing that occurs during the repair process may be used or introduced as evidence to support a spoliation defense by any potential party in any subsequent litigation.

§ 923. Documentation relation to repair work; requests for copies

The builder shall provide the homeowner or his or her legal representative, upon request, with copies of all correspondence, photographs, and other materials pertaining or relating in any manner to the repairs.

§ 924. Partial repair of claims; statement of reasons

If the builder elects to repair some, but not all of, the claimed unmet standards, the builder shall, at the same time it makes its offer, set forth with particularity in writing the reasons, and the support for those reasons, for not repairing all claimed unmet standards.

§ 925. Failure to repair within time allowed

If the builder fails to complete the repair within the time specified in the repair plan, the claimant is released from the requirements of this chapter and may proceed with the filing of an action. If this occurs, the standards set forth in the other chapters of this title shall continue to apply to the action.

§ 926. Release or waiver in exchange for repair work

The builder may not obtain a release or waiver of any kind in exchange for the repair work mandated by this chapter. At the conclusion of the repair, the claimant may proceed with filing an action for violation of the applicable standard or for a claim of inadequate repair, or both, including all applicable damages available under Section 944.

§ 927. Claims for violation of statutory process or inadequate repair; limitation of action; extension of time

If the applicable statute of limitations has otherwise run during this process, the time period for filing a complaint or other legal remedies for violation of any provision of this title, or for a claim of inadequate repair, is extended from the time of the original claim by the claimant to 100 days after the repair is completed, whether or not the particular violation is the one being repaired. If the builder fails to acknowledge the claim within the time specified, elects not to go through this statutory process, or fails to request an inspection within the time specified, the time period for filing a complaint or other legal remedies for violation of any provision of this title is extended from the time of the original claim by the claimant to 45 days after the time for responding to the notice of claim has expired. If the builder elects to attempt to enforce its own nonadversarial procedure in lieu of the procedure set forth in this chapter, the time period for filing a complaint or other legal remedies for violation of any provision of this part is extended from the time of the original claim by the claimant to 100 days after either the completion of the builder's alternative nonadversarial procedure, or 100 days after the builder's alternative nonadversarial procedure is deemed unenforceable, whichever is later.

§ 928. Mediation after repair completion

If the builder has invoked this chapter and completed a repair, prior to filing an action, if there has been no previous mediation between the parties, the homeowner or his or her legal representative shall request mediation in writing. The mediation shall be limited to four hours, except as otherwise mutually agreed before a nonaffiliated mediator selected and paid for by the builder. At the homeowner's sole option, the homeowner may agree to split the cost of the mediator and if he or she does so, the mediator shall be selected jointly. The mediator shall have sufficient availability such that the mediation will occur within 15 days after the request for mediation is received and shall occur at a mutually convenient location within the county where the action is pending. In the event that a mediation is used at this point, any applicable statutes of limitations shall be tolled from the date of the request to mediate until the next court day after the mediation is completed, or the 100-day period, whichever is later.

§ 929. Cash offer in lieu of repair; release

(a) Nothing in this chapter prohibits the builder from making only a cash offer and no repair. In this situation, the homeowner is free to accept the offer, or he or she may reject the offer and proceed with the filing of an action. If the latter occurs, the standards of the other chapters of this title shall continue to apply to the action.

(b) The builder may obtain a reasonable release in exchange for the cash payment. The builder may negotiate the terms and conditions of any reasonable release in terms of scope and consideration in conjunction with a cash payment under this chapter.

§ 930. Failure to act within mandated timeframes and other requirements; right to file action; motion to stay proceedings

(a) The time periods and all other requirements in this chapter are to be strictly construed, and, unless extended by the mutual agreement of the parties in accordance with this chapter, shall govern the rights and obligations under this title. If a builder fails to act in accordance with this section within the timeframes mandated, unless extended by the mutual agreement of the parties as evidenced by a postclaim written confirmation by the affected homeowner demonstrating that he or she has knowingly and voluntarily extended the statutory timeframe, the claimant may proceed with filing an action. If this occurs, the standards of the other chapters of this title shall continue to apply to the action.

(b) If the claimant does not conform with the requirements of this chapter, the builder may bring a motion to stay any subsequent court action or other proceeding until the requirements of this chapter have been satisfied. The court, in its discretion, may award the prevailing party on such a motion, his or her attorney's fees and costs in bringing or opposing the motion.

§ 931. Causes of action or damages exceeding scope of actionable defects; applicability of standards

If a claim combines causes of action or damages not covered by this part, including, without limitation, personal injuries, class actions, other statutory remedies, or fraud-based claims, the claimed unmet standards shall be administered according to this part, although evidence of the property in its unrepaired condition may be introduced to support the respective elements of any such cause of action. As to any fraud-based claim, if the fact that the property has been repaired under this chapter is deemed admissible, the trier of fact shall be informed that the repair was not voluntarily accepted by the homeowner. As to any class action claims that address solely the incorporation of a defective component into a residence, the named and unnamed class members need not comply with this chapter.

§ 932. Subsequently discovered claims of unmet standards

Subsequently discovered claims of unmet standards shall be administered separately under this chapter, unless otherwise agreed to by the parties. However, in the case of a detached

single family residence, in the same home, if the subsequently discovered claim is for a violation of the same standard as that which has already been initiated by the same claimant and the subject of a currently pending action, the claimant need not reinitiate the process as to the same standard. In the case of an attached project, if the subsequently discovered claim is for a violation of the same standard for a connected component system in the same building as has already been initiated by the same claimant, and the subject of a currently pending action, the claimant need not reinitiate this process as to that standard.

§ 933. Evidence of repair efforts

If any enforcement of these standards is commenced, the fact that a repair effort was made may be introduced to the trier of fact. However, the claimant may use the condition of the property prior to the repair as the basis for contending that the repair work was inappropriate, inadequate, or incomplete, or that the violation still exists. The claimant need not show that the repair work resulted in further damage nor that damage has continued to occur as a result of the violation.

§ 934. Evidence of conduct during enforcement process

Evidence of both parties' conduct during this process may be introduced during a subsequent enforcement action, if any, with the exception of any mediation. Any repair efforts undertaken by the builder, shall not be considered settlement communications or offers of settlement and are not inadmissible in evidence on such a basis.

§ 935. Construction of chapter with similar provisions

To the extent that provisions of this chapter are enforced and those provisions are substantially similar to provisions in Section 6000, but an action is subsequently commenced under Section 6000, the parties are excused from performing the substantially similar requirements under Section 6000.

§ 936. Parties subject to application of title; determination; defenses available; joint and several liability; strict liability

Each and every provision of the other chapters of this title apply to general contractors, subcontractors, material suppliers, individual product manufacturers, and design professionals to the extent that the general contractors, subcontractors, material suppliers, individual product manufacturers, and design professionals caused, in whole or in part, a violation of a particular standard as the result of a negligent act or omission or a breach of contract. In addition to the affirmative defenses set forth in Section 945.5, a general contractor, subcontractor, material supplier, design professional, individual product manufacturer, or other entity may also offer common law and contractual defenses as applicable to any claimed violation of a standard. All actions by a claimant or builder to enforce an express contract, or any provision thereof, against a general contractor, subcontractor, material supplier, individual product manufacturer, or design professional is preserved. Nothing in this title modifies the law pertaining to joint and several liability for builders, general contractors, subcontractors, material suppliers, individual product

manufacturer, and design professionals that contribute to any specific violation of this title. However, the negligence standard in this section does not apply to any general contractor, subcontractor, material supplier, individual product manufacturer, or design professional with respect to claims for which strict liability would apply.

§ 937. Construction with professional negligence actions

Nothing in this title shall be interpreted to eliminate or abrogate the requirement to comply with Section 411.35 of the Code of Civil Procedure or to affect the liability of design professionals, including architects and architectural firms, for claims and damages not covered by this title.

§ 938. Application of Title 7 to certain residences

This title applies only to new residential units where the purchase agreement with the buyer was signed by the seller on or after January 1, 2003.

Chapter 5. PROCEDURE

Section

§ 941. Limitation of action; tolling

(a) Except as specifically set forth in this title, no action may be brought to recover under this title more than 10 years after substantial completion of the improvement but not later than the date of recordation of a valid notice of completion.

(b) As used in this section, “action” includes an action for indemnity brought against a person arising out of that person's performance or furnishing of services or materials referred to in this title, except that a cross-complaint for indemnity may be filed pursuant to subdivision (b) of Section 428.10 of the Code of Civil Procedure in an action which has been brought within the time period set forth in subdivision (a).

(c) The limitation prescribed by this section may not be asserted by way of defense by any person in actual possession or the control, as owner, tenant or otherwise, of such an improvement, at the time any deficiency in the improvement constitutes the proximate cause for which it is proposed to make a claim or bring an action.

(d) Sections 337.15 and 337.1 of the Code of Civil Procedure do not apply to actions under this title.

(e) Existing statutory and decisional law regarding tolling of the statute of limitations shall apply to the time periods for filing an action or making a claim under this title, except that repairs made pursuant to Chapter 4 (commencing with Section 910), with the exception of the tolling provision contained in Section 927 , do not extend the period for filing an action, or restart the time limitations contained in subdivision (a) or (b) of Section 7091 of the Business and Professions Code . If a builder arranges for a contractor to perform a repair pursuant to Chapter 4 (commencing with Section 910), as to the builder the time period for calculating the statute of limitation in subdivision (a) or (b) of Section 7091 of the Business and Professions Code shall pertain to the substantial completion of the original construction and not to the date of repairs under this title. The time limitations established by this title do not apply to any action by a claimant for a contract or express contractual provision. Causes of action and damages to which this chapter does not apply are not limited by this section.

§ 942. Sufficiency of claim for violation of Chapter 2 standards

In order to make a claim for violation of the standards set forth in Chapter 2 (commencing with Section 896), a homeowner need only demonstrate, in accordance with the applicable evidentiary standard, that the home does not meet the applicable standard, subject to the affirmative defenses set forth in Section 945.5 . No further showing of causation or damages is required to meet the burden of proof regarding a violation of a standard set forth in Chapter 2 (commencing with Section 896), provided that the violation arises out of, pertains to, or is related to, the original construction.

§ 943. Exclusiveness of title; exceptions

(a) Except as provided in this title, no other cause of action for a claim covered by this title or for damages recoverable under Section 944 is allowed. In addition to the rights under this title, this title does not apply to any action by a claimant to enforce a contract or express contractual provision, or any action for fraud, personal injury, or violation of a statute. Damages awarded for the items set forth in Section 944 in such other cause of action shall be reduced by the amounts recovered pursuant to Section 944 for violation of the standards set forth in this title.

(b) As to any claims involving a detached single-family home, the homeowner's right to the reasonable value of repairing any nonconformity is limited to the repair costs, or the diminution in current value of the home caused by the nonconformity, whichever is less, subject to the personal use exception as developed under common law.

§ 944. Damages; determination of amount

If a claim for damages is made under this title, the homeowner is only entitled to damages for the reasonable value of repairing any violation of the standards set forth in this title, the reasonable cost of repairing any damages caused by the repair efforts, the reasonable cost of repairing and rectifying any damages resulting from the failure of the home to meet the

standards, the reasonable cost of removing and replacing any improper repair by the builder, reasonable relocation and storage expenses, lost business income if the home was used as a principal place of a business licensed to be operated from the home, reasonable investigative costs for each established violation, and all other costs or fees recoverable by contract or statute.

§ 945. Binding effect upon original purchases and their successors-in-interest

The provisions, standards, rights, and obligations set forth in this title are binding upon all original purchasers and their successors-in-interest. For purposes of this title, associations and others having the rights set forth in Sections 4810 and 4815 shall be considered to be original purchasers and shall have standing to enforce the provisions, standards, rights, and obligations set forth in this title.

§ 945.5 Affirmative defenses

A builder, general contractor, subcontractor, material supplier, individual product manufacturer, or design professional, under the principles of comparative fault pertaining to affirmative defenses, may be excused, in whole or in part, from any obligation, damage, loss, or liability if the builder, general contractor, subcontractor, material supplier, individual product manufacturer, or design professional, can demonstrate any of the following affirmative defenses in response to a claimed violation:

(a) To the extent it is caused by an unforeseen act of nature which caused the structure not to meet the standard. For purposes of this section an “unforeseen act of nature” means a weather condition, earthquake, or manmade event such as war, terrorism, or vandalism, in excess of the design criteria expressed by the applicable building codes, regulations, and ordinances in effect at the time of original construction.

(b) To the extent it is caused by a homeowner's unreasonable failure to minimize or prevent those damages in a timely manner, including the failure of the homeowner to allow reasonable and timely access for inspections and repairs under this title. This includes the failure to give timely notice to the builder after discovery of a violation, but does not include damages due to the untimely or inadequate response of a builder to the homeowner's claim.

(c) To the extent it is caused by the homeowner or his or her agent, employee, general contractor, subcontractor, independent contractor, or consultant by virtue of their failure to follow the builder's or manufacturer's recommendations, or commonly accepted homeowner maintenance obligations. In order to rely upon this defense as it relates to a builder's recommended maintenance schedule, the builder shall show that the homeowner had written notice of these schedules and recommendations and that the recommendations and schedules were reasonable at the time they were issued.

(d) To the extent it is caused by the homeowner or his or her agent's or an independent third party's alterations, ordinary wear and tear, misuse, abuse, or neglect, or by the structure's use for something other than its intended purpose.

(e) To the extent that the time period for filing actions bars the claimed violation.

(f) As to a particular violation for which the builder has obtained a valid release.

(g) To the extent that the builder's repair was successful in correcting the particular violation of the applicable standard.

(h) As to any causes of action to which this statute does not apply, all applicable affirmative defenses are preserved.

Section 16.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

Grand Ballroom

Friday, May 18th 2018
9:30 AM – 10:30 AM

Course Title:
Finding Evidence for your Coverage Case

John Podesta, Esq. and Sherrianne Hanavan

Finding the Evidence For Your Coverage Case

By: John H Podesta[1]

I. Introduction

Once the claim is made or lawsuit served, the insurance company investigates and/or hires counsel to respond to the pleadings, conduct discovery, hire consultants/experts, and report back to the carrier and the insured regarding settlement and trial evaluation. Internally, the insurance company evaluates whether the claims presented are covered entirely, or only partially covered or not at all. The goal: get to the bottom line…. how much is this case worth in terms of defense costs and indemnity amounts? It is put through the three part filter: Coverage, Liability and Damages.

As for liability and the amount of damages, defense counsel for the insured will develop that with the help of the claim professional. As for coverage, however, the challenge is more specific and, unfortunately, not always discovered by defense counsel or the evidence of key facts is either privileged or impossible to prove. A complete coverage evaluation considers not only what coverage issues are present and the substantive law, but what facts are necessary, the sources of evidence and how much it will cost to establish a right to coverage or a coverage defense.

The goal of this presentation is to provide ideas for strategy and handling cases that will benefit both defense and coverage counsel. More important, however, we hope that this information will help policyholders and insurers make better decisions when coverage issues are present.

II. THE BEGINNING

A. The Duty to Defend and Relevant Evidence

The complaint is served and tendered to the insurance company. The first question for either the policyholder or the insurer: is there a duty to defend and what evidence is relevant and useable? Most states use the "potential for coverage" standard, but they differ with regard to the evidence that can be considered. For example:

- In California, it's the factual allegations in the complaint, plus information learned by the insurer at the time of the initial investigation. *Montrose v Superior Court* (1993) 6 Cal.4th 287

- In Oregon, it's a comparison of the complaint to the policy, so called "four corners", but with some exceptions. *Ledford v. Gutoski, (1994)* 319 Ore. 397.

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[1] John Podesta is a Partner in the San Francisco office of Wilson, Elser, Moskowitz, Edelman & Dicker, who specializes in insurance coverage litigation.

- In Washington, it's the factual allegations in the complaint, but if it is ambiguous, the insurer must investigate to determine if there is a potential for coverage from extrinsic evidence. *E-Z Loader Boat Trailers v. Travelers Indem. Co.,* (1986) 106 Wn.2d 901, 908, 726 P.2d 439, 444.

- In Nevada, the Supreme Court hasn't ruled definitively, but there is support for both a "complaint rule" and the use of extrinsic evidence. (*Andrew v. Century Surety Co.,* 2014 U.S. Dist. LEXIS 60972 at *15– with a survey of decisions).

In California, the duty to defend does not exist if *either* (1) there is no possibility for indemnity as a matter of law for the cause of action if there are no reasonable amendments, *State Farm Fire & Cas. Co. v Drasin* (1985) 152 Cal.App.3d 864 or (2) if there is admissible evidence of facts that *conclusively* demonstrate there is no coverage for the claim. *Montrose Chemical Corp. v Superior Court* (1993) 6 Cal.4th 287, 300. The nature of the claim and the allegations may be examined to see if there is any possibility that liability could be based on covered conduct. *The Travelers Property Casualty Co. of America v. Actavis, Inc.,* (2017)16 Cal. App. 5th 1026. Because the duty to defend is determined at the outset of the litigation, there is less potential that a tactical approach to evidence will affect the outcome. For purposes herein, there is a limited body of evidence that can be used, as the threshold duty is based on the complaint, and potentially extrinsic evidence that conclusively demonstrates the policy doesn't apply.

Whatever the jurisdiction, know the sources of useable facts and evidence. If it can't even be considered, the "fact" that it supports is irrelevant, even if true.

B. Defending Under a Reservation of Rights

The decision whether to defend and "reserve rights" is the second important decision. In California, for example, a reservation of rights letter avoids a waiver of coverage defenses, and should point out to the insured the likely grounds for non-coverage. This is especially true when the facts suggest that an obvious coverage defense would apply. For example, in *Miller v Elite Insurance Co.* (1980) 100 Cal.App.3d 739, the insurer defended but did not reference an exclusion for motorcycles all the way up to trial. The Appellate court found that the failure to raise it, when the insurer knew a motorcycle was involved was a waiver of the right to rely on it in coverage litigation. However, in California, the court has generally held that if there was a denial of coverage, if the policy actually does not apply, the carrier may rely on grounds not initially raised. *Waller v. Truck Ins. Exchange, Inc*. (1995) 11 Cal. 4th 1, 31, 900 P.2d 619, 635. A similar rule applies in other states such as Colorado. *Management Specialists, Inc. v. Northfield Ins. Co.,* (Colo App 2004) 117 P.3d 32, 37.

III. The Middle: Preparing for the Duty to Indemnify

A. Burden of Proof – Planning Your Strategy

The duty to defend is qualitatively different from the duty to indemnify. The duty to defend exists at the outset of the case if there is a *potential* for coverage, i.e. that there is any logical possibility that the facts as alleged the complaint could result in an award covered by the policy in part. The duty to indemnify, however, does not arise until after liability is established, and is triggered if the actual basis of liability is on a claim covered by the policy. In practice, the duty to indemnify depends on facts, but is determined largely on burden of proof and evidence.

To begin with, most states adopt the rule that as to indemnity, an insured has the burden of bringing the claim within the terms of coverage, and the insurer has the burden to prove that an exclusion or other limitation on coverage applies. see e.g. *Aydin Corp. v. First State Ins. Co.,* (1998) 18 Cal. 4th 1183, 1188, 959 P.2d 1213, 1215. Often, the *absence of evidence* on a key fact will drive the ultimate outcome and the evaluation. For instance: is there evidence that the insured's stucco work caused damage to other property? If your client has the burden of proof on a particular issue, what facts are needed to support that claim or defense, what evidence is available or likely to become available, and is it desirable or even required that it be determined as part of the liability lawsuit? Will development of that evidence require a separate investigation and discovery, or expert testimony in the coverage case based on facts determined in the liability trial? If these questions aren't asked early, evidence may be lost or findings not made that will handicap or even become determinative of the coverage issue.

In the construction defect arena, two very typical coverage issues illustrate how early appreciation of the necessary evidence leads to better decision making: 1) in the claim presented, what is the amount of damage related to repairing the insured's work versus consequential damage, and 2) when did the damage that is the subject of the lawsuit begin?

As for the first question, consequential damage versus work product, most of the evidence is likely to be obtained in the liability suit in response to written discovery and expert depositions. However, the actual finding of liability for which claims is not done until trial, so that potentially significant defense costs will be incurred before there is "evidence" of the allocation between covered and uncovered claims. As to the second, timing of damages, it is both unlikely to be litigated (the liability case is about the defective condition, the total amount of damage and the cost to repair only) and very expensive and possibly impossible to determine, for example when wood began deteriorating. Millions of dollars have been spent by insurers in unsuccessful coverage litigation over continuous damage limitations because they failed to analyze how they would prove when damage begins and plan accordingly.

In an excellent article entitled "Allocating Between Covered and Non-Covered Damages in the Judgment Context," [2] the author explains the interplay between the reservation of rights, and allocating the jury's verdict where there are both covered and uncovered damages asserted. Whereas the insured must demonstrate initially that the basis for the award is covered damage, since the insurer is controlling the defense so it has a duty to advise that the insured may ask for a special verdict and a failure to so inform the insured may constitute a waiver by the insurer of the right to challenge allocation between covered and uncovered claims. (citing *Duke v Hoch (*5 Cir. 1972) 468 F.2d 973 and *Harleysville Group Ins v Heritage Communities.* (S.C. 2017) 803 S.E.2d 288, 296-301, among others). The point is: the reservation of rights letter is important not just to avoid a waiver of the right to litigate certain coverage issues, but properly executed, there is a direct connection to a source of evidence: trial court findings on critical facts. If your case has proceeded to trial without a proper reservation of rights, it may be too late to raise coverage defenses or challenge allocation between covered and uncovered claims.

In the "fund and chase" scenario arising out of a settlement, California allows an insurer to settle and then seek recovery of the settlement when certain prerequisites are met. The three "prerequisites for seeking reimbursement for non-covered claims" are: (1) a timely and express reservation of rights; (2) an express notification to the insureds of the insurer's intent to accept a proposed settlement offer; and (3) an express offer to the insureds that they may assume their own defense when the insurer and insureds disagree whether to accept the proposed settlement. *Blue Ridge Ins. Co. v. Jacobsen*,(2001) 25 Cal.4th 489. When an insurer settles a case, it bears the burden of proof by preponderance of the evidence that the settlement isn't covered, a difficult scenario in construction defect litigation where there are often many claims presented. See. e.g. *Navigators Specialty Ins. Co. v. Moorefield Construction, Inc*. (2016) 6 Cal.App.5th 1258.[3]

B. The Problem With Mediation From an Evidence Perspective

Given the complexities of construction defect litigation, including the number of parties and issues joined, there is no question but that mediation is an effective tool for resolution. In most jurisdictions, mediations are done in parallel with discovery and trial preparation; in others it is done sequentially – first mediation and then percipient and expert discovery and trial. To accomplish this juggling act, a court first enters a Case Management Order (sometimes referred to as a Pre Trial Order) that organizes the case and sets litigation timelines. However, from the perspective of a coverage litigator and post-mediation pursuit of recalcitrant parties, mediation's most powerful tool for settlement, confidentiality, creates the most headaches. When mediation is proposed, policyholder and

[2] By Patrick M. Aul, of Cozen & O'Connor, presented for DRI December 2017

[3] In California the carrier has a right to recoup both defense costs and settlements in certain circumstances. Other states do not allow reimbursement in some circumstances, so the individual state's laws should be consulted. *Buss v Superior Court* (1997) 16 Cal4th 35.

insurers alike should consider the likelihood of post settlement coverage or contribution litigation.

The general rule as set out in FRE 408, followed in many states, is that mediations are confidential proceedings, and that evidence of settlement offers or conduct cannot be used in evidence. However, the exception nearly swallows the rule: "The court may admit this evidence for another purpose." Thus, the fact that the parties proceed to mediation does not present a significant impediment in planning your subsequent coverage case. If presentations are made, for example, that would encourage subcontractors to settle, information from that presentation could likely be used "for a different purpose" if the insurer decided to settle and seek recovery from the insured or other insurers. Moreover, it doesn't apply to non-parties, and doesn't prevent discovery. (c.f. *Morse/Diesel, Inc. v. Fidelity & Deposit Co.,* (1988)122 F.R.D. 447) In one unpublished decision, the 9th Circuit reviewing an appeal from the United States District Court in Nevada held that evidence from mediation could be used in a post settlement contribution action as it was not for the purpose of proving liability of the original party. *Clarendon Nat'l Ins. Co. v. Nat'l Fire & Marine Ins. Co.,* (9Cir 2013) 512 Fed. Appx. 671.[4]

That is not the case in California, where there is a comprehensive scheme protecting information disclosed in mediation. Evid. Code §1115 *et seq.*. It protects not only the documents prepared for the mediation (i.e. PowerPoints and reports) but ALL communications *in connection with* the mediation. Specifically, Cal. Evid Code §1119(a) states: "No evidence of *anything said* …in the course of, or pursuant to, a mediation or a mediation consultation is admissible *or subject to discovery*, and disclosure of the evidence shall not be compelled, in *any* arbitration, administrative adjudication, *civil action*, or other noncriminal proceeding in which, pursuant to law, testimony can be compelled to be given."

Cal Evid. Code 1119(a) has been interpreted literally by California courts. In *Simmons v. Ghaderi* (2008) 44 Cal.4th 570, the California Supreme Court was asked to find an exception to the protection in a medical malpractice case that was all but resolved in an agreement reached at mediation. The Insured doctor gave consent to settle at the mediation[5], but afterwards revoked his consent. Despite several attempts around the evidence bar, including a motion to enforce the settlement, the Supreme Court stated simply that if the only evidence of the Insured's consent occurred at the mediation, it did not exist for purposes of the litigation, and entered judgment in favor of the defendant. While arguments were made to bring the statute closer to FRE 408 and find "some other purpose" for the introduction, the Supreme Court drew a bright line.

As applied to California construction defect litigation, mediation goes beyond the sessions that are scheduled to discuss settlement. Often, plaintiff's preliminary statement of defects

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[4] The court did remark, however, "Moreover, the district court did not rely upon or make any explicit finding of fact related to any mediation information." *Clarendon Nat'l Ins. Co., supra* at pg, 673.

[5] In this professional liability policy, the insurer was required to obtain the consent of the insured to settle.

is a "mediation protected document" as is the defendants' initial response. Joint expert meetings may be held under the mediation penumbra. Most CMOs have a standard set of interrogatories and document production responsibilities which are verified but they are usually general and not terribly helpful later. Construction Form Interrogatories[6], which would provide verified information, are rarely required. Discovery disputes and law and motion is kept to a minimum. Early settlement in mediation may be appropriate, but the ability to chase a non-participant after the fact is handicapped.

One of the coverage litigator's first inquiries in a new construction defect file, is the scope of mediation from the underlying case. Much of the needed information about what claims were made and the amount thereof, may be irrelevant to a coverage case. This potential handicap affects later efforts between the Named Insured and the insurer, contribution claims against co-carriers, as well as subrogation claims against parties that didn't participate.

IV. Evidence of Covered Damages After Trial – The End of the Beginning or the Beginning of the End

A. Special Verdicts and Phrasing the Questions to the Jury – The FountainCourt Decision

If a factual issue is determined in the trial of the underlying matter, it is highly persuasive, if not practically dispositive in the coverage case. How the verdict form is phrased may directly affect the coverage issues, from the perspective of either the policyholder or the insurer. As the burden of proof makes clear, even no finding or special inquiry will affect coverage as it could prevent either the insurer or the policyholder from proving necessary elements of the claim for coverage.

Many defense counsel believe they can be "coverage neutral" and not affect coverage at all. Respectfully, if the issues are properly reserved, *most* decisions made by defense counsel will affect the outcome of the coverage case in some way. How questions are asked in written discovery and at deposition may affect whether the answer is useful for coverage or not. Not seeking a special verdict or asking certain questions may help or hurt the insured depending on the burden of proof later. The Motions In Limine and instructions to the jury will likely affect coverage, as each affects the findings (jury questions) or the evidence that the findings will be based on (Motions in Limine).

A good example of the effect of mere phrasing of a jury instructions is *FountainCourt Homeowners' Ass'n v. FountainCourt Dev., LLC,* (2016) *360 Ore. 341.* In that case, an unremarkable construction defect lawsuit, a jury verdict was rendered against Sideco, the named insured, and the coverage question was litigated in the context of a garnishment

[6] http://www.courts.ca.gov/documents/disc005.pdf

proceeding.[7] The insurer argued that the liability case focused on defective work and it was entitled to litigate the amount of the judgment attributable to "work-product", as distinct from the amount of the verdict related to covered resulting "property damage" to the complex. The rationale was that the liability result was based on the amount of "damages" (not "property damage") that related to defective work by the insured and therefore the allocation of that amount was left to be litigated in the coverage case. The insurer was prepared to introduce evidence that the insured's work was defective and that a majority of the award was uncovered because it was for re-work, rather than for damage to other property, i.e., "property damage".

In the liability trial, the *FountainCourt* jury was instructed in a seemingly innocuous manner: "Plaintiffs must allege and prove ***physical damage to their property***." In the garnishment proceeding the Judge remarked that he saw no meaningful distinction between "physical damage to the property" and "physical injury to tangible property," the definition of "property damage" in the policy. The court therefore found that the entire award against the policyholder was for "property damage" covered by the policy, shifting the burden to the carrier to establish how much was excluded by the work-product exclusions. That small difference in phraseology was enough for the Supreme Court of Oregon, who upheld the award because the insurer was apparently unable to prove the application of the exclusion. Did defense counsel believe that this instruction would essentially create coverage for the policyholder to the detriment of the insurer? In a tripartite state, where the insurer and the insured are both clients of the defense attorney, that could be an ethical problem.

A second case illustrates to some degree the "classic" approach of asking the insured to seek a special verdict, but also shows the effort of the carrier to seek special verdicts to allocate covered and uncovered claims. In *Owners Ins. Co. v. Shep Jones Constr.,Inc.*, 2012 U.S. Dist. LEXIS 62095 (N.D. Al.) Owners properly reserved rights, and when the insured refused to obtain a special verdict, the insurer attempted to intervene to seek the special verdict. The district court found that where the ultimate verdict did not allocate between different claims, the insured was not entitled to coverage, as it retained the burden of establishing how much of the verdict was for damage covered by the policy.

B. Coverage Evidence Outside of the Trial Court Record.

The next possible source of evidence is extrinsic evidence that was not presented to the trial at all. Can it be used? On the one hand, if an issue wasn't litigated, neither insurer nor policyholder is barred from introducing evidence on it. On the other, in post trial coverage litigation, the burden is on the insured to bring the judgment within the terms of the policy.

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[7] "Whenever a judgment debtor has a policy of insurance covering liability, or indemnity for any injury or damage to person or property, which injury or damage constituted the cause of action in which the judgment was rendered, the amount covered by the policy of insurance shall be subject to attachment upon the execution issued upon the judgment." ORS § 18.352

Hostility toward evidence outside the trial court record is found in the maxim that a trial court is presumed to have found in favor of the prevailing party on "all the facts necessary to support the judgment". *Williamson & Vollmer Engineering, Inc. v. Sequoia Ins. Co.,* (1976) 64 Cal. App. 3d 261. However, that is to be squared with an equally compelling argument that an insurer that is not a party and has reserved its right to assert non-coverage is not bound by a judgment against the insured and is not collaterally estopped from asserting coverage defenses. *Marie Y. v. General Star Indemnity Co*., (2003) 110 Cal. App. 4th 928.

The problem of what evidence to present in the liability trial is squarely addressed in *Rafeiro v. American Employers' Ins. Co.,* (1970) 5 Cal. App. 3d 799. In that case, the judgment creditor, the underlying plaintiff, pursued a claim for construction defects against the insured but, unlike the plaintiffs in *FountainCourt* argued only that there was inferior materials and workmanship, and judgment was entered in her behalf in the liability trial. In the coverage case, she sought to introduce evidence of diminution in value of her property that was not presented to the trial court. The evidence was refused because it was not evidence of the basis of the judgment and the court found that the judgment was not covered by the policy.

Therefore the coverage litigator must always consider: was the issue presented? Should the issue or relevant facts be presented so that findings are made in the liability case? The point to any defense attorney is this: no matter what you do, you will be influencing the coverage case. The question, really, for defense counsel is: by your actions, are you making it more likely that key facts to coverage will be "determined" and part of the record and have you advised your client(s) what facts and issues are likely to be determined based on the Motions In Limine and likely jury verdict form.

C. Affecting Coverage Evidence by Other Litigation Decisions

Purely strategic litigation decisions can directly affect, and possibly determine coverage. The easiest example of this is the parties in the case. It is possible, and in some cases likely, that certain subcontractors will be responsible for uncovered damages. In that case, the inclusion or exclusion of that subcontractor in the final trial may have the same effect as asking the jury to separate covered and uncovered damage claims against others.

V. Settlements and Evidence From The Liability Case

What happens when the liability case does not result in useful findings for coverage, or there are no findings at all? This situation is presented when there is a general verdict or a where the coverage issue is unrelated to the liability one, or where the matter was handled in arbitration without a record. When there is a settlement, by far the most common situation, there are several different questions to address:

(1) What is the claim(s) that was/were presented and settled that represent the settlement amount?

(2) Are there barriers to introducing evidence of discovery, testimony or other documents to establish coverage and allocation?
(3) Does the available records establish coverage or non-coverage by preponderance of the evidence?

In a construction defect claim, from the standpoint of the General Contractor, there may be different theories of liability and different costs of repair. Plaintiffs could be $12,000,000 and the defense could be $1,000,000. There could be a fraud claim for failure to disclose known defect and a claim for defectively constructing eight different areas of the project – one is covered and the rest are not. The Plaintiffs may be pursuing different defect claims for which the defense feels there is no liability. If there is a settlement of all issues for a lump sum, the usual way of doing so, what is the claim being settled? I will provide two examples from settlements I was involved in: (1) the roofer that settled before DT, and (2) a pollution claim with two different theories of liability.

As to the roofer, the claim was presented by the owner of a commercial project. In writing, and in written discovery, the claim was that the roof needed to be replaced because the drip edges were not correctly done and therefore, under a warranty claim, the owner was entitled to a new roof. (a little like *Rafeiro)* There was roughly $10,000 in interior drywall damage that was repaired and the roof had lasted two additional winters without incident. The claim presented was a removal and replacement of the insured's work. However, prior to the settlement demand being made, the roofer's expert had noted some suspicious staining on the exterior stucco indicating, perhaps, that water had penetrated behind the stucco due to the drip edge condition, but no testing was done to confirm it, and the Owner was willing to give a release for any damage relating to the entire project. Replacing the stucco would likely be covered and the cost would be more than the settlement demand being made. In hypothetical coverage litigation, what was the claim that was settled? Was it the uncovered removal and replacement of work that was defectively installed? Was it the potential claim for resulting damage to the stucco? Can the policyholder argue that the reason for the settlement was the potential stucco claim, even if it was never made prior to the settlement?

A second example is a PCE[8] contamination claim. The insured was a water company with policies containing a pollution exclusion with a "sudden and accidental" exception. Formally, (in discovery, motions and court filings) the California Department of Toxic Substance Control argued that the water company's production wells, drilled hundreds of feet into the earth piercing different water bearing aquifers, were allowing the PCE to move vertically between aquifers. The movement of PCE and damage to the aquifers (moving PCE into uncontaminated sources of water) would take years to accomplish. While unknown, unintended and unexpected, it is hardly "sudden" in the temporal sense of the word. During discovery, however, defense counsel discovered that a separate liability risk from vertical aquifer contamination was that the PCE was moving within a single aquifer due to the huge water extraction pumps literally moving the plume in rapid bursts. The

[8] perchloroethylene, a solvent used in Dry Cleaning.

case settled, but an issue in the coverage litigation was: which claim was the basis of the settlement?

Ultimately at trial of a coverage case, the court will have to decide "what claim was settled" by preponderance of the evidence. Presumably, though there is no case law on point, the court would lean a little on the side of the party that paid it and be subject to a preponderance of the evidence standard. A settlement is presumptive evidence of liability and the amount of damages, but not coverage. "A settlement is only presumptive evidence of liability and the amount thereof." *Peter Culley & Associates v. Superior Court,*(1992) 10 Cal. App. 4th 1484, 1494. Evidence that would be used to show what claim was settled or the relative value of different claims would include:

- Whether the defense attorney is chosen by the Insurer or the Policyholder such that there could be an inherent bias argued;
- Written Discovery especially contention interrogatories
- Pleadings – since any ultimate resolution will start with the claims that were formally asserted;
- Deposition testimony and declarations in support of motions
- Testimony of defense counsel and possibly opposing counsel if the issue was feasibility of different theories
- Declarations from Motions setting out parties' positions.

Therefore, the attorney or the client must analyze each basis of liability for coverage.

V. Conclusion

Just as much as the substantive law, the evidence of facts that will support coverage, or coverage defenses, is critical to proper decision making. Claims professionals are always balancing different priorities, which makes it impossible to create a "best practices", a right and wrong answer. A thorough reservation of rights might protect the carrier's rights to force the Insured to prove how much of the result is covered (*Shep Smith*), but it could also create a conflict of interest for defense counsel that entitles the insured to independent counsel. A mediation might be the most cost-effective resolution technique overall, but will it shield critical evidence of covered or uncovered claims? Overlaying these concerns early, however, will allow for better decision making early in the life of the file, and while the underlying case is developing.

The important takeaway from this handout is this: think through your coverage issues to resolution, especially with your larger cases. If coverage disputes or litigation seems possible or even likely, think of the evidence you will need and consult with coverage counsel early to map out a strategy to obtain it.

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With any questions or comments, feel free to contact the author:

John H. Podesta
Wilson, Elser, Moskowitz, Edelman & Dicker, LLP
525 Market St., 17th Fl
San Francisco, CA 94105

Phone: (415) 625-9258
Email: john.podesta@wilsonelser.com

West Coast Casualty's 2018 CD Conference

Finding the Evidence For Your Coverage Case

John Podesta
Wilson Elser, Moskowitz, Edelman & Dicker, LLP
San Francisco

Sherrianne Hanavan,
Catalina U.S. Insurance Services
San Diego

Its not what is true, its what you can prove

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The Duty to Defend – The Potential for Coverage

- The First Evidence Question:
- The Duty to Defend
  - Four Corners Rule
  - Use of Extrinsic Evidence

The Reservation of Rights

- The Beginning -- Reserve Rights?
  - Avoid waiver of coverage defenses
  - May determine if the Insured entitled to Independent counsel or the insurer can assign panel counsel (in tri-partite states)
  - Advise Insured of actions insurer might take relative to indemnity
    - Withdraw from the defense
    - File action for declaratory relief
    - Burden of Proof for indemnity

What Coverage Issues? Two Important Points to Consider:

- Proper Reservation of Rights Necessary?
  - Does it limit issues to be litigated, and therefore evidence that is relevant?
- How much of the underlying case is subject to mediation protection.

The Duty to Indemnify – The actual basis of liability

Settlement or Trial

It Makes A Difference

Fact Questions in Post Settlement Coverage Litigation

1. What "claims" are presented against the Insured?
2. Were the "claims" likely to be successful, were they supported by evidence?
3. Was the settlement "reasonable"?
4. Is the settled "claim" covered?
   - If there are covered and uncovered "claims", is the insurance company able to allocate?

The First Decision: Cost/Benefit

- Having identified the coverage issues:
  - Does any coverage issue affect the duty to defend or just the amount of indemnity?
  - Is the evidence regarding coverage issues undisputed?
  - Is the coverage issue the subject of the liability trial?
- Cost/Benefit
  - Policy limits?
  - Anticipated defense costs?
    - Defense inside or outside of limits

Compare two cases for Cost/Benefit of Post Settlement Recovery Based on Coverage

- First: Coverage issue is soils exclusion that eliminates the duty to defend -- $2m estimated liability exposure. Defense outside of limits.
- Second: Soils exclusion would not eliminate the duty to defend, only indemnify. Defense inside of limits.
- Question: Based on information when case gets started, is either a case to set up for recovery of uncovered damages?

The point?

- Much greater covered damage exposure, and evidence available in the first case:
  - Proper set up may reduce exposure from $2m to zero
- Lower total cost exposure, and evidence of covered damages not available until trial in the second:
  - Settlement before facts fully developed much more likely

Multiple Claims Against the Policyholder

- Is there coverage for some but not others?
- Can value of claims be separated in a persuasive way?
  - What is the role of subjective belief/intent of the party settling as to the claim settled?
- What evidence supports the insurer's allocation? The Insureds?

Post resolution coverage case – Cost

- Settlements
  - Wide ranging evidence is admissible and can be hotly contested
  - If Carrier is a plaintiff, will likely have Burden of Proof on recovery
- Depending on the coverage issue(s), record must be developed.

Examples of evidence as to what claim was settled

- Consider for Contribution Claims or Insurer/insured coverage litigation
  - Recommendations of defense counsel regarding total value, but allocation?
  - Reports of informal conversations -- mediation?
  - Experts and reports from underlying case
  - Written discovery, depositions and documents produced

Sources of Evidence From The Liability Case

- From the Underlying Case
  - Pleadings and Court Records
    - Complaint/Cross Claims
    - Motions – especially ones with declaration
    - Orders – substantive and discovery
    - Discovery Responses
    - Documents from depository

Useful materials

- These are inadmissible by themselves but may reflect other admissible evidence
  - Defense counsel reports and reports
    - Indentify witnesses, documents, and conversations with opposing counsel
    - Evaluation of liability theories
  - Mediation statements of the parties
    - Inadmissible but identify claims, witnesses documents supporting positions

Separating the wheat from the chaff– What can't be used?

First: Mediation Documents and Statements

- Documents created for, or in the course of mediation
  - Cal. Ev Code Sec 1119:
    - **(a)** No evidence of anything said …pursuant to, a mediation …is admissible …in ***any*** …civil action…
    - **(b)** No writing, …that is prepared for the purpose of, …a mediation …is admissible …, in any …civil action…
- Very difficult to prove a coverage case in court in California if case subject to Mediation in CMO or Pre Trial Order

Second: Attorney Client Privileged Material

- Legal Bills: Evidence of Damages: Are attorneys fees an item of damage so that party pursuing reimbursement must choose between waiving Insured's privilege and waiving recovery?
- Defense Counsel Reports: Are reports from counsel privileged in a contribution action – they may show reasons for settlement. In action between insured and insurer it would be "joint client" privilege. E.C. 962

Summary – Post Settlement Recovery or Coverage Litigation

- The insurer needs to consider:
  1. Is coverage issue part of liability case for indemnity only or could it affect defense?
  2. If the case is to be settled is there evidence of what claim is settled and the dollar amount available in liability case?
  3. What is the *evidence* that will be used to prove non-coverage or allocation and is it persuasive?
  4. How much of the indemnity exposure will be avoided if successful?

Different post trial coverage challenges

1. Insured claim
2. Garnishment or Direct Action by statute
3. Assignment to plaintiff to collect judgment
4. Contribution/Subrogation Claims by settling insurers

Trial and Arbitration – three different evidence problems

- Collateral Estoppel – the coverage issue is determined by findings in liability trial
- Where evidence submitted at trial affects but does not determine coverage issue.
- Where coverage issue wholly unrelated to liability issue

Collateral Estoppel in California

- Where the insurer does not defend:
  - An insurer that has been notified of an action and refuses to defend . . . is bound by a judgment in the action . . . as to all material findings of fact essential to the judgment of liability of the insured.
  - The insurer is not bound, however, as to issues not necessarily adjudicated in the prior action and can still present any defenses not inconsistent with the judgment against the insured.

Geddes & Smith, Inc. v. St. Paul Mercury Indem. Co. (1959) 51 Cal. 2d 558, 561-562.

May an insurer obtain findings relative to coverage issues?

- Purpose is to ask jury to separate different claims.
  - Intervention for limited purpose
  - Ask for findings or special verdict or demand that the insured do so?
    - Burden of proof in coverage case
      - Insured: Evidence within the insuring agreement
      - Insurer: Exclusions. Allocation?

The FountainCourt Decision

- FountainCourt Homeowners' Ass'n v. FountainCourt Dev., LLC. (2016) 360 Ore. 341
  - Garnishment Proceeding against liability insurer for Sideco, a Siding and Window Subcontractor
  - Insured found negligent for $485,877.84 after a jury trial
  - Plaintiff instituted garnishment proceedings against AFM and Clarendon under ORS 18.775

Carrier Arguments that Allocation of Verdict Was Not Litigated:

- AFM contends that FountainCourt failed to establish that Sideco had become obliged to pay damages because of "property damage." , i.e. physical injury to tangible property. The gist of AFM's argument seems to be that, ...the parties were not bound by the facts found by the jury in the underlying trial.

Coverage is a Judge, not jury question

[W]hat the insured had become obligated to pay as damages and whether the insurer ultimately was liable under its policy presented ***questions of law*** for the court to determine by reference to (a) the contract [policy] and (b) ***the judgment and record in the underlying proceeding.***

Example of Special Verdicts In Relationship to Collateral Estoppel

The jury instruction in the CD case:

"Plaintiffs must allege and *prove physical damage to their property.* * * * The plaintiffs must prove damages by a preponderance of the evidence

"If you find the plaintiffs are entitled to damages, you should—or shall determine *the amount of physical damage to plaintiffs' real property, if any, that was caused by the defendants' fault or negligence. The measure of damages for partial destruction of real property is the reasonable cost of repairing the damaged property.*"

Court Accepted Jury's Findings and Refused Additional Evidence of PD

- We find no significant legal distinction between physical damage to property as awarded in the underlying case and "physical injury to tangible property" as used in the insurance contracts. ***The trial court did not err in determining . . . that the sum that Sideco became legally obligated to pay as damages in the underlying action were for "property damage."***

Lesson Learned

- The basis of liability, and the amount of damages is fixed in the liability case.
  - If the issue is decided by the prior case, it is likely to be binding
- Most of your "evidence" for the coverage case after trial is the record you create using
  - Jury Instructions – Findings will mirror the question
  - Motions in Limine – limit evidence – not part of the award

Case Example One

- Nevada Construction Defect Lawsuit – Housing Development
- Primary liability issue = collapsible soils. Cost $2,000,000 appx
- Insured = General Contractor
- Policy had unique soils exclusion that eliminated the duty to defend if soils part of the case

Evidence On Coverage Issues Limited

- Pleadings:
  - Complaint. Chapter 40 Notices
- Expert Reports
  - (Chapter 40) from Plaintiffs re claims presented
  - Carrier prepared expert report re policy language
- Policies

Decision and Result

- Coverage action filed given cost/benefit and limited evidence required
- Successful MSJ
- Resolution on Appeal for confidential amount that left judgment intact
- Published decision: *Probuilders Specialty Insurance Company RRG v Double M Construction.* 116 F.Supp.3d 1173 (D. Nev. 2015)

Case Example 2

- Single Family House.
- Garden Variety Defects – Structural and some water intrusion
- Coverage issues
  - When damage began
  - Resulting damage versus work product
  - Coverage litigation begun by the insured principally over duty to defend

Key facts regarding coverage

- The Insured was in bankruptcy so Plaintiff could only pursue insured to the extent of insurance coverage.
- Nevada has no direct action or garnishment, so Plaintiff would have to proceed by assignment of insured's rights.
  - *Gallegos v. Malco Enters. of Nev.*, (2011)127 Nev. 579

Plaintiff limited to claims covered by insurance,

- Allowed more latitude regarding factual findings
- Dismissed intentional claims (and inflammatory evidence that would result)

Evidence of Coverage Issues

- Actual basis of liability and when did damage first occur?
- Require findings at trial
- Much more expense to develop evidence for coverage case

Pre-Trial Motions

- Motions in Limine and Trial Brief covering insurance issues
  - i.e. damage to other property versus work product
  - Court rejected request for special verdict on timing but did allow resulting damages
- In the absence of an ethical conflict, Defense counsel can actively assist

Jury Verdict

- Favorable verdict on liability and damages
- Settled on appeal for a confidential sum dramatically lower than jury verdict

Take Aways

- Defense counsel affects coverage with virtually everything they do: discovery, motions, case management, and parties to the case.
- Insurers need to consider not only the coverage issue, but how they are going to prove their case.
- If the coverage issue be proven, how much will it cost.

The Scale of Expense

- First: can the coverage defenses be established on the pleadings or on the basis of undisputed evidence eliminating the duty to defend?
- Second, if a settlement is likely, requiring a fund and chase, can you prove what was settled and with what?
- Third, if a trial is to occur, can findings be obtained as to the basis of liability and coverage issues?
- Fourth, does evidence outside the trial record support your coverage position or your opponent?

Thank you

Section 17.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

North Ballroom

Friday, May 18th 2018
9:30 AM – 10:30 AM

Course Title:
Northwest Insurance Coverage and Extra-Contractual Issues

Tom Lether, Esq., Sandra Heiden and Edward McKinnon

Northwest Coverage and Extra-Contractual Claims

West Coast Casualty

Construction Defect Seminar

May 18, 2018

Disneyland Resort, CA

Presented by:

Thomas Lether, Lether & Associates

Sandra Heiden, The Navigators Group

Ed McKinnon, Claims Resource Management

SPECIAL ISSUES INVOLVING NW COVERAGE AND BAD FAITH ISSUES

SECTION I – AN OVERVIEW OF NORTHWEST INSURANCE LAW

A. Washington Law

1. Rules of Policy Construction

In Washington State, insurance policies are construed as contracts. *Findlay v. United Pac. Ins. Co.*, 129 Wn.2d 368, 378, 917 P.2d 116 (1996). It is the obligation of a court to enforce the terms and conditions of the policy as written. *See id.* The interpretation of an insurance policy is a question of law. *Overton v. Consol. Ins. Co.*, 145 Wn.2d 417, 424, 38 P.3d 322 (2002).

In reviewing coverage for a particular loss, Washington courts undergo a two-step analysis. Initially, the court determines whether an event has occurred which triggers coverage. The burden of proof in establishing that the policy has been triggered is on the insured. Only if the insured meets this burden does the court consider the second step in the analysis. The second step in the analysis requires the court to determine if there are any applicable exclusions or limitations. The burden of establishing an exclusion is on the insurer. *McDonald v. State Farm*, 119 Wn.2d 724, 731, 837 P.2d 1000 (1992).

Definitions provided in the policy are controlling. *Overton, supra* at 427. However, if a term is left undefined, the term is given a plain and ordinary meaning found in a standard English dictionary. Id. at 428; see also *Queen City Farms v. Cent. Nat'l Ins*., 126 Wn.2d 50, 77, 882 P.2d 703 (1994). A court may deviate from this general rule only if the policy language is determined to be ambiguous or if there are conflicting terms in the policy. *Stanley v. SAFECO Ins. Co. of Am.*, 109 Wn.2d 738, 741, 747 P.2d 1091 (1988). An ambiguity exists only if the term or provision is reasonably susceptible to two meanings. *Id.* Simply because the policy is confusing or difficult to read does not render the policy ambiguous. *McDonald*, 119 Wn.2d at 734. The terms of a policy are given a fair and reasonable construction that would be given to the contract by the average person buying insurance. *Id.* at 733.

2. Legal Standards Regarding the Duty to Defend

Washington is a "four corners" state but with a requirement that the insurer investigate extrinsic evidence. Under Washington Law an insurer has a duty to defend if the complaint, construed liberally, alleges facts which, if proven, would impose liability within the policy's coverage. *Equilon Enterprises, LLC v. Great American Alliance Insurance Company*, 132 Wn. App. 430, 435-6, 132 P.3d 758 (2006); *Truck Insurance Exchange v. Van Port Homes*, 147 Wn.2d 751, 58 P.3d 276 (2003).

If it is not clear from the face of the complaint that the policy provides coverage, the insurer must investigate the claim and should give the insured the benefit of the doubt on the duty to defend. *Woo v. Fireman's Fund Insurance Company,* 161 Wn.2d 43, 53, 164 P.3d 454 (2007).

Moreover, if the allegations in the complaint conflict with facts known to or readily ascertainable by the insurer or if the allegations are ambiguous, facts outside the complaint should be considered. However, ***an insurer may not rely on facts extrinsic to the complaint to deny the duty to defend, it may do so only to trigger the duty to defend.*** *Woo v. Fireman's Fund Insurance Company, supra.*

The duty to defend rules apply equally to additional insureds and named insureds under Washington law. *See Ledcor v. Mutual of Enumclaw*, 150 Wn. App. 1, 206 P.3d 1255 (Ct. App. 2009).

A liability insurer has no duty to consider coverage unless a claim is tendered to the insurer. *Unigard v. Leven*, 97 Wn. App. 417, 425, 983 P.2d 1155 (1999)). However, under Washington law an insurer is liable for pre-tender defense fees unless the insurer can establish prejudice. *Griffin v. Allstate*, 108 WN. App., 133, 141 (2001). Finally, an insurer cannot seek reimbursement of defense fees from the insured if it is determined that there is no coverage unless the policy allows for such recovery. *National Surety Corp. v. Immunex*, 176 Wn.2d 872, 888-889, 297 P.3d 688 (2013).

As a result, if an insurer is unclear as to its duty to defend in a particular case, it should defend under a reservation of rights and seek a coverage determination in a separate declaratory judgment action or other authorized action. *Van Port*; *Woo, supra*. In such a claim, the insurer can have both the defense and indemnity obligations considered. *Van Port; Woo; See also Standard Fire Ins. Co. v. Blakeslee*, 54,Wn.App. 1, 771 P.2d 1172 (1989).

With respect to environmental cases, Washington Courts have held that a Potentially Liable Party ("PRP") Notice constitutes a suit for purposes of a general liability policy, even in the absence of a formal complaint. *Gull Indus. v. State Farm Fire and Cas. Ins. Co.*, 181 Wn. App. 463, 326 P.3d 782, 790 (Wash. App. 2014). The *Gull* Court determined that a PRP notice has the functional equivalency of a "suit" as contemplated by the general liability policy. *Id.*

More recently, the Federal Court for the Western District of Washington reviewed the *Gull* rule, and upheld the same, stating as follows:

> [The insurer] argues that all action taken by the County prior to the County's tender was completely voluntary and cooperative, and, therefore, not adversarial or coercive. The County responds that coercion and cooperation are not mutually exclusive in the environmental enforcement context. The Court agrees. Once a party bears the scarlet letters "PRP," it may be called upon at any time to assume responsibility for the cleanup effort. Indeed, "it makes no difference whether an insured voluntarily cleans up contamination or waits until government intervention—it is liable either way.

King Cty. v. Travelers Indem. CO., 2017 U.S. Dist. LEXIS 19397 (W.D. Wash. Feb. 10, 2017), *citing Gull, supra, at 790.*

3. Legal Standards for Determining the Duty to Indemnify

In Washington, an insurer's obligation to defend is distinct from its obligation to indemnify. *Weyerhaeuser v. Aetna,* 123 Wn.2d 891, 874 P.2d 172 (1994). As discussed above, an insurer has an obligation to defend the insured based upon an objective reading of the complaint regardless of the merits of the factual allegations. *State Farm v. Emerson,* 102 Wn.2d 477, 687 P.2d 1139 (1984); *Aetna Casualty v. M&S Industries,* 64 Wn.App. 916, 827 P.2d 321 (1992). An insurer's duty to indemnify, however, depends upon "the insured's actual liability to the claimant and actual coverage under the policy." *Hayden v. Mut. of Enumclaw Ins. Co.,* 141 Wn.2d 55, 64, 1 P.3d 1167 (2000).

B. Oregon Law

1. Rules of Policy Construction

Oregon law holds that insurance policies are construed as contracts. *Stanford v. American Life Ins. Co.,* 280 Ore. 525, 571 P.2d 909 (1977). An insurance policy must be interpreted in accordance with its terms and conditions. *Stanford v. American Life Ins. Co.,* 280 Ore. 525, 571 P.2d 909 (1977)*; see also Usinger v. Campbell,* 280 Ore. 751, 755, 572 P.2d 1088 (1977). Interpretation of an insurance policy is a question of law. *Id. at 527.* The Court must enforce the terms and conditions of the policy as written, unless a particular provision is ambiguous. *Id.; see also Usinger v. Campbell,* 280 Ore. 751, 755, 572 P.2d 1088 (1977). Oregon Courts have expressly held that "[i]t is not permissible to apply a strained meaning to unambiguous language to create an ambiguity where none exists so that interpretation may be indulged to extend coverage." *Mortgage Bancorp. V. New Hampshire Ins. Co.,* 67 Ore. App. 261, 264, 677 P.2d 726, *rev. den.* 297 Ore. 339, 683 P.2d 1370 (1984). The Court has an obligation to enforce unambiguous provisions according to their plain language. *Stanford v. American Life Ins. Co.,* 280 Ore. 525, 571 P.2d 909 (1977); *see also National Family Ins. v. Bunton,* 509 N.W.2d 565, 567 (Minn. App. 1993).

Under Oregon law, establishing coverage is also a two-step process. First, the insured has the burden of proving that the alleged property damage is covered by the policy. *See St. Paul Fire & Marine Ins. Co. v. McCormick and Baxter Creosoting Co.,* 324 Ore. 184, 923 P.2d 1200 (1996); *See also Lewis v. Aetna Ins. Co.,* 264 Ore. 314, 316, 505 P.2d 914 (1973); *See also Nielson v. St. Paul Companies,* 283 P.2d 545 (1978). An insurer is only required to provide indemnity for a claim if it arises from the insured's covered conduct. *Ledford v. Gutokski,* 319 Ore. 397, 399, 877 P.2d 80 (1994). Second, if an insured is able to establish coverage, the burden shifts to the insurer to show that the exclusionary language contained within the policy operates to limit or bar coverage. *ZRZ Realty Co. v. Beneficial Fire and Cas. Ins. Co.,* 349 Ore. 117, 127, 241 P.3d 710, 716 (2010), *modified on recons. on other grounds*, 349 Ore. 657, 249 P.3d 111 (2011).

2. Legal Standards Regarding the Duty to Defend

Oregon is also a "four corners" state. An insurer's duty to defend is a question of law determined by the terms of the insurance policy and the allegations of the complaint against the insured. *Bresee Homes, Inc. v. Farmers Ins. Exch.*, 353 Or. 112, 116, 293 P.3d 1036 (2012); *Mutual of Enumclaw Ins. Co. v. Gutman,* 172 Or. App. 528, 531, 21 P.3d 101 (2001). The insurer

should be able to determine from face of the complaint whether to accept or reject the insured's tender of defense. *Ledford v. Gutoski*, 319 Or. 397, 400, 877 P.2d 80 (1994).

The insurer has a duty to defend if the complaint provides any basis for which the subject policy may provide coverage. *Bresee*, 353 Or. at 117; *Ledford*, 319 Or. at 397. The insurer must defend if the complaint alleges any facts that would impose liability under the policy, even if some of the alleged conduct would not be covered. *Bresee*, 353 Or. at 117; *Gutman*, 172 Or. App. at 528; *Abrams v. General Star Indem. Co.*, 335 Or. 392, 400, 67 P.3d 931 (2003). Further, any ambiguity as to coverage must be resolved in favor of the insured. *Bresee*, 353 Or. at 117; *Ledford*, 319 Or. at 397. To the extent that the allegations of the complaint are ambiguous or unclear but a reasonable interpretation would bring them within coverage, the insurer has a duty to defend. *Nat'l Union Fire Ins. Co. v. Starplex Co.*, 220 Or. App. 560, 572, 188 P.3d 332 (2008).

The Oregon Supreme Court recently reaffirmed these standards in the construction-defect-lawsuit, *Bresee Homes, Inc. v. Farmers Insurance Exchange*. 363 Or. at 117. In *Bresee,* the insurance policy at issue excluded damage occurring after completion of the insured's work. The complaint contained no dates, however, and did not allege when the damage occurred. 363 Or. at 122. Despite significant extrinsic evidence suggesting the damage occurred after completion of the insured's work, the Court held that the absence of dates in the complaint created an ambiguity as to the timing of the property damage. As a result, the insurer had a duty to defend because "under the facts alleged . . . the [insured] could have liability for conduct covered by the policy." *Bresee*, 363 Or. at 125. The *Bresee* Court further reiterated that allegations of uncovered conduct are immaterial if the complaint includes allegations of covered conduct. *Bresee*, 363 Or. at 117.

The United States District Court for the District of Oregon reiterated and confirmed the scope of an insurer's duty to defend its insured previously articulated in *Bresee. Navigators Ins. Co. v. K & O Contr., LLC,* 2013 U.S. Dist. LEXIS 171731 (D. Or. Sept. 23, 2013)("[E]xtrinsic evidence, no matter how conclusive, cannot be used to end the duty to defend in a situation like the one before the court.").

In at least one circumstance, however, the Oregon courts have held that an insurer can consider extrinsic evidence in determining its duty to defend. In circumstances where there is a question as to whether the claimant qualifies as an insured under a policy, the Oregon courts have distinguished the *Ledford* rule and held that it is appropriate to consider extrinsic evidence. *Fred Shearer & Sons v. Gemini Ins. Co.*, 237 Or. App. 468, 240 P.3d 67 (2010). It should be noted, however, that the *Fred Shearer* case involved an additional insured claim. See below.

Under Oregon law there is no duty to provide coverage unless there is an actual tender. . *Oregon Ins. Guaranty Assoc. v. Thompson,* 93 Ore. App. 5, 10, 760 P.2d 890 (1988). It is an open question of law in Oregon whether or not an insurer must provide coverage for pretender defense fees. Oregon law is also undecided on the issue of defense fee recovery in a situation where it is determined there is no coverage.

With respect to environmental claims, an insurer's duty to defend an insured identified by the EPA as a Potentially Responsible Party ("PRP") under a CGL policy is codified under ORS 465.480. Specifically, ORS 465.480(2)(b) states:

> (b) Any action or agreement by the Department of Environmental Quality or the United States Environmental Protection Agency against or with an insured in which the Department of Environmental Quality or the United States Environmental Protection Agency in writing directs, requests or agrees that an insured take action with respect to contamination within the State of Oregon is equivalent to a suit or lawsuit as those terms are used in any general liability insurance policy.

This statute functions to potentially trigger a defense obligation, even when no formal complaint has been filed. As a result of the statute, a PRP Notice must be treated as a "suit" for purposes of evaluating the duty to defend.

3. Legal Standards for Determining the Duty to Indemnify

In Oregon, the duty to indemnify is independent of the duty to defend. An insurer is only required to provide indemnity for a claim if it arises from the insured's covered conduct. *Ledford v. Gutokski*, 319 Ore. 397, 399, 877 P.2d 80 (1994). The insurer is only obligated to indemnify the insured where the insured is actually liable for harm or injury that is covered by the policy. *Leach v. Scottsdale Indem. Co.*, 261 Ore. App. 234, 247, 323 P.3d 337 (2013). An insurer may have a duty to defend its insured, but no duty to indemnify. *ZRZ Realty Co. v. Benefit Fire & Cas. Ins. Co*., 351 Ore. 255, 265, 266 P.3d 61 (2011).

SECTION II - ADDITIONAL INSURED CLAIMS

Additional Insured status under a general liability policy is the critical element of risk allocation in the context of construction claims. As an additional insured, a person or organization can make a claim directly against an insurance policy issued to, and paid for by, another party. Moreover, an additional insured can typically expect the same coverage as afforded to the policy holder.

A. <u>Washington</u>

Washington is a "four-corners" state with respect to the duty to defend. In one unpublished case, *Hartford v. Leahy*, 2011 WL 813458 (W.D. WA 2011), the Court found an exception to this rule. The Court held that extrinsic evidence may be used to establish that the claimant is an insured under the policy. The implication of this holding is that, for the purposes of determining whether a claimant is an additional insured, evidence outside the complaint can be considered. *Hartford v. Leahy*, 2011 WL 813458 (W.D. WA 2011)

Furthermore, under Washington law, "Certificates of Insurance" by themselves do not create Additional Insured status. *See Postlewait Constr., Inc. v. Great Am. Ins. Co.*, 41 Wn. App. 763, 767, 706 P.2d 636 (1985).

Blanket Additional Insured endorsements typically provide coverage only with respect to liability arising out of, or caused by, the named insured's acts or omissions. *See Equilon Enter. LLC v. Great Am. Alliance Ins. Co.*, 132 Wn. App. 430 (2006); *Hartford Ins. Co. v. Ohio Cas. Ins. Co.*, 145 Wn. App. 765 (2008). As a result, the additional insured must show causation from the

named insureds acts in order to be afforded coverage. The Washington Courts typically provide a very broad definition of coverage when the "arising out of" language is used.

Moreover, the Western District of Washington Court has held that an insurer is relieved of its duty to defend an additional insured based on an ongoing operations limitation only where the complaint alleges facts which clearly demonstrate that the loss arose after operations had been completed. *Absher Construction Company v. North Pacific*, 2012 U.S. Dist. Lexis 38555 (March 20, 2012).

B. Oregon

Oregon is a "four-corners" state when it comes to assessing the duty to defend. However, in the case of *Fred Shearer & Sons, Inc. v. Gemini Ins. Co.*, 237 Or. App. 468, 240 P.3d 67 (Or. App. 2010), the Court held that when determining whether a party qualifies as an insured under a policy, the parties may look beyond the allegations contained in the complaint. The Court in *Fred Shearer* stated as follows:

> The facts relevant to an insured's relationship with its insurer may or may not be relevant to the plaintiff's case in the underlying litigation. The plaintiff in the underlying case is required to plead facts that establish the defendant's liability; the plaintiff often is not required to establish the nature of the defendant's relationship to some other party or to an insurance company in order to prove a claim. …For that reason, we do not see the logic in requiring [a party] to demonstrate that the underlying complaints establish the relationship between [parties], or, consequently, that [a party] is [an] 'insured' within the meaning of the policy.

Id. at 477.

Although the Court in *Fred Shearer* addresses the situation where an insured was using extrinsic evidence to prove that it qualified as a named insured under the terms of the policy, the reasoning by the Court should also apply to determine that a party is not a named insured. Moreover, the *Shearer* court cited to a Fifth Circuit Court of Appeals and a New Jersey case which both recognized an exception to the general rule against extrinsic evidence "when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case." *Id.* citing *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir. 2004) and *Burd v. Sussex Mutual Insurance Company*, 56 NJ 383, 388, 267 A.2d 7 (1970).

The scope of a liability carrier's duty to defend obligation was reviewed in *West Hills Development Co. v. Oregon Automobile Ins. Co., et al*, 271 Ore. App. 155 (2015). In that case, the general contractor tendered as an additional insured to Oregon Automobile Insurance Company ("OAIC") under a policy issued to a subcontractor of West Hills.

OAIC denied any duty to defend West Hills. OAIC contended that the complaint indicated the alleged property damage occurred after the subcontractor had completed its work, and not during the subs "ongoing operations" for West Hills.

West Hills filed a declaratory action against OAIC, alleging a breach of the duty to defend. The Trial Court determined that OAIC failed to properly defend West Hills as an additional insured. West Hills appealed.

The Oregon Court of Appeals upheld the Trial Court's decision. The Appellate Court reviewed the underlying complaint and determined it alleged damage for which the subcontractor was responsible. Moreover, the Appellate Court agreed with OAIC's contention that the underlying complaint did not specify when the damage occurred. However, the complaint did contain allegations that would permit proof at trial that the possibility of damages occurred before the subcontractor had finished its work. Since the complaint did not rule out the possibility that damage occurred during the subcontractors ongoing operations, OAIC had a duty to defend West Hills.

SECTION III – COMMON COVERAGE ISSUES UNDER CGL POLICIES

A. Insuring Agreement.

The Typical Insuring Agreement for Coverage A of the Commercial General Liability (Coverage Form CG 00 01 (10/01)) provides as follows:

> **SECTION I – COVERAGES**
>
> **COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY**
>
> **1. Insuring Agreement**
>
> **a.** We will pay those sums that the insured becomes obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or suit that may result. But:
>
> **(1)** The amount we will pay for damages is limited as described in Section III Limits Of Insurance; and
>
> **(2)** Our right and duty to defend ends when we have used up the applicable limit of insurance in the payment of judgments or settlements

under Coverages **A** or **B** or medical expenses under Coverage **C**.

No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under Supplementary Payments Coverages **A** and **B**.

b. This insurance applies to "bodily injury" and "property damage" only if:

(1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory";

(2) The "bodily injury" or "property damage" occurs during the policy period; and

(3) Prior to the policy period, no insured listed under Paragraph **1.** of Section **II – Who Is An Insured** and no "employee" authorized by you to give or receive notice of an "occurrence" or claim, knew that the "bodily injury" or "property damage" had occurred, in whole or in part. If such a listed insured or authorized "employee" knew, prior to the policy period, that the "bodily injury" or "property damage" occurred, then any continuation, change or resumption of such "bodily injury" or "property damage" during or after the policy period will be deemed to have been known prior to the policy period.

. . .

d. "Bodily injury" or "property damage" will be deemed to have been known to have occurred at the earliest time when any insured listed under Paragraph **1.** of Section **II – Who Is An Insured** or any "employee" authorized by you to give or receive notice of an "occurrence" or claim:

(1) Reports all, or any part, of the "bodily injury" or "property damage" to us or any other insurer;

(2) Receives a written or verbal demand or claim for damages because of the

"bodily injury" or "property damage"; or

(3) Becomes aware by any other means that "bodily injury" or "property damage" has occurred or has begun to occur.

e. Damages because of "bodily injury" include damages claimed by any person or organization for care, loss of services or death resulting at any time from the "bodily injury".

SECTION V – DEFINITIONS

. . .

3. "Bodily injury" means bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.

. . .

5. "Employee" includes "leased worker". "Employee" does not include "temporary worker".

. . .

10. "Leased worker" means a person leased to you by a labor leasing firm under an agreement between you and the labor leasing firm, to perform duties related to the conduct of your business. "Leased worker" does not include "temporary worker".

. . .

13. "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

. . .

17. "Property damage" means:

a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.

18. "Suit" means a civil proceeding in which damages because of "bodily injury", "property damage" or "personal and advertising injury" to which this insurance applies are alleged. "Suit" includes:

a. An arbitration proceeding in which such damages are claimed and to which the insured must submit or does submit with our consent; or

b. Any other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent.

19. "Temporary worker" means a person who is furnished to you to substitute for a permanent "employee" on leave to to meet seasonal or short-term workload conditions.

CG 00 01 10 01 pp. 1-2; 12-15.

B. Common Exclusions

The common CGL coverage form also contains a number of exclusions which are commonly applicable to worksite accident claims:

1. Contractual Liability Exclusion

b. Contractual Liability

"Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:

(1) That the insured would have in the absence of the contract or agreement; or

(2) Assumed in a contract or agreement that is an "insured contract", provided the "bodily injury" or "property damage" occurs subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an "insured contract", reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be damages because of "bodily injury" or "property damage", provided:

(a) Liability to such party for, or for the cost of, that party's defense has also been assumed in the same "insured contract"; and

(b) Such attorney fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which damages to which this insurance applies are alleged.

CG 00 01 10 01 p. 2.

9. "Insured contract": means

a. A contract for a lease of premises. However, that portion of the contract for a lease of premises that indemnifies any person or organization for "premises damage" is not an "insured contract";

b. A sidetrack agreement;

. . .

f. That part of any other contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work performed for a municipality) under which you assume the tort liability of another party to pay for "bodily injury" or "property damage" to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

Paragraph **f**. does not include that part of any contract or agreement:

. . .

(2) That indemnifies an architect, engineer or surveyor for injury or damage arising out of:

a. Preparing, approving, or failing to prepare or approve, maps, shop drawings, opinions, reports, surveys, field orders, change orders or drawings and specifications; or

b. Giving directions or instructions or failing to give them, if that is the primary cause of the injury or damage; or

(3) Under which the insured, if an architect, engineer or surveyor, assumes liability for an injury or damage arising out of the insured's rending or failure to render professional services, including those listed in **(2)** above

and supervisory, inspection, architectural or engineering activities.

CG 00 01 10 01 at p. 13

Pursuant to the above exclusion, there is no coverage for "property damage" that the insured is obligated to pay as damages because the insured has assumed liability in a contract. However, this exclusion does not apply to liability for damages that the insured would have in the absence of the contract or agreement, or the assumption of liability in a contract that meets the definition of an "insured contract." The policy defines an "insured contract" as a sidetrack agreement or a contract or under which FSE assumed the tort liability of another party to pay for "bodily injury" or "property damage" to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

In *Truck Ins. Exch. v. BRE Props., Inc.*, 119 Wn. App. 582, 593, 81 P.3d 929, 934 (2003), the Court held that a typical indemnity agreement between a general contractor and a subcontractor qualified as an "insured contract" under subsection f. of the definition. Accordingly, the Court held that the contractual liability exclusion did not apply in that case and the insurer was required to cover the subcontractor's obligation to indemnify the general contractor's tort liability.

2. Worker's Compensation Exclusion

d. Workers' Compensation And Similar Laws

Any obligation of the insured under a workers' compensation, disability benefits or unemployment compensation law or any similar law.

CG 00 01 10 01 p. 2.

3. Employer's Liability Exclusion

e. Employer's Liability

"Bodily injury" to:

(1) An "employee" of this insured arising out of and in the course of:
  (a) Employment by the insured; or
  (b) Performing duties related to the conduct of the insured's business; or
(2) The spouse, child, parent, brother or sister of that "employee" as a consequence of Paragraph (1) above.

This exclusion applies:

(1) Whether the insured may be liable as an employer or in any other capacity; and

(2) To any obligation to share damages with or repay someone else who must pay damages because of the injury.

This exclusion does not apply to liability assumed by the insured under an "insured contract".

CG 00 01 10 01 p. 2.

The Washington State Court of Appeals did not apply the Employer's Liability Exclusion where the exclusion was limited in scope to "bodily injury" to an employee of "the insured" and the injury occurred to an employee of an additional insured. *See Truck Ins. Exch. v. BRE Props., Inc.*, 119 Wn. App. 582, 81 P.3d 929 (2003). The Court drew a distinction between "the insured" and "an insured." The Court held that only the named insured could be identified as "the insured." In order to encompass the Additional Insured, the exclusion would have to be broadened to include "an insured."

Oregon Courts have ruled that this exclusion must be analyzed separately as to each insured. *Am. Hallmark Ins. Co. v. Am. Family Mutual Ins. Co.*, 2911 U.S. Dist. LEXIS 60695 (D. Ore. June 1, 2011). Therefore, where the defendant is not alleged to be the plaintiff's employer, the exclusion does not apply. *Klamath Pac. Corp. v. Reliance Ins. Co.*, 152 Ore. App. 738, 740, 955 P.2d 340 (1998).

4. Damage to Property Exclusion

j. Damage To Property

"Property damage" to:

(1) Property you own, rent, or occupy, including any costs or expenses incurred by you, or any other person, organization or entity, for repair, replacement, enhancement, restoration or maintenance of such property for any reason, including prevention of injury to a person or damage to another's property

. . .

(5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations; or

(6) That particular part of any property that must be restored repaired or replaced because "your work" was incorrectly performed on it.

…

Paragraph **(6)** of this exclusion does not apply to "property damage" included in the "products completed operations hazard".

CG 00 01 10 01 p. 4-5.

22. "Your work":

a. Means:

(1) Work or operations performed by you or on your behalf; and

(2) Materials, parts or equipment furnished in connection with such work or operations.

b. Includes:

(1) Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of "your work", and

(2) The providing of or failure to provide warnings or instructions.

CG 00 01 10 01 at p. 15.

16. "Products-completed operations hazard":

a. Includes all "bodily injury" and "property damage" occurring away from premises you own or rent and arising out of "your product" or "your work" except:

(1) Products that are still in your physical possession; or

(2) Work that has not yet been completed or abandoned. However, "your work" will be deemed completed at the earliest of the following times:

(a) When all of the work called for in your contract has been completed.

(b) When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site.

(c) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.

Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, will be treated as completed.

CG 00 01 10 01 at p. 14.

As set forth above, "property damage" is excluded under the j(5) exclusion, to "that particular part of property on which the insured is performing operations".

Additionally, under the j(6) exclusion "property damage" is excluded if any particular part of property on which the insured is working must be "repaired or replaced because of incorrect work" performed by the insured or on behalf of the insured during ongoing operations at the project. *Id.*

In *Canal Indemnity Company v. Adair Homes, Inc.*, 737 F.Supp.2d 1294, 2010 U.S. Dist. LEXIS 77688, The District Court for the Western District of Washington held that a policy containing the same language found in FMIC's j(5) exclusions "bars coverage for damages occurring during [the] construction of the home." *Canal* at 1301. Further, the Court held that the j(6) exclusion "also bars coverage for [t]hat particular piece of property that must be restored, repaired, or replaced because [the insured or its subcontractors'] work was incorrectly performed on it." *Canal* at 1302. Accordingly,

> this exclusionary language is designed to exclude coverage for defective workmanship by the insured builder causing damage to the construction project. In *Harrison Plumbing & Heating, Inc. v. New Hampshire Insurance Group, 37 Wn. App. 621, 626, 681 P.2d 875 (1984),* the court held ongoing operations exclusion ensures that an insured is not indemnified for damages resulting because the insured furnished defective materials or workmanship.
>
> Accordingly, the plain and unambiguous language of the ongoing operations exclusion bars coverage for the . . . property damages occurring during construction of the residence.

Canal at 1302.

Consequently, the property damage, even alleged to be latent, would still not be covered if it occurred during ongoing operations based on the j(5) and (6) exclusions of the policy. In *Canal,* the insured protested that the Court's ruling appears to foreclose coverage as to any possible damage, and that a purchaser of commercial general liability insurance would not expect such a result. The Court explained:

> [T]his interpretation of the exclusion is entirely consistent with commercial general liability policies. ***Commercial general liability policies are designed generally to provide coverage for a number of risks, including employee injuries while on the work site and physical damage to property other than the work of the insured.*** The two exclusions for damages to work of the insured during construction and after competition are common "business risks" exclusions, designed to prevent the commercial general liability policy from being considered a performance bond, product liability insurance, or malpractice insurance. *See, e.g., Hayden v. Mutual of Enumclaw Ins. Co.,* 141 Wn.2d 55, 64, 1 P.3d 1167 (2000); *Schwindt v. Underwriters at Lloyd's of London,* 81 Wn. App. 293,

302, 914 P.2d 119 (1996); *Aetna Cas. & Sur. Co. v. M&S Indus., Inc.*, 64 Wn. App. 916, 921, 827 P.2d 321 (1992). This is the insurance [the insured] purchased.

Canal at 1302. (emphasis added)

5. The "Your Product" Exclusion

k. Damage To Your Product

"Property damage" to "your product" arising out of it or any part of it.

CG 00 01 10 01 p. 5.

21. "Your Product":

a. Means:

(1) Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by:

(a) You;

(b) Others trading under your name; or

(c) A person or organization whose business or assets you have acquired; and

CG 00 01 10 01 p. 15.

6. The "Your Work" Exclusion

l. Damage To Your Work

"Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard".

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a sub-contractor.

CG 00 01 10 01 p. 5.

7. The "Impaired Property" Exclusion

m. Damage To Impaired Property Or Property Not Physically Injured

"Property damage" to "impaired property" or property that has not been physically injured, arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work"; or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

CG 00 01 10 01 p. 5.

SECTION V – DEFINITIONS

. . .

8. "Impaired property" means tangible property, other than "your product" or
"your work", that cannot be used or is less useful because:

a. Incorporates "your product" or "your work" that is known or thought to be defective, deficient, inadequate or dangerous; or

b. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by:

a. the repair, replacement, adjustment or removal of "your product" or "your work"; or

b. Your fulfilling the terms of the contract or agreement.

CG 00 01 10 01 p. 13.

8. The Construction Management Exclusion

This insurance does not apply to "bodily injury", "property damage", "personal injury" or "advertising injury" arising out of:

1. The preparing, approving, or failure to prepare or approve, maps, shop drawings, opinions, reports, surveys, field orders, change orders or drawings and specifications by any architect, engineer or surveyor performing services on a project on which you serve as construction manager; or

2. Inspection, supervision, quality control, architectural or engineering activities done by or for you on a project on which you serve as construction manager.

This exclusion does not apply to "bodily injury" or "property damage" due to construction or demolition work done by you, your "employees" or your subcontractors.

CG D2 93 11 03 p.1.

9. The Architectural, Engineering or Surveying Professional Services Exclusion

1. . . .

"Bodily injury" or "property damage" arising out of the rendering of or failure to render any "professional services" by or on behalf of any insured, but only with respect to any of the following operations:

a. Providing or hiring independent professionals to provide, architectural, engineering, or surveying services to others in any insured's capacity as an architect, engineer or "surveyor"; or

b. Providing, or hiring independent professionals to provide, architectural, engineering, or surveying services in connection with construction work any insured performs.

. . .

3. . . .

"Professional services":

a. Includes:

(1) Preparing, approving, or failing to prepare or approve, maps, shop drawings, opinions, reports, surveys, field orders, or change orders, or preparing, approving or failing to prepare or approve, drawings and specifications; and

(2) Supervisory or inspection activities performed as part of any related architectural, or engineering or surveying activities.

b. Does not include services within construction means, methods, techniques, sequences and procedures employed by you in connection with your operations in your capacity as a construction contractor.

CG D5 46 10 11.

10. The Wrap-Up Insurance Program Exclusion

1. . . .

This insurance does not apply to "bodily injury" or "property damage" arising out of any project that is or was subject to a "wrap-up insurance program".

This exclusion does not apply to "bodily injury" or "property damage" arising out of your ongoing operations that:

a. Are being performed at any location owned "by, or rented to, you that is outside the project site for that project and is not covered by the "wrap-up insurance program" for that project; or

b. Are punch list or warranty work, if coverage was available to the insured under the "wrap-up insurance program" for "bodily injury" or "property damage" arising out of your ongoing operations and the "bodily injury" or "property damage" occurs after the expiration of all such coverage.

The exceptions in this exclusion do not apply to "bodily injury" or "property damage" included in the "products-completed operations hazard" even if you are required to provide such coverage for an additional insured by a written contract or agreement.

2. . . .

"Wrap-up insurance program" means any agreement or arrangement, including any contractor-controlled, owner-controlled or similar insurance program, under which some or all of the contractors working on a specific project, or specific projects, are required to participate in a program to obtain insurance that:

a. Includes the same or similar insurance as that provided by this Coverage Part; and

b. Is issued specifically for injury or damage arising out of such project or projects.

CG D3 91 03 07.

11. The Continuous And Progressive Injury or Damage Exclusion

> This insurance does not apply to any damages because of or related to bodily injury or property damage:
>
> 1. which first existed, or alleged to have first existed, prior to the inception date of this policy, or
>
> 2. which are, or are alleged to be, in the process of taking place prior to the inception date of this policy, even if the actual or alleged bodily injury or property damage continues during this policy period.
>
> 3. which were caused, or are alleged to have been caused, by the same condition or construction defect which resulted in bodily injury or property damage which first existed prior to the inception date of this policy.
>
> We shall have no duty to defend any insured against any loss, claim, suit or other proceeding alleging damages arising out of or related to bodily injury or property damage to which this endorsement applies.

Form CVX-GL-5066 (05/2004)

This exclusion excludes coverage for any property damage that existed or was alleged to have existed prior to the inception of the policy, even if the damage continues into the actual policy, or which were caused or alleged to have been caused by the same construction defect.

> That clause excludes coverage under the Policy from injuries that first exist, begin to take place, or are caused by any condition on the Property prior to the effective date of the Policy. Accordingly, the application of the clause turns on the timing of any and all relevant events. *See e.g.*, *Montrose Chem. Corp. v. Admiral Ins. Co*., 10 Cal. 4th 645, 42 Cal. Rptr. 2d 324, 913 P.2d 878 (Cal. 1995) (coverage of continuous or progressive injuries depends on the "timing of the accident, event, or conditions causing the bodily injury or property damage").

Mt. Hawley Ins. Co. v. Dania Distrib. Ctr., Ltd., 763 F. Supp. 2d 1359, 1366, 2011 U.S. Dist. LEXIS 9007, affirmed by 2013 U.S. App. LEXIS 5466 (11TH Cir. Fla. Mar. 20, 2013).

In a recent Washington case, the Court applied this exclusion to bar coverage for damage alleged caused by a leaking roof. The insured was hired to install the roof, and then was asked to do some repairs when leaks were found. The leaks allegedly continued. The Court found as follows:

> The evidence highlighted by FMIC shows that the property damage first existed, and was alleged to have first existed, prior to the policy period; the property damage was in the process of taking place prior to the policy period and the property damage was caused , and was alleged to have been caused, by the same defect that resulted in property damage prior to the policy period.

Zurich Am. Ins. Co. v. Ledcor, et al., King County Cause No. 09-2-12732-8 SEA (Oct. 31, 2016).

12. The EIFS Exclusion

DESIGNATED WORK EXCLUSION - EXTERIOR INSULATION AND FINISH SYSTEMS

CVX-GL-500 (07/2000)

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

PRODUCT/COMPLETED OPERATIONS LIABILITY COVERAGE PART

This insurance does not apply to "bodily injury" or "property damage" included in the "products-completed operations hazard" and arising out of "your work" described as:

1. The design, manufacture, construction, fabrication, preparation, installation, application, maintenance or repair, including remodeling, service, correction, or replacement, of an "exterior insulation and finish system" (commonly referred to as synthetic stucco) or any part thereof, including the application or use of conditioners, primers, accessories, flashings, coatings, caulking or sealants in connection with such a system.

2. Any work or operation with respect to any exterior component, fixture or feature of any structure if any "exterior insulation and finish system" is used on any part of that structure.

   For the purposes of this endorsement, an "exterior insulation and finish system" means an exterior cladding or finish system used on any part of any structure, and consisting of:

   (1) A rigid or semi-rigid insulation board made of expanded polystyrene or other materials, and

   (2) The adhesive and/or mechanical fasteners used to attach the insulation board to the substrate; and

   (3) A reinforced based coat; and

(4) A finish coat providing surface texture and color.

As set forth above, the EIFS exclusion excludes "property damage" arising out of any work or operation with respect to any exterior component, fixture or feature of any structure if any "exterior insulation and finish system" is used on any part of that structure.

One Washington Court as held that the EIFS exclusion applies even if the insured did not perform the work with the EIFS, or if the alleged property damage did not involve the EIFS. In *FMIC v. Miller Roofing, et al.,* C11-0105-JCC, 2013 Us. Dist. LEXIS 24728 (W.D. Wash. Feb. 22, 2013), the Court held that:

> The exclusion applies not only to property damage arising from *EIFS*-related work by the insured; it applies to property damage arising from "*any*" work by the insured on an exterior component, fixture, or feature of a structure, as long as "„exterior insulation and finish system‟ is used on any part of that structure." Those conditions are met here.

Miller Roofing, supra.

C. Other Policy Considerations.

In addition to the insuring agreement and exclusionary provisions of a policy, there are conditions governing the rights and duties of both the insurer and insured.

1. Transfer of Rights

> **F. TRANSFER OF YOUR RIGHTS AND DUTIES UNDER THIS POLICY**
>
> Your rights and duties under this policy may not be transferred without our written consent except in the case of death of an individual named insured.
>
> If you die, your rights and duties will be transferred to your legal representative but only while acting within the scope of duties as your legal representative. Until your legal representative is appointed, anyone having proper temporary custody of your property will have your rights and duties but only with respect to that property.

IL T0 01 01 07 (Rev. 06-09) p. 2.

2. Duties in the Event of Occurrence, Offense, Claim or Suit

a. You must see to it that we are notified as soon as practicable of an "occurrence" or an offense which may result in a claim. To the extent possible, notice should include:

(1) How, when and where the "occurrence" or offense took place;

(2) The names and addresses of any injured persons and witnesses; and

(3) The nature and location of any injury or damage arising out of the "occurrence" or offense.

b. If a claim is made or "suit" is brought against any insured, you must:

(1) Immediately record the specifics of the claim or "suit' and the date received; and

(2) Notify us as soon as practicable.

You must see to it that we receive written notice of the claim or "suit" as soon as Practicable.

c. You and any other involved insured must:

(1) Immediately send us copies of any demands, notices, summonses or legal papers received in connection with the claim or "suit";

(2) Authorize us to obtain records and other information;

(3) Cooperate with us in the investigation or settlement of the claim or defense against the "suit"; and

(4) Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the insured because of injury or damage to which this insurance may also apply.

d. 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.

CG 00 01 10 01 pp. 10-11.

3. Legal Action Against Us

No person or organization has a right under this Coverage Part:

a. To join us as a party or otherwise bring us into a "suit" asking for damages from an insured; or

b. To sue us on this Coverage Part unless all of its terms have been fully complied with.

A person or organization may sue us to recover on an agreed settlement or on a final judgment against an insured; but we will not be liable for damages that are not payable under the terms of this Coverage Part or that are in excess of the applicable limit of insurance. An agreed settlement means a settlement and release of liability signed by us, the insured and the claimant or the claimant's legal representative.

CG 00 01 10 01 p. 11.

4. Other Insurance

Most General Liability policies contain an Other Insurance provision similar to the following:

If valid and collectible other insurance is available to the insured for a loss we cover under Coverages **A** or **B** of this Coverage Part, our obligations are limited a described in Paragraphs **a.** and **b.** below:

As used anywhere in this Coverage Part, other insurance means insurance, or the funding of losses, that is provided by, through or on behalf of:

(i) Another Insurance company;

(i) Us or any of our affiliated insurance companies, except when the Non Cumulation of Each Occurrence Limit provision of Paragraph **5.** of Section **III** Limits Of Insurance or the Non Cumulation of Personal and Advertising Injury Limit provision of Paragraph **4.** of Section **III** Limits of Insurance applies because the Amendment - Non Cumulation Of Each Occurrence Limit Of Liability and Non Cumulation Of Personal and Advertising In jury Limit endorsement is included in this policy;

(ii) Any risk retention group;

(iii) Any self-insurance method or program, including any failure to buy insurance, or decision to not buy insurance, for any reason, in which case the insured will be deemed to be the provider of other insurance; or

(iv) Any similar risk transfer or risk management method.

Other insurance does not include umbrella insurance, or excess insurance, that was bought specifically to

apply in excess of the Limits of Insurance shown in the Declarations Page of this Coverage Part.

As used anywhere in this Coverage Part, other insurer means a provider of other insurance As used in Paragraph **c.** below, insurer means a provider of insurance.

a. Primary Insurance

This insurance is primary except when **b.** below applies. If this is insurance is primary, our obligations are not affected unless any of the other insurances is also primary. Then, we will share with all that other insurance by the method described in **c**. below.

b. Excess Insurance

This insurance is excess over:

(1) Any of the other insurance, whether primary, excess, contingent or on any other basis:
   a. That is Fire, Extended Coverage, Builder's Risk, Installation Risk, or similar coverage for "your work,"
   b. . . .
   c. That is insurance purchased by you to cover your liability as a tenant for "property damage" to premises rented to you or temporarily occupied by you with permission of the owner; or
   d. . . .

When this insurance is excess, we will have no duty under Coverages **A** or **B** to defend the insured against any "suit" if any other insurer has a duty to defend the insured against that "suit". If no other insurer defends, we will undertake to do so, but we will be entitled to the insured's rights against all those other insurers.

When this insurance is excess over other insurance, we will pay only our share of the amount of the loss, if any, that exceeds the sum of:

(1) The total amount that all such other insurance would pay for the loss in the absence of this insurance; and

(2) The total of all deductible and self-insured amounts under all that other insurance.

We will share the remaining loss, if any, with any other insurance that is not described in this Excess Insurance provision and was not bought specifically to apply in excess of the Limits of Insurance shown in the Declarations of this Coverage Part.

This insurance is excess over any of the other insurance, whether primary, excess, contingent or on any other that is available to the insured when the insured is added as an additional insured under any other policy, including an umbrella policy

CG 00 01 10 01 pp. 11-12; CG D4 20 07 08.

Recently, it has been observed that a number of policies are incorporating "Super Excess" clauses which have been asserted to preclude any coverage obligation, in both named insured and additional insured claims. These clauses typically look like the following:

a. This insurance is primary, expect when b. below applies.

b. This insurance is excess over any other insurance that is valid and collectible insurance available to the insured or any Additional Insured whether such insurance is primary, excess, contingent or on any other basis and regardless of the nature, type, date of issuance or limits of such other insurance available to the insured or any Additional Insured. Our obligation under this policy shall not arise until the limits of such insurance are exhausted.

c. As a condition precedent to our obligations to provide or continue to provide indemnity, coverage or defense hereunder, each insured, upon receipt of notice of any "suit", incident or "occurrence" that may give rise to a "suit" shall first demand indemnity, coverage or a defense to it. The insured waives any right it may have to insist that we provide indemnity, coverage or defense to the insured. The insured waives any rights it may have to a targeted tender or any other right to select us as the insurer to provide indemnity, coverage or defense.

Section b. is a "super-excess" clause that states the policy provides coverage which is excess to other available insurance, even if that other insurance says it also provides excess coverage. The last sentence could also be read as an escape clause because it states that the policy

does not owe any obligation until the limits of any other insurance are exhausted. In other words, the insurer escapes liability under the policy due to the presence of other insurance.

Most jurisdictions recognize that excess other insurance clauses in an otherwise primary liability insurance policy are generally enforceable as written. *See e.g. Horace Mann Ins. Co. v. General Star Nat'l Ins. Co.*, 514 F.3d 327, 330-331 (4th Cir. 2008) (citing, inter alia, *Couch on Insurance* § 219:3); *State Farm Mut. Auto. Ins. Co. v. United Servs. Auto. Ass*, 176 S.E.2d 327, 331 (Va. 1970). However, the issue becomes more complicated when there are two insurers with policies containing excess other insurance clauses which potentially cover the same loss. There is abundant case law discussing how courts resolve conflicts between other insurance clauses in multiple policies covering the same loss (i.e. excess vs. pro-rata or excess v. excess). However, cases specifically discussing the effect of "super" excess/escape language when pitted against policies with simple excess or other types of other insurance clauses are not as numerous.

a. Washington

Washington courts have addressed the effect of a super excess clause and held that it is effective and forces an insurer with a simple excess clause to provide primary coverage. *N.H. Indem. Co. v. Budget Rent-a-Car Sys.*, 148 Wn.2d 929 (2003). In that case, Budget provided liability protection for its renters, but such coverage did not apply "until after the exhaustion of all automotive liability insurance available to the driver" and it only provided coverage to the extent needed to meet the minimum coverage required by law. *Id.* at 934. The Court enforced this super-excess/escape language against a contribution claim under the driver's personal auto policy which provided that its coverage "shall be excess" with respect to non-owned vehicles. *Id.* In other words, the Court held that the Budget policy was excused from providing coverage because the driver's policy only had a simple excess other insurance clause and, therefore, that policy was required to provide primary coverage.

The holding in *Budget* was applied under similar facts without any hesitation by the Ninth Circuit in *Genie Indus. v. Fed. Ins. Co.*, 316 Fed. Appx. 540 (2008). However, the Western District of Washington held that the court does not engage in reconciling other insurance clauses (whether super-excess or not) when the two insurers provided coverage for consecutive and non-overlapping policy periods. *Devington Condo Ass'n v. Steadfast Ins. Co.*, 2007 U.S. Dist. LEXIS 19761 (W.D. Wash. March 20, 2007).

b. Oregon

Oregon courts have not addressed super-excess clauses. However, Oregon courts have consistently held that, when two insurers cover a common insured for one loss and have conflicting other insurance clauses, the other insurance clauses will be considered mutually repugnant and coverage will be split between the insurers on a pro-rata basis. *Preferred Risk Mut. Ins. Co. v. Mission Ins. Co.*, 261 Or 576 (1972) (holding an escape clause in one policy and a pro rata clause in another policy conflicted with each other and resulted in pro rata allocation); *see also Lamb-Weston v. Oregon Auto. Ins. Co.*, 219 Or 110 (1959). In *Preferred*, the Court indicated that pro rata allocation applies whenever insurers "attempt to limit or exclude its coverage where other coverage exists."

5. No Duty to Defend After Exhaustion

(2) Our right and duty to defend ends when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages **A** or **B** or medical expenses under Coverage **C**.

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6. Non-Cumulation

AMENDMENT- NON CUMULATION OF EACH OCCURRENCE LIMIT OF LIABILITY and NON CUMULATION OF PERSONAL and ADVERTISING INJURY LIMIT

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

1. Paragraph 5 of SECTION III - LIMITS OF INSURANCE, is amended to include the following:

   Non cumulation of Each Occurrence Limit - If one "occurrence" causes "bodily injury" and/or "property damage" during the policy period and during the policy period of one or more prior and/or future policies that include a commercial general liability coverage part for the insured issued by us or any affiliated insurance-company, the amount we will pay is limited. This policy's Each Occurrence Limit will be reduced by the amount of each payment made by us and any affiliated insurance company under the other policies because of such "occurrence".

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7. Designated Project(s) General Aggregate Limit

Designated Project(s):

EACH "PROJECT" FORWHICH YOUHAVE AGREED, IN A WRITTEN CONTRACT WHICH IS IN EFFECT DURING THIS POLICY PERIOD, TO PROVIDE A SEPARATE GENERAL AGGREGATE LIMIT, PROVIDED THAT THE CONTRACT IS SIGNED ANDEXECUTED BY YOUBEFORE THE "BODILY INJURY" OR "PROPERTY DAMAGE" OCCURS.

A. For all sums which the insured becomes legally obligated to pay as damages caused by "occurrences" under **COVERAGE A. (SECTION I)**, and for all medical expenses caused by accidents un- der **COVERAGE C (SECTION I)**, which can be attributed only to operations at a single designated "project" shown in the Schedule above:

1. A separate Designated Project General Aggregate Limit applies to each designated "project", and that limit is equal to the amount of the General Aggregate Limit shown in the Declarations, unless separate **Designated Project General Aggregate(s)** are scheduled above.

2. The Designated Project General Aggregate Limit is the most we will pay for the sum of all damages under **COVERAG A.**, except damages because of "bodily injury" or "property damage" included in the "products- completed operations hazard", and for medical expenses under **COVERAGE C**, regard- less of the number of:

a. Insureds;

b. Claims made or "suits" brought; or

c. Persons or organizations making claims or bringing "suits".

3. Any payments made under **COVERAGE A.** for damages or under **COVERAGE C.** for medical expenses shall reduce the Designated Project General Aggregate Limit for that designated "project". Such payments shall not reduce the General Aggregate Limit shown in the Declarations nor shall they reduce any other Designated Project General Aggregate Limit for any other designated "project" shown in the Schedule above.

4. The limits shown in the Declarations for **Each Occurrence, Damage To Premises Rented To You and Medical Expense** continue to apply. However, instead of being subject to the General Aggregate Limit shown in the Declarations, such

limits will be subject to the applicable Designated Project General Aggregate Limit.

B. For all sums which the insured becomes legally obligated to pay as damages caused by "occurrences" under **COVERAGE A. (SECTION I)**, and for all medical expenses caused by accidents under **COVERAGE C. (SECTION I)**, which cannot be attributed only to operations at a single designated "project" shown in the Schedule above:

1. Any payments made under **COVERAGE A.** for damages or under **COVERAGE C.** for medical expenses shall reduce the amount available under the General Aggregate Limit or the Products- Completed Operations Aggregate Limit, whichever is applicable; and

2. Such payments shall not reduce any Designated Project General Aggregate Limit.

C. Part **2.** of **SECTION III LIMITS OF INSURANCE** is deleted and replaced by the following:

2. The General Aggregate Limit is the most we will pay for the sum of:

a. Damages under **Coverage B**; and

b. Damages from "occurrences" under **COVERAGE A (SECTION I)** and for all medical expenses caused by accidents under **COVERAGE C (SECTION I)** which cannot be attributed only to operations at a single designated "project" shown in the **SCHEDULE** above.

D. When coverage for liability arising out of the "products-completed operations hazard" is provided, any payments for damages because of "bodily injury" or "property damage" included in the "products-Completed operations hazard" will reduce the Products-Completed Operations Aggregate Limit, and not reduce the General Aggregate Limit nor the Designated Project Aggregate Limit.

E. For the purposes of this endorsement the **Definitions Section** is amended by the addition of the following definition:

"Project" means an are away from premises owned by or rented to you at which you are performing operations pursuant to a contract or agreement. For the purposes of determining the applicable aggregate limit of insurance, each "project" that includes premises involving the same or connecting lots, or premises whose connection is interrupted only by a street, roadway, waterway or right-of-way of a railroad shall be considered a single "project".

F. The provisions of **SECTION III LIMITS OF INSURANCE** not otherwise modified by this endorsement shall continue to apply as stipulated.

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SECTION IV -- EXTRA-CONTRACTUAL CLAIMS

A. Washington

The Washington Legislature has enacted a statute that requires *all* parties to an insurance contract to act in good faith and deal fairly in insurance transactions.

> The business of insurance is one affected by the public interest, requiring that all persons be actuated by good faith, abstain from deception and practice honesty and equity in all insurance matters. Upon the insurer, the insured, their providers, and their representatives rests the duty of preserving inviolate the integrity of insurance.

RCW 48.01.030

It is important to note that the duty of good faith runs both ways. The duty rests equally on the insured as well as the insurance company. This statute establishing Washington's strong public interest in good faith insurance practices forms the foundation for Washington's tort cause of action for insurance bad faith.

1. Legal Standard for Establishing Bad Faith

Starting in the 1960's, the California Supreme Court began to adopt the concept of insurance bad faith and apply a cause of action for bad faith in situations where an insurer violated its obligations under the duty to defend. *Crisci v. Security Ins.* Co., 58 Cal. Rptr. 13, 426 P.2d 173 (1967); *Comunale v. Traders* & *Genera/Ins.* Co., 50 Cal. 2d 654, 328 P.2d 198 (1958). The most significant case in this regard was the California decision of *Gruenberg v. Aetna Insurance* Co., 108 Cal. Rptr. 480, 510 P.2d 1032 (1973). The doctrine of insurance bad faith arising out of an insurer's mishandling of its obligation to defend was subsequently extended under California law all first party insurance claims.

Washington, along with other jurisdictions, also adopted a common law tort of bad faith involving the obligation of an insurer to defend. These claims include situations where an insurance company places its own financial interests above an insured's interest by refusing to accept a policy limits demand thereby exposing its insured to an excess judgment.

Insurer bad faith claims are analyzed by applying the same principles as any other tort claim. A plaintiff must establish a duty, breach of that duty, and damages proximately caused by any breach of duty. *Mutual of Enumclaw Ins. Co. v. Dan Paulson Constr. Co.*, 161 Wn.2d 903, 916, 169 P.3d 1 (2007); *see also Cardenas v. Navigators Ins. Co.*, 2011 U.S. Dist. LEXIS 145194 (W.D. Wash. 2011).

To establish bad faith, a Plaintiff/insured must show an insurer's actions were unreasonable, frivolous, or unfounded. *Smith v. SAFECO Insurance Company*, 150Wn.2d 478, 78 P.3d 1274 (2003); *American States v. Symes of Silverdale*, 150 Wn.2d 462, 78 P.3d 1266 (2003); *Overton v. Consol. Ins.* Co., 145 Wn.2d 417, 433, 38 P.3d 322 (2002).

As long as the insurer has a reasonable basis for its claims decision there is no bad faith. *Dombrosky v. Farmers Ins.* Co., 84 Wn. App. 245, 982 P.2d 1127; *Miller v. Indiana Ins.* Co., 31 Wn. App. 475, 479, 642 P.2d 769 (1982); *Transcontinental Ins.* Co. *v. Washington Public Utilities District*, 111 Wn.2d 452, 470, 760 P.2d 337 (1988).

The *Smith* court confirmed that an insured has a heavy burden in proving that an insurer acted in bad faith. The Supreme Court stated:

> Questions of fact may be determined on summary judgment as a matter of law where reasonable minds could reach but one conclusion...The legal inquiry shapes what is a material fact. *Ellwein* speaks to that shaping. If the insured claims that the insurer denied coverage unreasonably in bad faith then the insured **must** come forward with evidence that the insurer acted unreasonably. The policyholder has the burden of proof.

Smith v. SAFECO Insurance Company, 150 Wn.2d 478, 78 P.3d 1274 (2003)(emphasis added)(internal citations omitted).

Finally, the Supreme Court in *Smith* reiterated that if an insurer acted reasonably during its claims investigation, there is no bad faith:

> If the insurer can point to a reasonable basis for its action this reasonable basis is **significant evidence** that it **did not** act in bad faith and may even establish that reasonable minds could not differ that its denial of coverage was justified.

Smith, supra.

An insurer that has a reasonable basis for withholding payment under a policy cannot be said, as a matter of law, to be acting in bad faith in such a way to invoke a tort or CPA cause of action. As the Court stated in *Miller v. Indiana Ins.* Co., 31 Wn. App. 475, 642 P.2d 769 (1982):

> Bad faith requires a showing of frivolous and unfounded denial of benefits. Indiana denied coverage based on a reasonable interpretation of the policy; this was not bad faith as a matter of law...The mere denial of benefits due to a debatable question of coverage is sufficient.

Id. at 479, 642 P.2d 769 (internal citations omitted).

Further, in *Capelouto v. Valley Forge Ins. Co*., the Court of Appeals stated:

> Our courts have rejected attempts to base bad faith and CPA claims on legal arguments when, as here, there is no showing of bad faith, there is a debatable question regarding coverage for the loss, and the denial of coverage is based on a reasonable interpretation of the insurance policy.

98 Wn. App. 7, 22, 990 P.2d 414 (1999)(internal citations omitted).

2. Bad Faith Arising Out of the Duty to Defend

The Washington Courts typically draw a distinction between the duties in a first-party property claim and a liability claim. In the liability context, the insurer's obligation to the insured is quasi-fiduciary in nature. *See Tank v. State Farm Fire* & *Casualty* Co., 105 Wn.2d 381, 715 P.2d 1133 (1986); *Safeco Insurance* Co. *of America v. Butler*, 118 Wn.2d 383, 823 P.2d 499 (1992).

The Washington Supreme Court has specifically addressed the tort of bad faith arising out of an insurer's breach of its duty to defend. This issue was first recognized in Washington in *Burnham v. Commercial Casualty Ins. v. Newark,* 10 Wn.2d 624 (1941). The standard was set forth in the decision of *Tank v. State Farm Fire* & *Casualty* Co., 105 Wn.2d 381, 715 P.2d 1133 (1986). The subsequent case of *Safeco Insurance Co. of America v. Butler*, 118 Wn.2d 383, 823 P.2d 499 (1992) clarified this rule and expanded it to set forth a doctrine of estoppel which precludes the insurer from contesting coverage due to its bad faith conduct. Finally, Washington law has adopted a standard of "equal consideration". In other words, an insurance company must give equal consideration to its insureds interest as to its own financial concerns under a liability policy. An insurer may not put its own interests ahead of its insured's. *Mut. of Enumclaw Ins. Co. v. T&G Constr., Inc.*, 165 Wn.2d 255, 269, 199 P.3d 376 (2008) (citing *Butler*, 118 Wn.2d at 389). To that end, it must defend until it is clear that the claim is not covered. The entitlement to a defense may prove to be of greater benefit to the insured than indemnity. *Truck Ins. Exch.*, 147 Wn.2d at 765.

The violation of the duty to defend and resulting tort of bad faith exposes an insurer to liability for all damages proximately caused by the bad faith conduct. This includes recovery of attorneys' fees, actual injury, tort damages, etc. Finally, an insurer may be estopped to assert coverage defenses should an insurer be found to be in bad faith. *Truck Insurance Exchange v. Van Port Homes,* 147 Wn.2d 751, 58 P.3d 276 (2003).

In *American Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 405 (2010), the Washington Supreme Court reiterated the position an insurer is only relieved of its duty to defend if the alleged claim is clearly not covered by the policy of insurance. In *Alea London,* the insurer undertook a detailed legal analysis on their own applying the law to the facts of the situation. Alea London also undertook its own interpretation of case law and relied upon that interpretation to determine that a specific policy exclusion precluded coverage and therefore did not trigger a defense obligation. The Court held:

> Alea's interpretation of Washington law fails to persuade us that its interpretation of the contract is correct. We find persuasive precedent from other states that have found claims that the insured acted negligently after an excluded event is covered. Further, a balanced analysis of the case law should have revealed at least a legal ambiguity as to the application of an "assault and battery" clause with regard to postassault negligence at the time Café Arizona sought the protection of its insurer, and ambiguities in insurance policies are resolved in favor of the insured. *Mut. of Enumclaw Ins. Co. v. Jerome*, 122 Wn.2d 157, 161, 856 P.2d 1095 (1993) (*citing Rones v. Safeco Ins. Co. of Am*., 119 Wn.2d 650, 835 P.2d 1036 (1992)).

Am. Best Food, Inc. v. Alea London, Ltd., 168 Wn.2d 398, 410-411 (2010).

3. The Washington Insurance Fair Conduct Act, RCW 48.30.015

The Washington Insurance Fair Conduct Act ("IFCA") expressly provides as follows:

> (1) Any first party claimant to a policy of insurance who is unreasonably denied a claim for coverage or payment of benefits by an insurer may bring an action in the superior court of this state to recover the actual damages sustained, together with the costs of the action, including reasonable attorneys' fees and litigations costs.
> (2) The superior court may, after finding that an insurer has acted unreasonably in denying a claim for coverage or payment of benefits or has violated a rule in subsection (5) of this section, increase the total award of damages to an amount not to exceed three times the actual damages.
> (3) The superior court shall, after a finding of unreasonable denial of a claim for coverage or payment of benefits, or after a finding of a violation of a rule in subsection (5) of this section, award reasonable

> attorneys' fees and actual and statutory litigation costs, including expert witness fees, to the first party claimant of an insurance contract who is the prevailing party in such an action.
> (4) "First party claimant" means an individual, corporation, association, partnership, or other legal entity asserting a right to payment as a covered person under an insurance policy or insurance contract arising out of the occurrence of the contingency or loss covered by such a policy or contract.

This issue as to reasonableness has been specifically addressed by the Federal Courts in Washington. The Courts have held that a party ascertaining an IFCA claim must show not only a technical violation of the Washington Administrative Code but also unreasonable conduct. The Courts have stated:

> Irrespective of the diputed [sic] time frames, the purported delay in acknowledgement of the tender and completion of an investigation was not unreasonable and not a violation of the IFCA. Although violations of the enumerated regulations provide grounds for trebling damages or for an award of attorney's fees; they do not, on their own, provide a IFCA cause of action absent an unreasonable denial of coverage or payment of benefits.
>
> Violations, if any, of the 10 and 30 day time periods for acknowledging a claim and completing an investigation, are simple technical violations and standing alone, do not evidence any unreasonable conduct on the part of Navigators in promptly responding to the tender.

Cardenas v. Navigators Ins. Co., 2011 U.S. Dist. LEXIS 145194 (W.D. Wash. 2011)(internal cites omitted).

In *Pinney v. Am. Family Mut. Ins. Co.*, the Trial Court was presented with extra-contractual claims arising out of the dispute of value in a homeowner's claim and claims that American Family violated provisions of the Washington Administrative Code. Though the Court found there was a material question of fact regarding allegations of bad faith the Court found that there had not been a denial of benefits and therefore Plaintiffs IFCA claim was dismissed. Specifically, the Court held:

> Here, the Court follows the analysis of these courts and finds a violation of one of the enumerated WAC provisions alone is not sufficient to sustain a cause of action under IFCA. Since Defendants accepted coverage at the time the Pinneys' claim was submitted, Plaintiffs Pinneys' extensive discussion of whether American Family violated WAC provisions, i.e., failed to disclose provisions, act promptly, implement standards for prompt investigation, to conduct reasonable investigations, are inapposite. Without an

> unreasonable denial of coverage, IFCA claims under individual WAC violations fail. The Court GRANTS summary judgment and dismiss Plaintiffs' claims under IFCA.

Pinney v. Am. Family Mut. Ins. Co., 2012 U.S. Dist. LEXIS 22328 (W.D. Wash. 2012).

The United States District Court for the Eastern District of Washington has also recently ruled that there must be an actual unreasonable denial of benefits to trigger IFCA exposure. *Workland & Witherspoon, PLLC v. Evanston Ins. Co.*, 2015 U.S. District LEXIS 146950 (2015).

As the Courts in *Cardenas*, *Pinney*, and *Workland* state, without an unreasonable denial of coverage, IFCA claims must fail. In other words, a value dispute or a mere technical violation of the insurance regulations do not trigger IFCA liability. Rather, IFCA liability exists when there is an unreasonable denial of coverage.

Recently, The Washington State Supreme Court issued a ruling on whether an IFCA claim arises out of a technical violation, or from an unreasonable denial. In *Perex-Crisantos v. State Farm*, 187 Wn.2d 669 (2017), the Supreme Court for the first time was asked to decide whether, in the absence of an unreasonable denial of coverage or benefits, whether IFCA creates an independent and private cause of action for an alleged violation of Washington's Unfair Claims Settlement Practices Regulations. The Court held that it does not.

In fact, the Court repeatedly to note that the statute was unclear in many regards, and found that the statute was ambiguous.

> IFCA explicitly creates a cause of action for first party insureds who were "unreasonably denied a claim for coverage or payment of benefits." IFCA does not state it creates a cause of action for first party insureds who were unreasonably denied a claim for coverage or payment of benefits or "whose claims were processed in violation of the insurance regulations listed in (5)," which strongly suggests that IFCA was not meant to create a cause of action for regulatory violations." (Internal citations omitted) (emphasis added).

In summary, in order to maintain an IFCA action, a plaintiff must show 1) a denial of a claim for coverage, 2) that the denial was unreasonable, and 3) actual damages sustained therefrom. RCW 48.30.015. Again, proof of an IFCA violation relies upon proof of unreasonable conduct.

It is unclear whether IFCA claims are limited to first-party claims as opposed to liability claims. See case law update below. Moreover, it is undecided what the term "actual damages" means in the context of the statute. However, the Eastern District of Washington has ruled that emotional distress damages, attorney's fees, and litigation costs do not qualify as "actual damages". *Schreib v. Am. Family Mut. Ins. Co*., 2015 U.S. Dist. LEXIS 118189, 13 (W.D. Wash. Sept. 3, 2015).

However, there most recent cases apply IFCA to third-party claims. In *Navigators Spec. Ins. Co. v. Christenson Inc., et al.,* A Washington Court found that the legislative intent of the statute was to include third-party claims as well. *Christensen Inc.,* 140 F. Supp. 3d 1097 (W.D. Wash. 2015).

4. The Consumer Protection Act, RCW 19.86, et. seq.

In the 1950's and the 1960's, individual states began to enact consumer protection laws. These acts were generally modeled after §5 of the *Federal Trade Commission Act* [codified in 1938 as 15 U.S.C. 45(a)(1)] which was adopted by Congress to protect United States citizens against unfair trade practices. See Generally Note, *Toward Greater Equality in Business Transactions: A Proposal to Extend the Little FTC Acts to Small Businesses,* 96 Harv. L. Rev. 1621 (1983). Washington, along with Rhode Island, New York and Alaska, led the states in enacting consumer protection legislation. *Lovett, Private Actions for Deceptive Trade Practices,* 23 Ad. L. Rev. 271, 275 (1971).

In 1961, the Washington Legislature adopted RCW 19.86.020, which provides that unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce were declared unlawful.

The key provisions of the Act are set forth as follows:

> **19.86.020 Unfair competition, practices, declared unlawful.**
>
> Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.
>
> **19.86.090 Civil action for damages--Treble damages authorized-Action by governmental entities**
>
> Any person who is injured in his or her business or property by a violation of RCW 19.86.020, 19.86.030, 19.86.040, or 19.86.060, or any person so injured because he or she refuses to acceded to a proposal for an arrangement which, if consummated, would be in violation of RCW 19.86.030, 19.86.040, 19.86.050, or 19.86.060, may bring a civil action in superior court to enjoin further violations to recover the actual damages sustained by him or her, or both, together with the costs of the suit, including a reasonable attorney's fee, and the court may in its discretion, increase the award of damages to an amount not to exceed three times the actual damages sustained.

In order to successfully show a violation of the Consumer Protection Act, R.C.W. 19.86 et al., a party must prove each of the following elements by a preponderance of the evidence:

1. an unfair or deceptive act or practice;
2. occurring in trade or commerce;
3. impacting the public interest;
4. injury to business or property; and
5. a proximate causal relationship between the act and the injury.

Hangman Ridge Training Stables v. Safeco Title Insurance Co., 105 Wn.2d 778, 719 P.2d 531 (1986). Specifically, in the context of insurance cases, an insured must prove all five *Hangman Ridge* elements. *Industrial Indemnity Insurance* Co. *v. Kallevig,* 114 Wn.2d 907, 923, 792 P.2d 520 (1990).

In regard to handling an insurance claim, an insurer is directly regulated by WAC 284-30 *et al*., which sets forth a number a regulations which must be complied with by insurance companies in the context of adjusting and investigating claims. All claims representatives should be familiar with these rules.

WAC 284.30.300 states:

> **WAC 284-30-300 Authority and purpose.** RCW 48.30.010 authorizes the commissioner to define methods of competition and acts and practices in the conduct of the business of insurance which are unfair or deceptive. The purpose of this regulation, WAC 284-30-300 through 284-30-410, is to define certain minimum standards which, if violated with such frequency as to indicate a general business practice, will be deemed to constitute unfair claims settlement practices.

These regulations are based on a model Fair Claims Settlement Practice Act. These model acts have been adopted in most state jurisdictions across the United States. As addressed below, violations of these provisions may lead to bad faith or Consumer Protection Act claims.

a. Unfair or Deceptive Acts or Practices

Washington law is clear in the insurance context as to what constitutes an unfair act or practice. The Washington State Supreme Court's reasoning in the case of *Industrial Indemnity Insurance* Co. *v. Kallevig,* 114 Wn.2d at 923, sets forth the following analysis: If an insurer violates any one of the conditions set forth in WAC 284.30 *et al*., such violation will be a violation of the insurer's obligation of good faith codified under R.C.W. 48.01.030. This violation of the good faith statute in turn constitutes a *per se* unfair act or practice.

In short, if there is a single violation of any one of the regulatory requirements, the first element of the *Hangman Ridge* five-part test is met. There is no need to show that the violation is more than a technical violation or that there has been a pattern of violations.

b. Occurring in Trade or Commerce and Impacting the Public Interest

The Washington courts have held that the business of insurance is one involving trade or commerce and that the public has an interest in that business. As a result, these elements are deemed satisfied where an insured has proven an unfair act or practice in the business of insurance. See *Salois v. Mutual of Omaha,* 90 Wn.2d 355, 581 P.2d 1349 (1978); *Escalante v. Sentry Insurance,* 49 Wn.App. 375, 743 P.2d 832 (1987).

It is important to note, however, that actions occurring following the commencement of an action may not qualify as being in trade or commerce. Specifically, in *Blake v. Federal Way Cycle Center,* 40 Wn.App. 302, 698 P.2d 578 (1985), the Washington courts held that actions on the part of a party during the course of litigation were not actions occurring in trade or commerce. As a result, such actions cannot be the grounds for a violation of the Consumer Protection Act. Obviously, *Blake* is a non-insurance case. Whether or not an insurance company's activities during the course of litigation can be grounds for a Consumer Protection Act claim or bad faith claim is undecided in any published decision in Washington. A number of superior courts, however, have followed the *Blake* rationale. This rationale is also supported by the California State Supreme Court which has held that actions committed by an insurance company during the course of litigation cannot be the grounds for claim of insurance bad faith. See *California Physicians v. Superior Court,* 12 Cal.Rptr. 2d 95 (1992).

c. Injury to Business or Property Proximately Caused by the Violation

The most crucial element in the five-part test, and the one that is most frequently overlooked, is the injury element. An insured must establish injury to business or property. A failure to do so will result in the dismissal of the claim.

R.C.W. 19.86.090 specifically requires a showing of injury to business or property. Moreover, the Washington courts have consistently held that the failure to establish such injury to business or property bars recovery under the Consumer Protection Act. See *Seattle Rendering v. Darling-Delaware,* 104 Wn.2d 15, 71 P.2d 502 (1985); *Hangman Ridge Training Stables v. Safeco,* at 792-793; *Galvin,* 57 Wn.App. 47, 786 P.2d 804 (1990); *Sign-0-Lite Signs v. DeLaurenti Florists,* 64 Wn.App. 553, 546, 825 P.2d 714 (1992). In a bad faith claim involving property coverage an insured must also show actual damages. *Coventry* Associates *v. American States Ins.* Co., 136 Wn.2d 269, 961 P.2d 933 (1998). In the duty to defend context, however, these damages are presumed. *Butler v. SAFECO Ins.* Co., 118 Wn.2d 383, 823 P.2d 499 (1992); *Truck Insurance Exchange v. Van Port* Homes, 147 Wn.2d 751, 58 P.3d 276 (2003).

Under Washington law, emotional distress or inconvenience do no constitute actual injury to business or property under the Consumer Protection Act in the absence of pecuniary loss. *Keyes* v. *Bollinger,* 31 Wn.App. 286, 640 P.2d 1077 (1982). Moreover, attorneys' fees do not constitute such injury. *Sign-0-Lite Signs v. DeLaurenti Florists, supra.*

The Washington Supreme Court has specifically held that personal injury damages and damages for emotional distress are not compensable under the Consumer Protection Act. In *Physicians Insurance Exchange v. Fisons Corp.*, 122 Wn.2d 299, 858 P.2d 1054 (1993) the Court held as follows:

> The *Stevens Court* 54 Wn.App at 37 concluded that had our legislature intended to include actions for personal injury within the coverage of the CPA it would have used a less restrictive phrase than "injured in his or her business or property." We agree, personal injuries are not compensable damages under the CPA. . .

Fisons, 122 Wn.2d at p. 318.

5. The Olympic Steamship Doctrine

In *Olympic Steamship v. Centennial Insurance,* 117 Wn.2d 37, 811 P.2d 673 (1991), the Washington Supreme Court adopted a common law rule allowing an insured to recover attorneys' fees in coverage litigation.

The case of *Estate of Jordan v. Hartford Accident and Indemnity* Co., 120 Wn.2d 90, 849 P.2d 403 (1993) clarified this situation apparently once and for all. In that case the Supreme Court extended the *Olympic Steamship* award to all insurance cases, including first party disputes, and regardless of whether the policy provided for fees. The Supreme Court also has held that this rule does not allow for an insurer's recovery of fees if the insurer prevails. *Gossett v. Farmers,* 82 Wn.App. 375, 382, 917 P.2d 1124 (1996), *rev'd on other grounds,* 133 Wn.2d 954, 948 P.2d 1264 (1997)

The Supreme Court in *Dayton v. Farmers Insurance Group,* 124 Wn.2d 277, 280, 876 P.2d 435 (1994), has limited the application of attorneys' fees awards under *Olympic Steamship.* The Court held that Washington follows the American Rule in not awarding attorneys' fees in the absence of contract, statute, or recognized ground of equity providing for fee recovery. The Court went on to state in *Dayton,* 124 Wn.2d at 280:

> We have recognized a narrow exception to this Rule where the specific facts or circumstances warrant. *Olympic Steamship* presented such a situation.

Dayton, 124 Wn.2d at p. 280.

The Court distinguished *Olympic Steamship* and found that in disputes as to the amount of loss there could be no recovery for fees.

> Unlike the insured in *Olympic Steamship,* Mr. Dayton has not compelled Farmers to honor its commitment to provide coverage.

> Instead, this case presents a dispute over the value of the claim presented under the policy. Such disputes are not properly governed by the Rule in *Olympic Steamship.*

Dayton at p. 280.

6. Negligence

The issue of negligent claims handling was first addressed by the Washington Supreme Court in *Coventry v. American States Ins. Co.*, 136 Wn.2d 269, 961 P.2d 933 (1998).

In *Coventry*, American States conceded that it acted in bad faith in investigating Coventry's claim. However, American States contended its bad faith was not actionable, as a matter of law, because the policy issued to Coventry did not provide coverage for the loss. Essentially, American States argued that because its denial of Coventry's claim was ultimately proved to be correct, Coventry was not harmed as a result of American States' bad faith investigation of the claim.

The Court declined to adopt American States' argument. Specifically the Court held:

> American States would have us adopt the same "no harm, no foul" rule, in which bad faith is not actionable, as a matter of law, when the insured's policy does not provide coverage for the loss. We decline to do so.
>
> We hold an insured may maintain an action against its insurer for bad faith investigation of the insured's claim and violation of the CPA regardless of whether the insurer was ultimately correct in determining coverage did not exist. An insurer's duty of good faith is separate from its duty to indemnify if coverage exists. This result creates no insurmountable burden on the insurer. The insurer is required only to fulfill its contractual and statutory obligation to fully and fairly investigate the claim. The problem arises when the insurer fails to investigate, in bad faith, thereby placing the insured in the difficult position of having to perform its insurer's statutory and contractual obligations.

Coventry, 136 Wn.2d at 279.

The Court continued in its analysis by stating that reasonableness is a defense to the actions of the insurance company. Realizing that mistakes happen the Court held, [a]s long as the insurance company acts with honesty, bases its decision on adequate information, and does not overemphasize its own interest, an insured is not entitled to base a bad faith or CPA claim against its insurer on the basis of a good faith mistake." *Coventry*, 136 Wn.2d at 280.

B. <u>Oregon</u>

1. Negligence Tort Claims

Under Oregon law, the courts have concluded that "bad faith" claims are contractual in nature. *Radcliffe v. Franklin Nat'l Ins. Co*., 208 Or. 1 298 P.2d 1002 (1956); *Georgetown Realty v. Home Ins. Co.*, 313 Or. 97, 831 P.2d 7 (1992). As a result, Oregon does not allow for separate bad faith remedies. *Farris v. U.S. Fidelity & Guaranty Co.*, 284 Or. 453, 587 P.2d 1015 (1978). Moreover, Oregon law does not provide a "coverage by estoppel" remedy where an insurer has relied on a coverage exclusion to avoid the duty to defend. *Timberline Equipment Co v. St. Paul Fire & Marine Ins. Co.*, 281 Or. 639, 576 P.2d 1244 (1978) *DeJonge v. Mutual of Enumclaw*, 315 Or. 237, 843 P.2d 914 (1992). *Northwest Pump v. American States Ins. Co.*, 144 Or.App. 222, 925 P.2d 1241 (1996).

Oregon courts have recognized, however, a claim for negligence. Negligence claims brought by an insured against its insurer have been sustained in Oregon in three circumstances:

> (1) When the insurer has made negligent misrepresentations concerning coverage;
> (2) When an agent of the insurer has voluntarily given the insured advice, upon which the insured relies to its detriment; and
> (3) When an insurer fails to settle an excess claim within the policy limits where it has undertaken a defense of the insured.

The third scenario is most clearly discussed in the case of *Georgetown Realty, Inc.* v. *Homes Ins. Co*., 313 Or. 97, 831 P.2d 7 (1992). The Supreme Court of Oregon formally recognized a duty independent of the contract in liability insurance situations where the insurer undertakes to defend the insured. The Supreme Court decided that a breach of this duty by the insurer in failing to settle an excess claim within the policy limits where the insurer is controlling the defense may give rise to tort liability. Specifically, it held that an insured can make a negligence claim against its liability insurer based upon failure to exercise good faith in the settlement of a claim against the insured when the result is an excess monetary payment that the insured must pay.

Tort claims are not allowed against insurers who wrongfully deny a defense. Rather the insured is limited to contract damages only because the insurer never assumed a fiduciary duty of defense. *Farris v. U.S. Fidelity & Guaranty Co.*, 284 Or. 453, 587 P.2d 1015 (1978).

Punitive Damages are authorized in the situation where a tort claim is made against the insurer to act in good faith by refusing to settle after undertaking the defense, if the insured can show "aggravating factors" regarding the insurer's actions in breaching its duties. A showing beyond mere negligence is required in that instance. *See Georgetown Realty v. Home Insurance Company*, 113 Or. App. 641, 833 P.2d 1333 (1992).

2. Attorney's Fees

The statute that addresses when a plaintiff can obtain attorneys' fees from an insurer on a matter involving an insurance case is ORS 742.061. This statute provides in pertinent part as follows:

> (1) Except as otherwise provided in subsections (2)[1] and (3)[2] of this section, if settlement is not made within six months from the date proof of loss is

[1] This subsection is inapplicable here since it addresses PIP benefits.
[2] This subsection is inapplicable here since it addresses UIM benefits.

> filed with an insurer and an action is brought in **any court of this state upon any policy of insurance of any kind or nature**, and the **plaintiff's recovery** exceeds the amount of any tender made by the defendant in such action, a reasonable amount to be fixed by the court as attorney fees shall be taxed as part of the costs of the action and any appeal thereon. If the action is brought upon the bond of a contractor or subcontractor executed and delivered as provided in ORS 279B.055, 279B.060, 279C.380 or 701.430 and the plaintiff's recovery does not exceed the amount of any tender made by the defendant in such action, a reasonable amount to be fixed by the court as attorney fees shall be taxed and allowed to the defendant as part of the costs of the action and any appeal thereon. If in an action brought upon such a bond the surety is allowed attorney fees and costs and the contractor or subcontractor has incurred expenses for attorney fees and costs in defending the action, the attorney fees and costs allowed the surety shall be applied first to reimbursing the contractor or subcontractor for such expenses.
>
> […]

ORS 742.061 (emphasis added).

In 2012, the Oregon Supreme Court decided *Morgan v. Amex Assurance Company*, 352 Ore. 363 (2012). In this case, the court interpreted ORS 742.061 and whether the statute applied to any insurance case in Oregon, regardless of whether the policy was issued in or delivered in Oregon and applies to out-of-state insurers. In this case, Morgan, a Washington resident, had an auto policy issued to her by Amex Assurance Company, an Illinois insurer. The policy was delivered to her in Washington. While driving her vehicle in Oregon, she was involved in an automobile accident within the territorial boundaries of Oregon. The tortfeasor driver was uninsured. Morgan made a UIM claim, which Amex denied based on some interpretation it had of its policy. She sued Amex in Oregon. After they settled, she made an application for attorneys' fees under ORS 742.061. Amex disputed her entitlement to fees based on its interpretation of a later enacted statute within the same chapter, ORS 742.001. This statute provided that "[t]his chapter [i.e., chapter 742]," applies "to all insurance policies delivered or issued for delivery in" Oregon. Amex argued that this statute dictated that ORS 742.061 applied **only** to policies delivered within Oregon. The trial court denied her request, which was upheld on appeal.

The Oregon Supreme Court reversed this decision. In analyzing the statute and its extensive legislative history, the Oregon Supreme Court concluded that the context of the involved statutes and the legislative history were such that the Oregon legislature did not intend to limit the scope of ORS 742.061 to policies delivered in Oregon. As a result, ORS 742.061 would apply to out of state insurers and also to policies created outside of Oregon and delivered outside of Oregon.

3. Application of ORS 742.061 to Third Party Liability Claims

ORS 742.061 is viewed as remedial in nature and not a matter of regulating the business of insurance in Oregon. It essentially describes a remedy available to a prevailing party against a defendant insurer when the action is on the insurance policy. By its terms, ORS 742.061 applies

to any action brought in Oregon on any insurance policy of any kind. The statute also describes a "plaintiff" prevailing against the insurer. It does not use the word "insured."

Although most cases deal with first party claims, ORS 742.061 has been applied in a third party liability insurer context. In *Kessler v. Weigandt*, 73 Ore App.48 (1985), Kessler was involved in an automobile accident with Weigandt. Weigandt was insured by USAA. Kessler settled with USAA for the "policy limits," but then a dispute arose as to what the remaining policy limits were due to advances made to Kessler. USAA became a direct defendant in the case. Kessler made an application for fees under ORS 742.061 (which was numbered differently at the time of this action). The Oregon courts allowed Kessler to claim fees incurred after USAA became a party, reasoning that a "judgment creditor that successfully sues its judgment debtor's insurer is entitled to attorney fees under ORS [742.061]." *Kessler* at 51. The court further reasoned that when an action becomes one upon the insurance policy, ORS 742.061 applies. The language of using "plaintiff" rather than "insured" in ORS 742.061 also seems relevant.

4. Director Enforcement of Regulatory Violations

Oregon statute 731.256 permits the Director of the Department of Consumer and Business Services to initiate actions necessary for the enforcement of any provision of the Insurance Code. However, it does not create a private cause of action for violations of the Insurance Code or other law applicable to insurance operations. *See Hansen v. Western Home Ins. Co.*, 89 Ore. App. 68, 747 P.2d 1007 (1987).

SECTION V - SPECIFIC AREAS OF CONCERN AND PROBLEMS

A. Timely Responses to Tenders

Consistent with most jurisdictions, Washington has explicit regulatory requirements involving responses to notifications of claims. For example, under the Washington regulations, the WACs provide as follows:

> (1) Within ten working days after receiving notification of a claim under an individual insurance policy, or within fifteen working days with respect to claims arising under group insurance contracts, the insurer must acknowledge its receipt of the notice of claim.
>
> (a) If payment is made within that period of time, acknowledgment by payment constitutes a satisfactory response.
>
> (b) If an acknowledgment is made by means other than writing, an appropriate notation of the acknowledgment must be made in the claim file of the insurer describing how, when, and to whom the notice was made.
>
> (c) Notification given to an agent of the insurer is notification to the insurer.

WAC 284-30-360(1)

As a result, under the rules applicable in Washington, an acknowledgement of a claim must be made within ten working days. The law is unclear in regard to whether the acknowledgment can be via email or written correspondence, or what constitutes "notation of acknowledgement" in the claim file.

For example, the WACs also provide as follows:

> (3) If the insurer needs more time to determine whether a first party claim should be accepted or denied, it must notify the first party claimant within fifteen working days after receipt of the proofs of loss giving the reasons more time is needed. If after that time the investigation remains incomplete, the insurer must notify the first party claimant in writing stating the reason or reasons additional time is needed for investigation. This notification must be sent within forty-five days after the date of the initial notification and, if needed, additional notice must be provided every thirty days after that date explaining why the claim remains unresolved.

WAC 284-30-380(3)

The Washington regulation relating to the investigation of claims is as follows:

> Every insurer must complete its investigation of a claim within thirty days after notification of claim, unless the investigation cannot reasonably be completed within that time. All persons involved in the investigation of a claim must provide reasonable assistance to the insurer in order to facilitate compliance with this provision.

WAC 284-30-370 (emphasis added).

B. Failure to Respond to Pertinent Communications

Once again, this issue is typically controlled through the regulations. For example, the Washington regulation provides as follows:

> (3) For all other pertinent communications from a claimant reasonably suggesting that a response is expected, an appropriate reply must be provided within ten working days for individual insurance policies, or fifteen working days with respect to communications arising under group insurance contracts.

WAC 284-30-360(3)

C. Failure to Settle

An insurer's failure to settle is one of the most common bases for a bad faith claim. Usually, the case law arises in situations involving third-party liability claims. The common law has typically

been adopted by regulatory requirements. For example, the Washington regulation provides as follows:

> The following are hereby defined as unfair methods of competition and unfair or deceptive acts or practices of the insurer in the business of insurance, specifically applicable to the settlement of claims:
>
> . . .
>
> (6) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear. In particular, this includes an obligation to promptly pay property damage claims to innocent third parties in clear liability situations. If two or more insurers share liability, they should arrange to make appropriate payment, leaving to themselves the burden of apportioning liability.

WAC 284-30-330(6).

The Washington Courts have also held that part of the duty to defend includes the duty to settle within policy limits where the insured is facing an excess exposure and the insurer is presented with an opportunity to settle within limits. *Besel v. Viking Ins. Co., 144 Wn.2d 1016; 32 P.3d 283 (2001).*

In Besel, the insured driver was involved in a single vehicle accident that caused substantial personal injuries to his passenger. The passenger's attorney made multiple offers to settle the personal injury claims with the driver's insurer for the available $25,000 liability limit on the subject policy. Viking refused to settle the passenger's claim due to the potential for other claims from other passengers in the vehicle. The passenger then entered into a settlement in the amount of $175,000 directly with the insured/driver. In finding Viking liable for the full amount of the settlement, the Washington Supreme Court held as follows:

> We have long recognized if an insurer acts in bad faith by refusing to effect a settlement for a small sum, an insured can recover from the insurer the amount of a judgment rendered against the insured, even if the judgment exceeds contractual policy limits. . .
>
> The same rule applies when an insured settles in similar circumstances. An insured may independently negotiate a settlement if the insurer refuses in bad faith to settle a claim. In such a case, the insurer is liable for the settlement to the extent the settlement is reasonable and paid in good faith.

*Besel,*144 Wn. 2d at 890.

D. <u>Garnishment Proceedings</u>

An insurer who has reserved its right to assert certain coverage issues, but does not file a Declaratory Judgment Action before resolution of the underlying action, may find itself in a difficult position. When this happens, the underlying Plaintiff may attempt to garnish the insurance funds in satisfaction of a judgment. The insurer may then be forced to litigate its coverage issues in the context of a garnishment proceeding. This is a difficult and undesirable venue for such an action.

The Oregon Court of Appeals issued a decision in the matter of *FountainCourt Homeowner' Association v. Fountain Court Development, LLC, et al.* that exemplifies why insurers should not wait to litigate their coverage defenses in Oregon and also underscores the difficulties of litigating coverage defenses in garnishment proceedings in that jurisdiction. *FountainCourt Homeowner' Association v. FountainCourt Development, LLC et al.*, 264 Ore. App. 468, 334 P.3d 973 (2014).

FountainCourt arose out of a construction defect claim regarding a housing development in Beaverton, Oregon (hereinafter the "Project"). After judgment was entered in favor of the Plaintiff HOA, the HOA initiated garnishment proceedings against American Family. Specifically, the HOA alleged that American Family's policy proceeds were property that was subject to garnishment. In response, American Family counterclaimed for declaratory judgment and asked that the case be removed from the garnishment calendar and placed on the regular trial calendar. American Family raised multiple coverage defenses, including the argument that the damage did not result from an "occurrence" and did not occur during American Family's policy period.

The Garnishment Court rejected American Family's request to have the case put on the regular trial calendar of the Oregon Circuit Court and instead ruled that it was appropriate to proceed with the consideration of coverage on an expedited calendar with minimal discovery.

Following the Garnishment hearing, the Court found that the HOA had met its initial burden of proving coverage for the judgment under American Family's policies. The Garnishment Court then held that the burden then shifted to American Family to prove what portions of the judgment entered against the subcontractor were not covered under the policy. The Garnishment Court found that American Family failed to meet its burden. As a result, the Garnishment Court dismissed American Family's counterclaim for declaratory relief and entered judgment against American Family for the previously unsatisfied portion of the judgment against the insured subcontractor.

On appeal American Family argued that the HOA had failed to meet its initial burden of proving a trigger of coverage. Specifically, American Family argued the following:

- The HOA did not prove a trigger of coverage under the insuring agreement because the judgment included damages that do not qualify as "property damage." Specifically, American Family argued that because the judgment did not segregate between damage to the Project and damage to the Subcontractor's work the HOA had failed to show that all the damage in the judgment were for "property damage."

- The HOA failed to demonstrate that the coverage was triggered under the insuring agreement because the HOA did not show that the judgment was for "property damage" that occurred solely during American Family's policy period.

The Appellate Court disagreed. First the Court held that the insured's initial burden only required the HOA to demonstrate that the judgment was because of "property damage," physical damage to tangible property. Contrary to American Family's contention, the Court held that the insured's burden to demonstrate "property damage" did not include the burden to show that the "property damage" was to property other than the insured's work.

Second, the Court held that the judgment did, in fact, include an award for damages because of "property damage" as used in the insuring agreement. Specifically, the Court held that the Subcontractor was held liable for physical damage to the HOA's property resulting from the Subcontractor's negligence.

Finally and most importantly, the Court held that under the insuring agreement the insured is only required to demonstrate that the judgment could have been for "property damage" that occurred during the policy period. Moreover, once the insured had met that burden, American Family was required to show that some portion of the damages included in the judgment did not reflect property damage occurring during the policy period.

Based on the foregoing, the Appellate Court affirmed the Garnishment Court's judgment. The Court held that the Garnishment Court did not err in ruling that the coverage dispute was properly resolved in the garnishment proceeding as opposed to a regular declaratory judgment action. The Court further held that the Garnishment Court did not err in entering judgment against American Family for the remaining unsatisfied portions of the underlying judgment.

These holdings represent a cautionary tale for insurers. Specifically, it is dangerous to wait until after a judgment against your insured has been entered to file a declaratory judgment action. Insurers that delay resolving coverage issues will have the difficult task of proving their coverage defenses based upon a judgment that will most likely be silent on the facts most crucial to the insurer's coverage defenses. The insurer, as a garnishee, will be presented with the task of attempting to decipher what damages were included in the Jury award and whether any exclusion could be applied to the same.

Furthermore, the expedited process of a garnishment hearing substantially prejudices an insurers' ability to prove up its case. Specifically, and as was the case in *FountainCourt*, the insurer will most likely be given limited discovery and even shorter time to prepare for the garnishment hearing.

SECTION VI - CONSENT JUDGMENTS

Over the past 15 years there has been a dramatic increase in the number of consent settlements arising from insurance claims. Such consent settlements typically arise in a situation where a liability insurer allegedly fails to either settle a claim or defend its insured. This allows the insured to proceed to settle the claim with the third party in exchange for the third party agreeing not to execute upon the settlement. In exchange for the covenant not to execute, the

insured assigns whatever extra contractual and contractual claims the insured has against their own insurer. This type of a consent settlement and assignment of a bad faith claim has become particularly common in the context of liability claims arising out of construction defect cases.

The increased frequency of construction defect claims has resulted in numerous situations wherein parties enter into stipulated settlements with accompanying covenants not to execute. Washington Supreme court decisions involving bad faith in the context of liability coverage cases have created a "cottage industry" wherein insurers are sued for bad faith following such settlements. See *Water's Edge Homeowners Ass'n v. Water's Edge Assocs*., 152 Wn. App. 572, 216 P.3d 1110 (2009), *review denied*, 168 Wn.2d 1019 (2010).

The typical pattern in these cases is as follows. A claim is made by a homeowner's association against a developer or general contractor. In many instances the general contractor tenders the claim to subcontractors. The general or subcontractor tenders the claim to their respective liability carrier. In almost all cases there are coverage issues which arise. The liability insurers may defend under a reservation of rights. The contractor or subcontractor retains personal coverage counsel. Personal counsel may request that the liability carrier split their file between a liability adjuster and a coverage adjuster. Personal counsel then may request that the assigned defense counsel refrain from providing any information to the coverage adjuster. In Washington, assigned defense counsel should refrain from providing any information to the insurance company which can be detrimental to his/her client. Such disclosure would be in violation of his/her obligations as set forth in the decision of *Tank v. State Farm Fire & Casualty Co.*, 105 Wn.2d 381, 715 P.2d 1133 (1986).

Thereafter a mediation is scheduled or settlement is discussed between the underlying plaintiff and general contractor or subcontractor. A settlement is reached. The settlement includes a covenant not to execute with an assignment of the defendant's contractual and extra contractual rights under the insurance policy.

The plaintiff then takes the bad faith assignment and pursues the liability carrier directly. By arguing that the liability carrier acted in bad faith in not settling the case, refusing to defend, or not being prepared at a mediation, the plaintiff may be able to hopefully avoid the application of any policy exclusions or limitations. Specifically, under the decision in the *Van Port* case a showing of bad faith may preclude raising such defenses or policy limitations. *Truck Insurance Exchange v. Van Port Homes*, 147 Wn.2d 751, 58 P.3d 276 (2003).

By utilizing this strategy, the underlying plaintiff and defendant may be able to expose an insurance company to the full payment for the plaintiff's claims even though there are valid policy limitations or exclusions which would probably preclude the coverage and result in there being no insurance available to the defendant.

Moreover, Oregon no longer requires that parties entering into a stipulated judgment only make an assignment after entry of judgment. *Brownstone Homes Condo. Ass'n v. Brownstone Forest Heights, LLC*, 358 Or. 223, 363 P.3d 467 (2015), *reconsideration denied Brownstone Homes Condo. Ass'n v. Brownstone Forest Heights, LLC*, No. S061273, 2016 Ore. LEXIS 10 (Jan. 14, 2016). In *Brownstone*, the Supreme Court of Oregon held a consent judgment cannot terminate an insurer's obligations under the policy.

Previously, in Oregon, the so-called *Stubblefield* Rule precluded an action against an insurer based on an assignment made prior to a non-execution agreement. The *Stubblefield* Court reasoned that in such a circumstance, given the operation of the non-execution agreement, the insured assignor was no longer "legally obligated to pay" the plaintiff assignee. Therefore the insurer had no payment obligation to the assignor insured, and consequently the assignee "acquired no rights which are enforceable against the insurer." *Stubblefield v. St. Paul,* 267 Ore. 397, 400-01, 517 P.2d 262 (1973).

The *Brownstone* Court reversed *Stubblefield,* holding that *Stubblefield* had been erroneously decided. As a result, the Oregon Supreme Court held that a covenant not to execute, obtained in exchange for an assignment of rights, does not have the effect of eliminating the insurer's liability.

A. General Legal Principles Arising In Consent Settlements

The following represents some of the basic legal principles applicable to consent judgments.

1. Insured's Duty to Cooperate

Almost all insurance policies contain language requiring an insured's cooperation. The policies also prohibit a voluntary payment by an insured. This language is often implicated in consent judgments.

The Washington courts have repeatedly held that an insured has an express obligation to cooperate with its insurer. This cooperation includes producing records and documents which are considered material to an insurer. See generally, *Downie v. State Farm Fire & Cas. Co.*, 84 Wn. App. 577, 929 P.2d 484 (1997), *review denied,* 132 Wn.2d 1003 (1997); *Herman v. SAFECO Insurance Co. of America*, 104 Wn. App. 783, 17 P.3d 631 (2001); *Pilgrim v. State Farm*, 89 Wn. App. 712, 950 P.2d 479 (1997), *review denied*, 136 Wn.2d 1009 (1998); *Tran v. State Farm Fire and Cas. Co.*, 136 Wn.2d 214, 961 P.2d 358 (1998).

In the context of liability insurance the courts have specifically held that a breach of an insured's policy obligations, however, only precludes coverage if there is actual prejudice to the insurer. The burden of proof to show prejudice is on the insurance company. *Griffin v. Allstate Ins. Co.*, 108 Wn. App. 133, 140, 29 P.3d 777 (2001)

In addition, RCW 48.01.030 specifically places a burden on both an insurer and the insured and the insured's representatives to act in good faith. The statute provides:

> **48.01.030 Public Interest**
>
> The business of insurance is one affected by the public interest, requiring that all persons be actuated by good faith, abstain from deception, and practice honesty and equity in all insurance matters. Upon the insurer, the insured, their providers, and their representatives rests the duty of preserving inviolate the integrity of insurance.

RCW 48.01.030.

Oregon has also addressed an insured's cooperation duties. Specifically, with respect to a homeowner's policy of insurance.

The issue in *Safeco Ins. Co. v. Masood,* 2014 Ore. App. LEXIS 898 (Or. Ct. App. July 2, 2014) was whether an insured, after filing a claim of loss, may condition compliance with an insurer's information requests by requiring the insurer to execute a confidentiality agreement that imposes limitations on the insurer's use of the insured's personal information.

Safeco rejected the proffered confidentiality agreement and filed a declaratory action seeking a declaration that Safeco was entitled to the requested information. The trial court entered summary judgment in favor of Safeco. The Court of Appeals affirmed the lower court's decision articulating that an insured cannot condition cooperation on the negotiation of additional contractual terms.

In Oregon, the duties of insurers and insureds are limited to those derived from the policy and the implied duty of good faith and fair dealing cannot be construed in a way that changes or inserts terms into a contract.

2. Reasonableness Hearing

A reasonableness hearing is required by RCW 4.22.060. This statute states, in relevant part, the following:

> **Effect of Settlement Agreement**
>
> (1) A party prior to entering into a release, covenant not to sue, covenant not to enforce judgment, or similar agreement with a claimant shall give five days' written notice of such intent to all other parties and the court. The court may for good cause authorize a shorter notice period. The notice shall contain a copy of the proposed agreement. A hearing shall be held on the issue of reasonableness of the amount to be paid with all parties afforded an opportunity to present evidence. A determination by the court that the amount to be paid is reasonable must be secured. If an agreement was entered into prior to the filing of the action, a hearing on the issue of the reasonableness of the amount paid at the time it was entered into may be held at any time prior to final judgment upon motion of a party. The burden of proof regarding the reasonableness of the settlement offer shall be on the party requesting the settlement.

RCW 4.22.060 (1).

A reasonableness hearing is a proceeding in equity held to determine if a settlement is reasonable. *Schmidt v. Cornerstone Investments, Inc.*, 115 Wn.2d 148, 159-61, 795 P.2d 1143

(1990). Reasonableness hearings have become commonplace in Washington in cases where a settlement includes an agreed judgment with a covenant not to execute on that judgment. *Schmidt*, 115 Wn.2d 148; *Leader Nat'l Ins. Co. V. Torres*, 113 Wn.2d 366, 779 P.2d 722 (1989); *Red Oaks Condominium Owners Assn. v. Sundquist Holdings, Inc.*, 128 Wn. App. 317, 116 P.3d 404 (2005).

a. *Chaussee* & *Glover* Factors

Within the context of a reasonableness hearing, the trial court should consider numerous factors when determining the reasonableness of a settlement. Specifically, in *Glover v. Tacoma General Hospital*, the Washington Supreme Court delineated nine factors that a trial court should consider when determining if a settlement is reasonable:

1. The releasing person's damages;
2. The merits of the releasing person's liability theory;
3. The merits of the released person's defense theory;
4. The released person's relative faults;
5. The risks and expenses of continued litigation;
6. The released person's ability to pay;
7. Any evidence of bad faith, collusion, or fraud;
8. The extent of the releasing person's investigation and preparation of the case; and
9. The interests of the parties not being released.

Glover v. Tacoma General Hospital, 98 Wn.2d 708, 658 P.2d 1230 (1983), *overruled on other grounds by Crown Control, Inc. v. Smiley*, 110 Wn.2d 695, 756 P.2d 717 (1988); see also, *Chaussee v. Maryland Casualty Co.*, 60 Wn. App. 504, 803 P.2d 1339 (1991).

The Washington Court of Appeals, in *Heights at Issaquah Ridge Owners Association v. Derus Wakefield I, LLC*, Wash. App. Div. 1, 2008, 187 P.3d 306, held that not all of these factors apply in construction defect claims. The court has held:

> [T]he nature of construction defect cases requires a different approach to determining reasonableness. Construction defect cases, like the case at hand, implicate contractual liability, rather than tort liability. Here, the defendants involved are not joint tortfeasors. Instead, they face liability due to statutory warranty or contractual obligations.
>
> ...
>
> In [construction defect] cases, protecting the insurer from excessive judgments that are the product of collusion or fraud between the claimant and insured, is the main concern. Therefore, in a contract action where the insurer is intervening to protect its interests in a

> separate bad faith claim, the insurer's interest relate only to the existence of bad faith, collusion, and fraud in the settlement agreement. The remaining *Glover* factors, otherwise applicable in a tort case, are relevant here only to the extent they inform the questions of bad faith, collusion, and fraud.

Id. at 309.

As a result, in the context of a construction defect claim the only relevant facts are bad faith, collusion or fraud.

b. What Constitutes Collusion or Fraud

Washington State courts have not formally defined the parameters of a collusive settlement in a published appellate decision. The Washington Supreme Court has, however, addressed the potential for collusion, in stipulated settlements where there are covenants not to execute. As noted by our Supreme Court:

> [P]ermitting the assignment of legal malpractice claims to an adversary in the same litigation that gave rise to the legal malpractice claim ought to be prohibited because of the opportunity and incentive for collusion in stipulating to damages in exchange for a covenant not to execute judgment in the underlying litigation . . . We merely observe that the opportunity and incentive for collusion were certainly present here.

Kommavongsa v. Haskell, 149 Wn.2d 288, 67 P.3d 1068 (2003).

Courts from other jurisdictions have found that a stipulated judgment involving a covenant not to execute warrants heightened scrutiny. *Continental Casualty Co. v. Westerfield*, 961 F. Supp. 1502 (D.N.M. 1997), *Andrade v. Jennings,* 54 Cal. App. 4th 307 (1997). See also *Spence-Parker v. Maryland Casualty Group*, 937 F. Supp. 551 (E.D. Va. 1996).

In *Andrade*, the court found substantial evidence of collusion based upon manipulation of the value of the claim and the underlying parties' efforts to conceal the settlement discussions from the liability insurer. *See also Spence-Parker v. Maryland Casualty Group*, 937 F. Supp. 551 (E.D. VA 1996).

In *Continental Casualty v. Westerfield*, 961 F. Supp. 1502 (1997), the parties entered into a settlement agreement insulating the attorney from personal liability in exchange for a $29.46 million stipulated judgment and assignment of claims against the liability insurer. The court identified several indicators of collusion, based on case law and a 'comprehensive article' on the subject. *Westerfield at* 1505. *Id., citing* Schmidt, *The Bad Faith Setup*, 29 Tort & Ins. L.J. 705 (1994). The court specifically found that "collusion and fraud in this context are not necessarily tantamount to the common-law tort of fraud in that there need not be a misrepresentation of material fact." *Westerfield* at 1505.

Among the indicators of collusion listed in *Westerfield* are

> (1) the unreasonableness of the settlement amount, (2) concealment, (3) lack of serious negotiation on damages, (4) profit to the insured, and (5) attempts to harm the interest of the insurer. *Id*. All factors have the common thread of unfairness to the insurer, "which is probably the bottom line in cases in which collusion is found." *Id*.

Westerfield, supra, at page 1505.

The Court concluded that the settlement was in fact collusive. The Court commented:

> . . . .[S]ettlement agreements such as the one at hand "skew the trial process" by realigning adversarial parties into a posture whereby they both will profit by a maximum judgment against the insured. Moreover, such settlements create conflicting interests that may compromise an attorney's ability to confirm his or her conduct to such ethical obligations as candor towards a tribunal and avoiding unjustified litigation. Most importantly, the point of such agreements is "not to end the litigation but to prolong it" by confusing and distorting the issues rather than resolving the parties' disputes. *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696. 712-14 (1996).

Continental Cas. Co. v. Westerfield, 961 F. Supp. 1502, 1506 (D.N.M. 1997).

A number of other jurisdictions have held that the terms collusion or fraud in the context of a reasonableness hearing are not comparable to establishing common law fraud or collusion. As one court has stated:

> Collusion occurs when plaintiff and insured enter into "a questionable collaboration. . . to impose an uncompromised full balance of a judgment upon the insurer, while the insured incur[s] no real detriment").

Sargent v. Johnson, 551 F.2d 221, 232 (8th Cir. 1977).

For example, collusion may be found where the evidence demonstrates an absence of conflicting interests- - the "lack of opposition between a plaintiff and an insured that otherwise would assure that the settlement is the result of hard bargaining." *Indiana Sch. Dist. No. 197 & W.R. Grace & Co. v. Accident and Casualty Insurance of Winterthur*, 525 N.W.2d 600, 606 (Minn. 1995). *Indiana Sch. Dist. No. 197 & W.R. Grace & Co. v. Accident and Casualty Insurance of Winterthur*, 525 N.W.2d 600, 606 (Minn. 1995).

In *Indiana School District,* the Minnesota Court of Appeals directly addressed the issue of whether or not collusion can be ruled on as a matter of law in the context of a stipulated settlement. The court also specifically pointed out that the issue of fraud and collusion cannot be separated out from determining whether or not a settlement is reasonable. As the court stated:

> Reasonableness and collusion, however, are not readily separable issues. Collusion would make a facially reasonable settlement unreasonable in fact.

Indiana Sch. Dist. at 607.

Of particular concern to the Court was the fact that the settlement in the *Indiana Sch. Dist.* was particularly suspect in a situation where a defendant with little to lose could agree to an inflated judgment in order to avoid personal liability. *Indiana Sch. Dist*. at p. 607 citing *Alton M. Johnson Company*, 463 N.W.2d 277 (1990). In conclusion, the *Indiana Sch. Dist*. reversed a summary judgment motion wherein the trial court found that there was insufficient evidence of collusion as a matter of law. The court specifically remanded the issue for further adjudication of the factual issues which are inherent in determining whether or not the settlement was reasonable. This included ascertaining whether or not there was collusion. *Indiana Sch. Dist*. at 607-608.

Moreover, in regard to the term collusion, there are dictionary definitions which make clear that actions undertaken by parties in agreement may be collusive simply if they are not an arm's length transaction. Specifically, the following dictionary definitions apply:

> "Collusion is . . . a lack of opposition between a plaintiff and an insured that otherwise would assure that the settlement is a result of hard bargaining."

Indiana Sch. Dist. No. 917 v. Accident & Cas. Ins., 525 N.W.2d 600, 607 (Min. Ct. App. 1995).

> "[Collusion is] a questionable collaboration [between plaintiff and insured]. . .to impose an uncompromised full balance of a judgment upon the insurer, where the insured incur[s] no real detriment."

Sargent v. Johnson, 551 F.2d 221, 232 (8th Cir. 1977).

a. Burden of Proof

In a reasonableness hearing, the "burden of proof regarding the reasonableness of the settlement offer shall be on the party requesting the settlement." *See* RCW 4.22.060 (1). *Also see Adams v. Johnson*, 71 Wn. App. 599, 860 P.2d 423 (1993).

As a result, the party requesting approval of the settlement, has the burden of establishing that the settlement was free of collusion, fraud or bad faith. In other words, the plaintiff, as the party requesting approval of the settlement in this matter, bears the burden of proving reasonableness. Under *Issaquah Ridge*, reasonableness of a settlement in a contract action, the elements to consider are the existence of bad faith, collusion and fraud.

b. If Settlement Is Unreasonable, the Reasonable Amount of the Insured's Liability must Be Set by the Judge

RCW 4.22.060(1) states, in part, that a "determination by the court that the amount to be paid is reasonable must be secured." Moreover, the Court of Appeals in *Meadow Valley Owners Association v. St. Paul Fire & Marine Insurance Company*, 137 Wn. App. 810, 817, 156 P.3d 240

(2007) stated that "[I]f the court determines the settlement amount is unreasonable..., the statute requires the court to then determine a reasonable amount."

Based upon the foregoing, a court will determine what the reasonable amount of settlement is if the court determines that the settlement was unreasonable as a result of fraud, collusion or bad faith.

As a result, the new settlement value will not be set by a jury. Rather, the court at the conclusion of the reasonableness hearing or in a separate proceeding will make an award. The due process and constitutional concerns of such a procedure have yet to be fully analyzed.

c. Presumed Measure of Harm

Once the amount of the settlement is determined, there is a reasonable hearing process. That amount becomes the presumed measure of harm in any subsequent bad faith or coverage action. *Moratti v. Farmers,* 162 Wn. App. 495, 254 P.3d 939 (2011). Moreover the Washington Courts have now made it clear that that presumed measure of harm is not the ceiling on any potential damages. Rather that amount is only a floor. *Miller v. Kenny*, 325 P.3d 278 (2014). As a result the amount determined in the reasonable hearing can potentially be trebled under IFCA or additional damages such as attorney's fees can be added.

SECTION VII- CASE LAW UPDATE

A. Washington

1. Perez-Crisantos v. State Farm, 187 Wn.2d 669 (2017)

The *Perez-Crisantos* Court was asked to decide whether, in the absence of an unreasonable denial of coverage or benefits, the Insurance Fair Conduct Act (IFCA) creates an independent and private cause of action for an alleged violation of Washington's Unfair Claims Settlement Practices Regulations. The Court held that it does not.

In that matter, the insured appealed directly to the Washington Supreme Court, seeking a determination as to whether IFCA creates an independent and private cause of action for an insurer's technical violation of the Unfair Claims Settlement Practices Regulations in the absence of an unreasonable denial of coverage or benefits.

Like many of the federal courts before it, the Washington Supreme Court struggled with the interplay of paragraphs 2, 3, and 5 of the statute, and ultimately found that the statute was ambiguous. The Court further admitted that the result of an isolated regulatory violation was not clear.

> IFCA explicitly creates a cause of action for first party insureds who were "unreasonably denied a claim for coverage or payment of benefits." IFCA does not state it creates a cause of action for first party insureds who were unreasonably denied a claim for coverage or payment of benefits or "whose claims were processed in violation of the insurance regulations listed in (5)," which strongly suggests

> that IFCA was not meant to create a cause of action for regulatory violations." (Internal citations omitted) (emphasis added).

The Washington Supreme Court then advised that Washington's current pattern jury instruction on IFCA is a misstatement of the law. The current pattern instruction concludes that IFCA creates a cause of action if an insurer "unreasonably denied a claim for coverage" or "unreasonably denied payment of benefits," or "*violated a statute or regulation governing the business of insurance claims handling.*" Based on the foregoing, this instruction is clearly incorrect.

2. Xia v. Probuilders, 188 Wn.2d 171, 400 P.3d 1234 (2017)

In *Xia,* the Plaintiff purchased a home built by Issaquah Highlands 48, LLC. Soon after moving in, the Plaintiff began feeling ill and it was determined that an improperly installed exhaust vent had been allowing carbon monoxide into the residence. The *Xia* Plaintiff filed a personal injury lawsuit against Issaquah Highlands, which tendered the lawsuit to its liability insurer, ProBuilders Specialty Insurance Company.

ProBuilders denied coverage, including any defense obligation, on the basis of two exclusions – the "townhouse" exclusion and the "pollution" exclusion. The *Xia* Plaintiff and Issaquah Highlands entered into a consent judgment settlement in the amount of $2 million with a covenant not to execute and an assignment of Issaquah Highland's rights against ProBuilders to the Plaintiff. The Plaintiff then brought a bad faith lawsuit against ProBuilders seeking a finding that ProBuilders acted in bad faith in denying the duty to defend.

The King County Superior Court entered summary judgment in favor of ProBuilders based on the townhouse exclusion. The Washington State Court of Appeals reversed that ruling but found that the pollution exclusion nonetheless operated to preclude coverage. The pollution exclusion at issue specifically excludes coverage for any injury:

> Caused by, resulting from, attributable to, contributed to, or aggravated by the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants, or from the presence of, or exposure to, pollution of any form whatsoever, and regardless of the cause of the pollution or pollutants.

The Washington Supreme Court accepted review and reversed the Court of Appeals, finding that the "efficient proximate cause" rule applies to the analysis of third-party liability coverage. The "EPC" rule has been applied for years in first-party property claims. The rule has never been applied to a liability claim.

The Supreme Court's analysis begins with a discussion of its historic treatment of pollution exclusions and concluded that the loss at issue was in fact caused by a "pollutant" as that term is defined in the policy and by Washington law. However, the Supreme Court's analysis did not stop with that conclusion. The Court held that insurers must consider whether, pursuant to established

Washington law, the excluded occurrence is in fact the efficient proximate cause of the claimed loss.

Based on a review of the briefing submitted to the Supreme Court, it does not appear as though any party, nor any of the *amici*, argued that the efficient proximate cause rule was implicated by the subject claim. Nonetheless, the Supreme Court discussed the efficient proximate cause rule at length and ultimately concluded that the efficient proximate cause of the loss was not the pollution, but the initial negligent installation of the exhaust vent. Thus, the Court concluded that the pollution exclusion did not apply.

Having concluded that the loss was not excluded, the Court further found that ProBuilder's denial was made in bad faith because it had failed to consider the efficient proximate cause rule or the Washington Supreme Court's prior precedent admonishing insurers against attempting to include policy language that would potentially circumvent the rule.

3. The Dolsen Companies, et al. v. Bedivere Ins. Co., et al., 264 F. Supp. 3d 1083 (2017)

Only one Washington Court has taken on the *Xia* analysis since it was issued by the Washington Supreme Court. In *The Dolsen Companies, et al. v. Bedivere Ins. Co., et al*., 1:16-cv-03141 (E.D. Wash. Sept. 11, 2017), the Court sheds light on how Courts may handle the *Xia* ruling and efficient proximate cause issues going forward.

In *Dolsen*, several insureds ("The Dolsen Companies") operated a farming operation that produced large amounts of manure as byproduct. The Dolsen Companies stored the manure in holding ponds and spread it on crops as fertilizer. The holding ponds leaked and caused seepage into the groundwater. In addition, The Dolsen Companies applied far too much manure on their land, which also resulted in seepage.

The Dolsen Companies were sued for the resulting groundwater contamination and tendered a claim to their insurance carriers (collectively, the "Insurance Carriers"). The Insurance Carriers denied coverage based on their policies' absolute pollution exclusion, and The Dolsen Companies sued the Insurance Carriers for breach of contract.

On summary judgment, the District Court held that the absolute pollution exclusion barred coverage, and that the Insurance Carriers' denials were proper. The Court found that the absolute pollution exclusion applied because the seepage of manure into groundwater was a contaminate that met the policies' definition of "pollution." Moreover, the manure was "acting as a pollutant" because its contaminating attributes directly polluted the groundwater.

More interesting was the *Dolsen* Court's treatment of the efficient proximate cause rule. The Court addressed the rule by applying the following analytical framework:

> The distinguishing feature … is the relation between the initial act and the pollutant causing harm—*viz*., whether the initial peril was the polluting act (*i.e., whether the incident involved pollutants in the first place*) or whether the initial peril was some other act that incidentally led to a polluting harm. Although subtle, this

> framework is workable and leads to a clear result in this case: the initial act was intimately tied to the pollutant and thus the initial peril was the polluting act.

Applying this framework, the *Dolsen* Court found that the absolute pollution exclusion applied because "the initial act giving rise to the peril was an excluded harm and there is no other covered occurrence that otherwise led to the harm." Specifically, with respect to the excess manure that was applied as fertilizer, only one relevant event led to the contamination; namely, the dispersal of manure directly onto the land. This dispersal was the polluting event and was the sole cause of the harm. Therefore, the pollution exclusion applied.

With respect to the seepage from the holding pond, the Court reasoned that the inadequate storage of the manure directly caused the seepage. The inadequate storage of manure was a polluting event and was the efficient proximate cause of the harm. There was also no other negligent act which preceded this polluting event. In contrast, in *Xia* the negligent installation of the water heater had preceded the polluting event of carbon monoxide emissions.

4. Westridge Townhomes Owners Assoc. v. Great Am. Assur. Co., 2017 U.S. Dist. LEXIS 180373 (W.D. Wash. Oct. 31, 2017)

In *Westridge,* the Court was asked to interpret a first-party condominium policy. This case is an example of how carefully Washington Courts will parse policy language.

This matter arose out of condominium claim. The policy at issues stated that it "insures against all risks of direct physical loss or damage from any external cause except as hereinafter excluded . . . ." The policy specifically stated it will not cover a list of excluded perils, including "errors in design, errors in processing, faulty workmanship or faulty materials..."

A bad faith lawsuit ensued. The insured moved for partial summary judgment, asking that the Court rule that the policy did not exclude, and therefore covered, the perils of faulty construction, faulty maintenance, and wet or dry rot.

The Court noted that the policy afforded "all risk" coverage, meaning it covered any peril not specifically excluded. The insured argued that while the policy excludes "faulty workmanship" is does not specifically exclude "faulty construction" and "faulty maintenance."

The insured argued that "faulty construction" and "faulty maintenance" are excluded under the umbrella term "faulty workmanship."

The Court sided with the insured, holding that the terms "faulty construction" and "faulty maintenance" did not fall within the term "faulty workmanship." The Court did not provide analysis of its rationale. However, as a result, the Court found that these were covered perils. The Court declined to rule as to whether "faulty workmanship" or some other peril caused the damage at issue in the matter.

5. *2FL Enters., LLC v. Houston Specialty Ins. Co.*, 2018 U.S. Dist. LEXIS 18605 (W.D. Wash. Feb. 5, 2018).

A recent Washington Federal Court decision illustrates how difficult Washington is for carriers who initially decline to provide a defense. In *2FL Enterprises v. Houston Specialty,* an insurer failed to respond to a tender for over five months, at which time it issued a denial based on extrinsic evidence. A year later the insurer attempted to "cure" its denial by issuing a reservation of rights letter. The insured declined to accept the defense.

The insured then brought a bad faith claim against the carrier. As a defense, the carrier asserted that it attempted to cure its breach by later extending a defense, but the insured would not accept the same.

The *2FL* Court held that once a carrier breached the contract, the insured "should no longer be bound by contractual obligations[.]" As a result, the insured had no obligation to accept the offer to defend, and the insurer was not allowed to cure its breach.

This case exemplifies the need for carriers to be cautious when dealing with a request for defense from an insured. The carrier may not be allowed to later amend its position. In fact, the *2FL* Court expressly disregarded boilerplate language in the carrier's reservation of rights which purported to reserve the right to later amend its position regarding defense.

6. *Trofimovich v. Progressive Direct Ins. Co.*, 2017 U.S. Dist. LEXIS 125328 (W.D. Wash. Aug. 8, 2017).

A new decision from the Western District of Washington demonstrates that insurers will not always find themselves in peril after a denial. In *Trofimovich v. Progressive Direct Insurance Company*, 2017 U.S. Dist. LEXIS 125328 (W.D. Wa.), Honorable John Coughenour ruled that Progressive's denial of an auto physical damage claim based on an exclusion for operation of the vehicle for hire was reasonable. The Court dismissed all contractual and extra-contractual causes of action based on that finding.

Trofimovich involved an accident occurring on June 17, 2016. After the accident, the insured contacted Progressive and gave a recorded statement. During that statement, the insured stated that he was working for Lyft, a ride share company, and that he had a passenger at the time of the accident. The insured further declined Progressive's offer to arrange towing services based on his belief that Lyft would provide a tow.

The next day, the insured gave a second statement. In this statement, the insured indicated that the passenger in his vehicle at the time of the loss was not a paying customer. He claimed that he had given that passenger a ride earlier in the day, but that the ride at issue was being given for free due to a financial hardship on the part of the passenger.

On June 30, 2016, Progressive issued a letter denying coverage based on an exclusion that precluded coverage for damage occurring while operating the vehicle to transport passengers for a fee.

In July, the insured retained counsel, who issued an Insurance Fair Conduct Act Notice alleging that the denial was in violation of the statute. On July 29, 2016, without amending its coverage position, Progressive agreed to pay the claim. On August 26, 2016, the insured filed suit alleging breach of contract, bad faith, and violations of IFCA and the Washington Consumer Protection Act.

On Cross-Motions for Summary Judgment on all causes of action, the Court ruled that Progressive's interpretation of the insured's initial statement was reasonable. The Court further held as follows:

> Progressive made the choice to reject one of two apparently conflicting statements, something that cannot be uncommon in claims adjusting. This alone does not render Progressive's denial unreasonable.
>
> Thus, the Court concludes as a matter of law that Progressive's initial denial of coverage was reasonable.

2017 U.S. Dist. LEXIS 125328 at 7-8.

Based on this finding, the Court proceeded to grant Summary Judgment in favor of Progressive dismissing the insured's causes of action for breach of contract, bad faith, violation of the Consumer Protection Act, and violation of the Washington Insurance Fair Conduct Act.

The Court's decision in *Trofimovich* demonstrates that insurers can secure good results in Washington when they play by the rules and act reasonably, basing their decisions on sound reasoning and a straight-forward assessment of the facts.

7. Schreib v. American Family Mut. Ins. Co., 2015 U.S. Dist. LEXIS 118189 (W.D. Wa.)

The Court held that an excess arbitration award in a UIM claim is not a measure of damages for purposes of claims of bad faith, violation of the CPA, and violation of IFCA.

The Court also concluded that under IFCA, a Plaintiff must prove "actual damages" caused by the alleged unreasonable denial of coverage or benefits. The Court held that emotional distress damages and attorney's fees do not constitute "actual damages" under IFCA.

8. *Crowthers v. The Travelers Indemnity Company,* United States District Court for the Western District of Washington, 2:16-cv-00606-RSL

In *Crowthers*, the Court again held that a technical violation of a regulatory provision under the Washington Administrative does not necessarily constitute an IFCA violation. In issuing this holding, the Court referenced the same result reached in *Schreib v. American Family Mut. Ins. Co*., *supra*.

The Court also addressed the fact that the Plaintiff in the *Crowthers* case had failed to establish any "actual damages" under IFCA, as well as a lack of any damage claims asserted as to the remaining extra-contractual claims asserted by Plaintiff. The Court held that a failure to establish actual damages as to these extra-contractual causes of action also warranted dismissal of the claims on a summary judgment motion. This decision again underscores the fact that in order to prosecute an IFCA claim, a party must prove actual damages or injuries. This ruling is again consistent with the ruling in *Schreib*.

9. *Norris v. Farmers Ins. Co. of WA*, Court of Appeals of the State of Washington, Case No. 76236-1, Division One (Mar. 19, 2018).

The *Norris* matter arose out of an automobile-pedestrian accident. Norris, the at fault driver, was insured by Farmers. Farmers offered the injured party the available liability limits. This offer was refused.

The insured then impleaded Farmers by third-party complaint, claiming negligence. The insured specifically argued that Farmers was negligent in failing to provide the insured with policy containing sufficient limits.

In Washington, and insurer and its agents may have an obligation to provide advise to an insured on the adequacy of a policy's limits, provided there is a "special relationship." The Washington courts have repeatedly addressed what constitutes a special relationship. A special relationship only exists if:

> (1) the agent holds himself out as an insurance specialist and receives compensation for consulting separate from the premiums paid by the insured; or
>
> (2) there is a longstanding relationship, some type of interaction on the question of coverage, and the insured's relied on the agent's expertise to the insured's detriment.

Gates v. Logan, 71 Wn. App. 673, 862 P.2d 134, 136 (1993)

The Court held that Famers had no "special relationship" with the insured that imposed a duty to advise the insured with regard to the amount of the policy's limits. There was no special consideration paid. Moreover, Farmer's presented evidence that the agents were never asked to evaluate the adequacy of coverage or the available limits.

The Court was further unpersuaded by the insured's argument that Farmers and its agents are required to review coverage for gaps and inadequate liability limits as part of the duty to

exercise reasonable and ordinary care. Again, the Court relied upon longstanding Washington law regarding a "special relationship" and denied the insured's appeal in its entirety.

10. *Keodalah v. Allstate Ins. Co*., Court of Appeals of the State of Washington, Case No. 75731-8-I, Division One (March 26, 2018).

In this recent decision by Division I of the Washington State Court of Appeals, the Court ruled that an insured can pursue bad faith and Consumer Protection Act claims directly against insurance adjusters as opposed to simply insurers. The Court reasoned that Washington law imposes a duty of good faith on "all persons" involved in insurance, including the insurer and its representatives. RCW 48.01.030. A "Person" is defined as "any individual, company, insurer, association, organization, reciprocal or interinsurance exchange, partnership, business trust, or corporation." RCW 48.01.070. The Court determined that, under the plain language of the statute, the adjuster had an individual duty to act in good faith and could be sued for breaching this duty.

The *Keodalah* decision is a dramatic departure from the law in most jurisdictions. Previously, most Washington State trial court decisions have refused to find adjusters directly liable for causes of action involving bad faith, particularly when adjusters are direct employees of the insurer. Although third-party administrators and independent adjusters are often sued for bad faith, this decision provides for the first time a bad faith claim against individual employees of an insurer.

The impact of this decision will be significant on the insurance industry and will raise even further questions.

B. Oregon

1. Long v. Farmers Ins. Co. of Oregon, 360 Ore. 791 (2017)

Prior to the decision in *Long v. Farmers Ins. Co. of Oregon*, 360 Or 791 (2017), most believed that an insured had to actually obtain a judgment awarding monetary damages in the suit seeking coverage to be entitled attorney fees. However, in *Long*, the Oregon Supreme Court identified a new way that an insured can obtain an attorney fee award under ORS 742.061, which can apply even if the insured does not prevail in the suit seeking additional coverage.

In *Long*, the Oregon Supreme Court decided that the "recovery" which must exceed the amount of any timely tenders made by an insurer does not need to be based on a judgment entered in favor of the insured. Accordingly, the Court held that voluntary payments given during litigation can qualify as a "recovery" which triggers entitlement to an attorney fee award under ORS 742.061.

In this case, the Court held that the insured was entitled to an attorney fee award for the work performed by his attorneys up until the time he received the additional ACV claim payments. However, the Court also ruled that the insured was not entitled to any further attorney fees because Farmers paid the RCV claim just days after that claim was submitted and the insured did not recover any more at trial than was timely tendered by Farmers.

The *Long* case reiterates the importance of determining and paying the full value of a claim within six months of the claim submission because it establishes that subsequent claim payments made during litigation will result in at least some attorney fee exposure. *See also Jones v. Nava*, 264 Or App 235, 240-241 (2014) (confirming that tenders must be made within six months of proof of loss to avoid attorney fee exposure, even if untimely tender exceeding ultimate recovery is given prior to filing of action). However, the decision is not completely adverse to insurers because it also confirms that the requirements for an attorney fee award must be separately met for each claim submitted, even if claims arise from the same loss.

2. Brownstone Homes Condo. Ass'n v. Brownstone Forest Heights, LLC, 358 Or. 223, 363 P.3d 467 (2015), *reconsideration denied Brownstone Homes Condo. Ass'n v. Brownstone Forest Heights, LLC*, No. S061273, 2016 Ore. LEXIS 10 (Jan. 14, 2016).

The Oregon Supreme Court recently issued a ruling overturning *Stubblefield v. St. Paul Fire & Marine*, 267 Ore 397, 400-01, 517 P2d 262 (1973). The *Brownstone* matter involved an assignee's right to recover against the assignor's insurer where a previously executed settlement agreement extinguished the insurer's potential liability. The lower court in this matter applied the *Stubblefield* Rule, which essentially terminates the insurer's obligations under the policy to the insured when the insured enters into a stipulated judgment with a covenant not to execute. Oregon maintains a statute (ORS 31.825) that allows for an assignment after a judgment had been entered, but not before. The Court of Appeals upheld the lower court's ruling that *Stubblefield* applied because the assignment had occurred before a judgment was entered.

The Oregon Supreme Court reversed, reasoning that although the facts of *Stubblefield* were not distinguishable from the *Brownstone* case, nor had it been superseded by statute, *Stubblefield* had been erroneously decided. The Court first recognized that the lower court's holding was contrary to the overwhelming rule across a majority of state courts. Specifically, it agreed that a covenant not to execute is a "contract and not a release - tort liability on behalf of the insured still exists and the provider is still obligated to indemnify its insured." Justin A. Harris, *Judicial Approaches to Stipulated Judgments, Assignments of Rights, and Covenants Not To Execute in Insurance Litigation*, 47 Drake L Rev 853, 858 (1999).

Second, the high Court determined that the *Stubblefield* Court erroneously failed to apply the appropriate rules of contract interpretation. The Oregon Supreme Court found that even if the lower court decided against applying the majority view on covenants not to execute, it committed further error by failing to apply the well settled principle that ambiguous terms in a policy contract are construed against the insurer. In particular, the phrase "legally obligated to pay" was considered ambiguous and the lower court supplied no consideration or analysis as to ambiguities in the policy language.

The lower court's holding was therefore deemed erroneous, and the *Brownstone* Court held that a covenant not to execute, obtained in exchange for an assignment of rights, does not have the effect of eliminating the insured and insurers liability.

3. West Hills Dev. Co. v. Chartis, et al., 360 Ore. 650 (2016)

In *W. Hills Dev. Co. v. Chartis Claims, Inc*., the Oregon Court of Appeals articulated that a party does not need to be specifically named in an action to trigger an insurer's defense obligation.

> To trigger the duty to defend, a complaint needs only to make allegations with which a claim covered by the policy may be proven. The insurer is charged with the responsibility to recognize the insured's exposure that the complaint presents. *See Ledford*, 319 Ore. at 400 (finding duty to defend generally); *see also Abrams v. General Star Indemnity Co.*, 335 Ore. 392, 67 P3d 931 (2003) (finding duty to defend a case due to potential conversion claim, despite intentional conduct alleged). The original complaint alleged that West Hills negligently supervised its contractors. It alleged that defects resulted from negligent supervision by "[f]ailing to properly coordinate, schedule, oversee, inspect, and supervise contractors, subcontractors, and other workers." Consequently, the original complaint alleged facts which, if proved, could subject West Hills to liability for work by a subcontractor.
>
> L&T was a subcontractor. It did not need to be identified in the complaint for the insurer to recognize its responsibility. In accord with *Shearer*, extrinsic evidence could be considered in order to identify West Hills as an additional insured. 237 Ore. App. at 476. West Hills reported to Oregon Auto that L&T, the policy's named insured, was West Hill's subcontractor on the same property that was the subject of the complaint. In its tender letter, West Hills reported, "Specifically, your insured [L&T] installed the front porch columns. The Complaint implicates work performed by your insured at Arbor Terrace."

W. Hills Dev. Co. supra at 162-63.

Although *W. Hills Dev. Co.* ultimately filed a third-party complaint against its subcontractor L&T, the Oregon Court of Appeals determined that W. Hills' additional insured tender to Chartis, prior to formally bringing claims against L&T, was sufficient to implicate Chartis' defense obligation. The Court articulated that the primary focus of the defense obligation inquiry was whether the complaint alleged damage for which L&T was responsible, not whether L&T was specifically identified in the Complaint.

4. FountainCourt Homeowners' Association v. American Family Mutual Insurance Company, 360 Ore. 341 (2016)

The *FountainCourt* case involved a judgment entered against American Family Mutual Insurance Company, (AmFam), in a garnishment proceeding in the Circuit Court of Washington County. In the original lawsuit, the FountainCourt Homeowners' Association, (HOA), secured a judgment against AmFam's insured SideCo, Inc. for various defects in construction and resulting damage. The HOA then sought to enforce that judgment by garnishing the insurance proceeds from the AmFam policy. As of the time of the underlying judgment, SideCo was no longer in business. By utilizing Oregon's garnishment proceeding, the HOA was able to pursue a direct claim against AmFam.

The Circuit Court found that AmFam was liable for the full amount of the judgment against its insured, less certain offsets, because AmFam had failed to show that the judgment against its insured included damages that were not covered by the policy. Specifically, AmFam had contended that portions of the judgment include repairs to SideCo's own work and that property damage did not occur during the AmFam policy. The Supreme Court rejected those arguments.

In summary, the Supreme Court held that the judgment entered into against SideCo established what AmFam was "legally obligated to pay" for the purposes of insurance coverage. Moreover, AmFam could not attempt to re-litigate those damages to determine what was actually covered under the policy. The Court did uphold prior Oregon law that a liability insurer is not collaterally estopped from litigating questions of coverage based upon the result of an underlying trial. However, the Court found that in this case AmFam could not re-litigate the issue of whether or not the policy had been triggered due to the fact that the policy provided coverage for a judgment which an insured is "legally obligated to pay" and that this coverage trigger had been established as a result of the underlying judgment itself.

The ruling underscores the fact that the best way for an insurer to potentially avoid a similar garnishment proceeding is to file a declaratory judgment action in advance of any judgment being entered against the insured. Subject to diversity issues, that action can likely be filed in Federal Court. To the extent the coverage issues can be resolved prior to the underlying judgment, we believe that the underlying plaintiff would then be precluded from attempting to resolve the coverage issues in a subsequent garnishment proceeding. Finally, this decision again points out the perils of not adequately raising coverage issues and the perils of attempting to litigate those issues in a garnishment action.

These seminar materials are provided as background information on what we have seen in our legal experience. These materials should not be construed as legal advice. As always, please consult with our office or other counsel if you have legal questions or questions regarding coverage issues on specific claims. Each claim and case is different and may be handled differently based on the specific facts and circumstances.

Northwest Coverage and Extra-Contractual Claims

PRESENTED BY:

THOMAS LETHER,
LETHER & ASSOCIATES

SANDRA HEIDEN,
THE NAVIGATORS GROUP

EDWARD MCKINNON
CLAIMS RESOURCE MANAGEMENT

Washington Law

- RULES OF POLICY CONSTRUCTION
- LEGAL STANDARDS REGARDING THE DUTY TO DEFEND
- LEGAL STANDARDS FOR DETERMINING DUTY TO INDEMNIFY

Oregon Law

- RULES OF POLICY CONSTRUCTION
- LEGAL STANDARDS REGARDING THE DUTY TO DEFEND
- LEGAL STANDARDS FOR DETERMINING DUTY TO INDEMNIFY

Tender Issues

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- DOES A NOTICE OF CLAIM CONSTITUTE A SUIT?
- PRE-TENDER AND PRE-SUIT DEFENSE COSTS

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- OREGON
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- CONTRACTUAL DEFENSE AND INDEMNITY OBLIGATIONS.
- CONTRACTUAL LIABILITY EXCLUSIONS AND THE INSURED CONTRACT EXCEPTION

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- WHO DOES WHAT?
- WHAT INFORMATION CAN BE SHARED?

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Extra-Contractual Claims

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  - Reasonableness Hearing
  - *Chausee & Glover* Factors
  - What Constitutes Collusion or Fraud
  - Burden of Proof
  - If Settlement is Unreasonable

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- REIMBURSEMENT OF DEFENSE FEES ON UNCOVERED CLAIMS ENDORSEMENT
- EXTRINSIC EVIDENCE ENDORSEMENT
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- COMPLETED WORKS AND CONTINUOUS/PROGRESSIVE ENDORSEMENTS
- MARIJUANA ENDORSEMENT

Case Law Update - Washington

- ***Perez-Crisantos v. State Farm*, 187 Wn.2d 669 (2017)**
- ***Xia v. Probuilders*, 188 Wn.2d 171, 400 P.3d 1234 (2017)**
- ***The Dolsen Companies, et al. v. Bedivere Ins. Co., et al.*, 264 F. Supp. 3d 1083 (2017)**

Case Law Update - Washington

- ***Westridge Townhomes Owners Assoc. v. Great Am. Assur. Co.*, 2017 U.S. Dist. LEXIS 180373 (W.D. Wash. Oct. 31, 2017)**
- ***2FL Enters., LLC v. Houston Specialty Ins. Co.*, 2018 U.S. Dist. LEXIS 18605 (W.D. Wash. Feb. 5, 2018)**
- ***Trofimovich v. Progressive Direct Ins. Co.*, 2017 U.S. Dist. LEXIS 125328 (W.D. Wash. Aug. 8, 2017)**

Case Law Update - Washington

- ***Schreib v. American Family*, 129 F. Supp. 3d 1129 (2015)**
- ***Crowthers v. Travelers*, 2016 U.S. Dist. LEXIS 142123 (W.D. Wash. October 13, 2016)**
- ***Norris v. Farmers Ins. Co. of WA*, Court of Appeals of the State of Washington, Case No. 76236-1, Division One (Mar. 19, 2018).**

Case Law Update - Washington

- ***Keodalah v. Allstate Ins. Co.*, Court of Appeals of the State of Washington, Case No. 75731-8-I, Division One (March 26, 2018).**

  The Washington Court of Appeals ruled in this recent decision that an insured can pursue bad faith and Consumer Protection Act claims directly against insurance adjusters and not only against the insurer.

Case Law Update - Oregon

- ***FountainCourt Homeowners' Association v. American Family Mutual Insurance Company*, 360 Ore. 341 (2016)**
- ***Long v. Farmers Ins. Co. of Oregon*, 360 Ore. 791 (2017)**
- ***West Hills Dev. Co. v. Chartis, et al.*, 360 Ore. 650 (2016)**
- ***Brownstone Homes Condo Assn. v. Brownstone Forest Hts.*, 358 Or 223 (2015) *reconsideration denied Brownstone Homes Condo. Ass'n v. Brownstone Forest Heights, LLC*, No. S061273, 2016 Ore. LEXIS 10 (Jan. 14, 2016).**
  - *Farris v. United States Fid. & Guar. Co.*, 284 Or. 453, 587 P.2d 1015 (1978).

Questions

?

Thank You

Thomas Lether
Lether & Associates

Sandra Heiden
The Navigators Group

Edward McKinnon
Claims Resource Management

Section 18.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

South Ballroom

Friday, May 18th 2018
11:00 AM – 12:00 PM

Course Title:
Subcontractor Wars: The Last AI

Richard D. Seely, Esq., Alex M. Chazen, Esq., Adam C. Flury, Esq.,
Sheila M. Totorp, Esq. and Michael Chorak

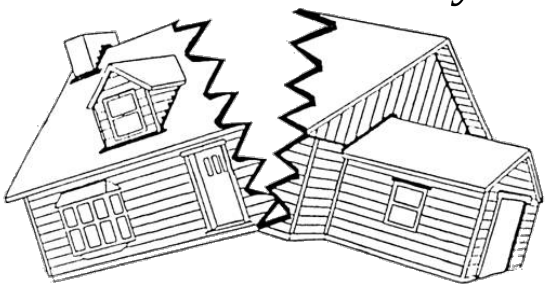
SUBCONTRACTOR WARS: THE LAST A.I.

THE CHANGING UNIVERSE OF

ADDITIONAL INSURED ENDORSEMENTS

Companion Materials for

West Coast Casualty's



Construction Defect Seminar

May 16-18, 2018

Richard D. Seely, Esq
SKANE WILCOX LLP

Sheila M. Totorp, Esq.
CLAUSEN MILLER P.C.

Alex M. Chazen, Esq.
KAHANA & FELD LLP

Michael A. Chorak
ENGLE MARTIN & ASSOCIATES

Adam Flury, Esq.
MASSIE BERMAN

GUARDIANS OF THE SUBCONTRACTOR GALAXY:

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EXHIBIT A

Sample Additional Insured Endorsement Language

20 10 11 85

Who is an insured is amended to include "the person or organization shown in the Schedule, but only with respect to liability arising out of 'your work' for that insured by or for you."

CG 20 10 10 93

Who is an insured is amended to include "the person or organization shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured."

CG 20 10 10 01
Endorsement relied on by Lexington in McMillin Management Services v. Financial Pacific Insurance (2017) 17 Cal.App.5th 187

Same as CG 20 10 10 93, but adds exclusions for bodily injury and property damage occurring after all work on the project to be performed by or on behalf of the additional insured at the site has been completed and for that portion of "your work" out of which the injury or damage arises has bene put to its intended use by any person other than another contractor or subcontractor performing operations as part of the project.

CG 20 26 07 04

Who is an insured is amended to include "the person(s) or organization(s) shown in the Schedule, but only with respect to liability for 'bodily injury', 'property damage' or 'personal and advertising injury' caused, in whole or in part, by your acts or omissions or the acts or omissions of those acting on your behalf: A. In the performance of your ongoing operations; or B. In connection with your premises owned by or rented to you."

Manuscript Endorsements - Examples

Endorsement at issue in Pulte Home Corp. v. American Safety Indemnity Co. (2017) 14 Cal.App.5th 1086
"WHO IS AN INSURED (SECTION II) is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of 'your work' which is ongoing and which is performed by the Named Insured for the Additional Insured on or after the effective date of this Endorsement."

Sample Additional Insured Endorsement Language

"WHO IS AN INSURED (SECTION II) is amended to include the person or organization shown in the Schedule, but only as respects liability imposed or sought to be imposed on such additional insured because of an alleged act or omission of the named insured.

1. If liability for injury or damage is imposed or sought to be imposed on the additional insured because of:

    a. Its own acts or omissions, this insurance does not apply;

    b. Its acts or omissions and those of the named insured, as to defense of the additional insured, this insurance will act as coinsurance with any other insurance available to the additional insured, in proportion to the limits of liability of all involved policies, and the Other Insurance provisions of this policy are amended accordingly. However, this insurance does not apply to indemnity of the additional insured for its own acts or omissions.

2. If an agreement between the named insured and the additional insured providing indemnity or contribution in favor of the additional insured exists or is alleged to exist, the extent and scope of coverage under this insurance for the additional will be no greater than the extent and scope of the indemnification of the additional insured which was agreed to by the named insured.

3. The naming of an additional insured will not increase our limit of liability."

EXHIBIT B

[Date]

Communication Protected Under Mediation Privilege
Evidence Code Sections 1115, et seq., 1119 and 1152

YZ Subcontractor, Inc. Counsel
Firm
Address

Re: Smith, et al. v. ABC, Inc., et al.
Court and Case No.
Your Client: YZ Subcontractor, Inc.

Dear Subcontractor Counsel:

This demand letter is issued in advance of the [date] mediation in the above-referenced matter. ABC, Inc. makes this demand without waiver of the attorney-client privilege or any applicable work product protections and is subject to all mediation protections, including but not limited to Evidence Code sections 1115 *et seq*., 1119 and 1152. Accordingly, the information set forth herein is inadmissible for all purposes.

YZ Subcontractor, Inc. ("YZ") entered into a subcontract with ABC, Inc. on [date]. The subcontract includes the following indemnity and defense provision:

> Subcontractor shall defend and indemnify ABC, Inc. from and against any and all claims to the extent such claims, in whole or in part, arise out of or relate to Subcontractor's work. …
>
> Subcontractor's duty to defend ABC, Inc. is entirely separate and independent from Subcontractor's duty to indemnify ABC, Inc. Subcontractor's duty to defend ABC, Inc. applies whether the issue of Subcontractor's liability, breach of this Agreement or other obligation or fault has been determined, and whether ABC, Inc. has paid any sums or incurred any detriment from Subcontractor's work. Such defense obligation shall arise immediately upon written notice of any claim to Subcontractor and includes, without limitation, the obligation to defend ABC, Inc. with respect to any alternative dispute resolution proceeding authorized under this Agreement, any investigation and resolution of the claim and claims brought pursuant to statute by homebuyers, successive homebuyers or homeowners associations or claims arising out of warranty.

> Any claim against ABC, Inc. that the project contains construction defects which Subcontractor defends and/or pays indemnity or that results in a final settlement, award or judgment that allocates any or all of the amount paid by Subcontractor to a party other than the Subcontractor, ABC, Inc. shall reimburse Subcontractor the specific dollar or percentage amount of such settlement, award or judgement that is allocated to other party(ies) to the extent previously paid by Subcontractor provided such specific dollar or percentage amount is paid to ABC, Inc. by another party.

Accordingly, YZ has a duty to provide ABC with a defense in this action pursuant to the indemnity and defense provision of the subcontract documents and confirmed in Crawford v. Weather Shield Mfg. Inc. (2008) 44 Cal.4th 541. ABC tendered the defense of this claim to YZ at the beginning of this case, specifically on [date]. Attached is a copy of that tender letter. However, to date, YZ has not acknowledged its duty to defend ABC.

Through [date near mediation], ABC has incurred approximately $400,000 in fees and costs to defend this action and pursue its claims for indemnity and defense. We expect that it will cost an additional $20,000 to conclude this matter assuming that the case settles at the upcoming mediation. We have reached settlements related to the defense fees and costs with five subcontractors thus far, for a total of $60,000, which reduces the balance to $360,000. No insurers have agreed to defend ABC.

Traditionally, parties have used two methods to allocate defense fees: 1) defense follows indemnity, or 2) pro-rata based on the number of participants. If we apply the defense follows indemnity allocation method, YZ paid $5,625 out of the $225,000 in settlements with the homeowners or 2.5%, and 2.5% of $360,000 is $9,000. If we apply the pro-rata method, there are 18 subcontractors left in the action that contributed to the settlement and 1/18 of $360,000 is $20,000. Since ABC cannot get all of the subcontractors to agree on a method, ABC hereby makes a demand of $20,000 to YZ for purposes of the mediation.

Unless otherwise revoked, this demand will remain open until the end of the day on [date-the date of the mediation]. Since additional fees and costs will be incurred thereafter, the demand will likely increase after [date].

Please contact me with any questions.

Very truly yours,

Counsel for Developer / General Contractor

Enclosures
128554.1

EXHIBIT C

Attorneys for Cross-Defendant,
SUBCONTRACTOR

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF RIVERSIDE

PLAINTIFF, Plaintiff, vs. DEVELOPER, Defendants. _____ DEVELOPER; Cross-Complainant, vs. ROES 1 through 500, inclusive, Cross-Defendants. Cross-Defendants. _____	CASE NO. RIC 1212930 DEPT: 3 JUDGE: **SUBCONTRACTOR'S SPECIAL INTERROGATORIES, SET NO. ONE (1)** *Trial Date:* *none set* *Complaint Filed:* *8/23/2012* *Cross Complaint filed:* *10/19/2012*

PROPOUNDING PARTIES: Cross-Defendant, SUBCONTRACTOR

RESPONDING PARTY: Cross-Complainant, DEVELOPER

SET NUMBER: ONE (1)

SPECIAL INTERROGATORIES

SPECIAL INTERROGATORY NO. 1:

Please state the precise dollar amount of the *CRAWFORD* CLAIM (for purpose of this Interrogatory, "*CRAWFORD* CLAIM" shall refer to any and all claims for attorneys' fees and costs in defending of this instant action for which YOU are currently seeking reimbursement in connection with this instant action (for the purpose of this Interrogatory, "YOU" or "YOUR" shall mean Cross-Complainant, DEVELOPER its agents, employees, accountants, and other representatives acting on its behalf) which YOU contend is owed by SUBCONTRACTOR (for purposes of this Interrogatory, "SUBCONTRACTOR" shall refer to Cross-Defendant, SUBCONTRACTOR) as of May 31, 2015.

SPECIAL INTERROGATORY NO. 2:

Please state the precise dollar amount of the *CRAWFORD* CLAIM which YOU contend is owed by SUBCONTRACTOR as of May 31, 2016.

SPECIAL INTERROGATORY NO. 3:

IDENTIFY (The term "IDENTIFY" with respect to a PERSON, shall mean to provide the name, last known business and residential addresses and phone numbers and their relationship to YOU) all PERSONS (The term "PERSON" or "PERSONS" shall mean any individual, corporation, partnership, joint venture, association or other form of legal entity unless the context indicates otherwise) with knowledge of the facts supporting YOUR *CRAWFORD* CLAIM as of December 31, 2014.

SPECIAL INTERROGATORY NO. 4:

IDENITFY all DOCUMENTS (the terms "DOCUMENT" or "DOCUMENTS" shall mean all documents and things as that term is defined in *Evidence Code* §250) that support YOUR *CRAWFORD* CLAIM as of May 31, 2015.

SPECIAL INTERROGATORY NO. 5:

Please IDENTIFY all PERSONS who have paid any portion of YOUR *CRAWFORD* CLAIM as of the date of response to this Interrogatory.

SPECIAL INTERROGATORY NO. 6:

Please IDENTIFY all PERSONS to whom YOU have tendered YOUR defense fees in this instant matter as of the date of YOUR response to these Interrogatories.

SPECIAL INTERROGATORY NO. 7:

As to the PERSONS identified in YOUR response to Interrogatory Number 6, Please IDENTIFY which PERSONS have accepted YOUR tender of defense fees in this matter as of the date of YOUR response to these Interrogatories.

SPECIAL INTERROGATORY NO. 8:

Please state how much of YOUR *CRAWFORD* CLAIM has been paid by YOU personally.

SPECIAL INTERROGATORY NO. 9:

As to any PERSONS who have paid any portion of YOUR *CRAWFORD* CLAIM, other than YOU, please state all facts that support YOUR contention that YOU are still entitled to recovery of this portion of YOUR *CRAWFORD* CLAIM.

SPECIAL INTERROGATORY NO. 10:

Please IDENTIFY all PERSONS who have paid any portion of YOUR attorneys' fees incurred in this instant action as of the date of response to this Interrogatory.

SPECIAL INTERROGATORY NO. 11:

Please IDENTIFY all PERSONS who have agreed to pay any portion of YOUR attorneys' fees incurred in this instant action as of the date of response to this Interrogatory.

SPECIAL INTERROGATORY NO. 12:

IDENTIFY all DOCUMENTS which would evidence an out of pocket payment of any portion of YOUR *CRAWFORD* CLAIM.

SPECIAL INTERROGATORY NO. 13:

Please IDENTIFY the name of the PERSON presently employed by YOU who is most knowledgeable regarding the facts and circumstances surrounding YOUR *CRAWFORD* CLAIM.

Dated: May __, 2018

SKANE WILCOX LLP

By: _____
Richard D. Seely

EXHIBIT D

14 Cal.App.5th 1086
Court of Appeal,
Fourth District, Division 1, California.

PULTE HOME CORPORATION, Plaintiff and Respondent,
v.
AMERICAN SAFETY INDEMNITY COMPANY, Defendant and Appellant.

D070478
|
Filed 8/30/2017

Synopsis

Background: General contractor, which was additional insured under comprehensive general liability (CGL) policies issued to three subcontractors, filed action against insurer asserting it had duty to defend general contractor in homeowners' separate construction defect lawsuits. Following summary adjudication that insurer had duty to defend general contractor as to one subcontractor's policies and a bench trial, the Superior Court, San Diego County, No. 2013-00050682-CU-IC-CTL, Ronald L. Styn, J., entered judgment in favor of general contractor, awarded it compensatory damages, punitive damages, and attorney fees, and subsequently denied insurer's motion for new trial. Insurer appealed.

Holdings: The Court of Appeal, Huffman, Acting P.J., held that:

[1] homeowners' claims were potentially covered by additional insured endorsements to CGL policies, thus triggering insurer's duty to defend;

[2] ongoing operations provision in additional insured endorsement did not exclude completed operations coverage for construction defect claims;

[3] faulty workmanship exclusions did not conclusively negate potential coverage;

[4] insurer lacked legitimate reasons for denying defense, so as to support determination that insurer acted in bad faith;

[5] evidence was sufficient to support finding that insurer acted in bad faith;

[6] evidence was sufficient to support finding that insurer acted with malice and oppression when it breached duty to defend, so as to warrant imposition of punitive damages; and

[7] contingency fee agreement in effect during trial, rather than hourly fee agreement entered into following trial, was proper basis for determining attorney fees.

Affirmed in part and reversed in part with directions.

****52** APPEAL from a judgment of the Superior Court of San Diego County, Ronald L. Styn, Judge. Affirmed in part and reversed in part with directions. (Super. Ct. No. 2013-00050682-CU-IC-CTL)

Attorneys and Law Firms

Wilson, Elser, Moskowitz, Edelman & Dicker, Gregory D. Hagen, San Diego; Greines, Martin, Stein & Richland, Robert A. Olson and Gary J. Wax, Los Angeles, for Defendant and Appellant.

Koeller, Nebeker, Carlson & Haluck, Robert C. Carlson, Sharon A. Huerta and Sarah P. Long, San Diego, for Plaintiff and Respondent.

Opinion

HUFFMAN, Acting P.J.

***1093** In this insurance defense dispute, defendant and appellant American Safety Indemnity ****54** Company (American Safety or ASIC) challenges a judgment after court trial that awarded over $1.4 million in compensatory and punitive damages to plaintiff and respondent Pulte Home Corporation (Pulte), who was the general contractor and developer of two residential projects in the San Marcos area. American Safety issued several sequential comprehensive general liability (CGL) insurance policies to three of Pulte's subcontractors,[1] and during 2003 to 2006, it added endorsements to those policies that named Pulte as an additional insured. The projects were completed by 2006.

1 Subcontractors on the projects who carried American Safety's insurance and who obtained additional insured endorsements for Pulte included Concrete Concepts, Inc. (Concrete), Frontier Concrete, Inc. (Frontier) and Foshay Electric Co., Inc. (Foshay). Where appropriate, we refer to these named insured "subcontractors" as a group, as it is not disputed that their policies had substantially similar endorsement language, as relevant here.

In 2011 and 2013, two groups of residents of the developments sued Pulte for damages in separate construction defect lawsuits. After American Safety declined to provide Pulte with a defense, Pulte filed this action, asserting that ***1094** the additional insured endorsements afforded it coverage and therefore required American Safety to provide it with defenses on the construction defect issues. The trial court resolved companion summary judgment and adjudication motions by ruling as a matter of law that a duty to defend was owed under at least one of the policies. (Code Civ. Proc.,[2] § 437c.) In bifurcated proceedings, the court proceeded to hear testimony to determine that contract damages were owed on each policy for the failure to carry out the duty to defend. (§ 592 [issues of law resolved before issues of fact].) The court also ruled that American Safety had breached its implied covenant duties through its bad faith conduct in claims handling that denied a defense.

2 All further statutory references are to the Code of Civil Procedure unless noted.

During the next phase of trial, the court awarded Pulte punitive damages and attorney fees under (*Brandt v. Superior Court* (1985) 37 Cal.3d 813, 210 Cal.Rptr. 211, 693 P.2d 796 (*Brandt*) [attorney fees recoverable as compensatory damages, attributable to counsel's efforts in obtaining rejected amounts due under insurance contract]; *Cassim v. Allstate Ins. Co.* (2004) 33 Cal.4th 780, 807, 16 Cal.Rptr.3d 374, 94 P.3d 513 [applying *Brandt* in context of contingency fee agreement].)

To address American Safety's challenges to the judgment, we first interpret the coverage provisions of the subject policies in light of the teachings of *Pardee Construction Co. v. Insurance Co. of the West* (2000) 77 Cal.App.4th 1340, 1356, 92 Cal.Rptr.2d 443 (*Pardee*). In that case, this court addressed the scope of coverage that may be afforded by additional insured endorsements in the factual context of construction defect litigation. We conclude that the trial court was correct in ruling that the language of American Safety's additional insured endorsements on the underlying insurance policies created ambiguities on the potential for coverage in the construction defect lawsuits, thus requiring it to provide Pulte with a defense to them. The trial court's subsequent decision that American Safety's failure to do so was unreasonable and in bad faith is supported by substantial evidence. We additionally uphold the court's decision that Pulte is entitled to an award of punitive damages that is proportional, on a one-to-one basis, to the award of compensatory damages in tort. (****55** *Bullock v. Philip Morris USA, Inc.* (2008) 159 Cal.App.4th 655, 690, fn. 18, 71 Cal.Rptr.3d 775.)

Although we affirm the judgment as to its substantive rulings, as above, we are required to reverse it in part as to the award of $471,313.52 attorney fees under *Brandt, supra,* 37 Cal.3d 813, 210 Cal.Rptr. 211, 693 P.2d 796, which we find to be inconsistent with the damages principles and policies set forth in *Brandt.* We believe the court abused its discretion in implementing an hourly attorney fee arrangement that Pulte did not arrive at until after trial, to replace the previous contingency fee agreement in a manner that Pulte intended would operate to increase its ***1095** demand.[3] Second, since the court calculated its $500,000 award of punitive damages by appropriately utilizing a one-to-one ratio to the compensatory damages under *Brandt* (fees in the amount of $471,313.52), it is necessary to direct the trial court to recalculate not only the fees award under *Brandt* but also to adjust the amount of punitive damages accordingly. The judgment will be reversed to

that extent, with directions to award *Brandt* fees only at a level consistent with Pulte's originally effective contingency fee agreement, and then to impose an amount of punitive damages that reflects the basic one-to-one proportion previously ordered. The balance of the judgment is affirmed.

[3] In contrast to the award of *Brandt* fees, the court based its contract damages award on the hourly billings and invoices submitted, along with a finding that the expert testimony supported the conclusion that the amount billed was reasonable based on analysis of such material. Accordingly, there is no apparent issue on appeal arising as to the change in fee agreements, except as to *Brandt*.

FACTUAL AND PROCEDURAL BACKGROUND

A. Underlying Lawsuits and Tenders

Beginning in 2003, Pulte was the general contractor and developer for two single-family residential housing projects, Meridian and Mariners' Landing (the projects), and it began to sell the homes in 2005 and 2006. During construction of both projects, Pulte entered into subcontracts with Concrete and Frontier to supply concrete foundations and flatwork. Pulte also entered into subcontracts with Foshay to supply electrical and related waterproofing work for both projects. All the subcontracts required that the subcontractors maintain liability insurance and that they name Pulte as an additional insured on their insurance policies.

In 2011, a group of Meridian homeowners filed a construction defect lawsuit against Pulte. (*Schaefer v. Pulte Home Corporation* (Super Ct. San Diego County, 2011, No. 37-2011-00086211-CU-CD-CTL) (the *Schaefer* action).) This lawsuit contained allegations against Pulte that its homes, sold after 2005 and 2006, were defectively constructed in their foundation systems and slabs, thus allowing moisture to enter into the structure and limiting the type of flooring materials and installation available. Such allegations, and those of other water intrusion and cracks in the walls and ceilings, potentially implicated the concrete subcontractors' work on the Meridian project. Pursuant to Concrete's and Frontier's policies and endorsements, Pulte tendered its defense of the lawsuit to American Safety. It provided copies of the subcontracts, insurance certificates and/or endorsements, and the construction defect complaint, with a homeowner matrix. American Safety refused for numerous reasons.

***1096** In 2013, a group of homeowners in Meridian and in Mariners' Landing filed their construction defect lawsuit against Pulte. (*Large v. Pulte Home Corporation* ****56** (Super. Ct. San Diego County, 2013, No. 37-2013-00043457-CU-CD-CTL) (the *Large* action).) This lawsuit contained water intrusion and other claims against Pulte potentially implicating the concrete subcontractors' work at the sites. Allegations were made that Foshay's electrical and related waterproofing work on the two projects was substandard and had contributed to damage at the projects, for which Pulte should be vicariously responsible. Pursuant to all three policies and with supporting documentation, Pulte tendered its defense of the lawsuit to American Safety, which declined. Numerous reasons were given.

Both construction defect actions went forward. Another carrier that is not a part of this lawsuit, Interstate, provided a partial defense to Pulte.

B. The Insurance Policies

During the time frames 2003 through 2006, American Safety issued to each of the three subcontractors, as "Named Insureds," several liability insurance policies for successive one-year periods. Each policy's insuring agreement provided coverage for property damage (or bodily injury, not involved here) to which the insurance applied, caused by an occurrence, during the policy periods.

The declarations page of each of the policies states that the aggregate limit for "products—completed operations" was $1 million. The insuring agreement and the definitions portions of the policies set forth terminology that is relevant here. The

definitions of "products—completed operations hazard," include all property damage occurring away from the insured's premises, ****57** "arising out of 'your product' or 'your work' " (except for incomplete work or abandoned work; not involved here). " 'Your work' " is defined as meaning "(a) [w]ork or operations performed by you or on your behalf, and (b) [m]aterials, parts or equipment furnished in connection with such work or operations." " 'Your work' " includes warranties as to fitness and quality.

Within the "products—completed operations" definitions, "your work" is deemed complete either when the work (a) called for in the contract is complete; (b) at a particular job site is complete; or (c) is put to its intended use.

Under the policy, "occurrence" means an accident, "including continuous or repeated exposure to substantially the same general harmful conditions." "Property damage" includes: "a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it."

***1097** With respect to what entities constitute "the insured" under the subcontractors' policies, American Safety issued additional insured endorsements (AIEs) to Pulte, to become effective upon policy issuance (or later, when work first started, etc.). Both appellant and respondent in this case agree that while the exact language of the various AIEs in the various policies varies slightly, they are all substantially similar. A key version of the grant of coverage in the AIEs states:

> "WHO IS AN INSURED (SECTION II) is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of 'your work' which is ongoing and which is performed by the Named Insured for the Additional Insured on or after the effective date of this Endorsement."

An alternative version of the AIE amended the definition of "who is an insured" to include Pulte as an additional insured, "but only with respect to liability arising out of 'your work' *and* only as respects ongoing operations performed by the Named Insured for the Additional Insured on or after" the endorsement's effective date. (Italics added.) Some of the policies replace the italicized "*and*" (as above) with "*but*."

In two of the Foshay versions (all three of which were applicable only to the *Large* project, not *Schaefer*), the AIEs are stated to provide coverage to the additional insured, "but only with respect to liability arising out of 'your work' which is performed *at the project designated above*. This Endorsement applies only to ongoing operations performed by the Named Insured on or after" the endorsement's effective date. (Italics added.) These Foshay policies specify "*at the project designated above*," because they include a line in the endorsement for the "Name of Project," which identifies, "Those projects on file with the Company."[4]

4 Although the Foshay policies are the only ones here that include a restriction that the policy covers only "projects on file with the company," some of the Concrete and Frontier denial letters from American Safety also use that policy language for a basis for denial (i.e., referring to failures to file the project with the company).

Each of the subcontractors' policies includes numerous exclusions in sections designated by that heading. As relevant here, American Safety relies on separate "faulty workmanship" or "work product" exclusions. In exclusion j. (5), the subcontractors' policies state that no coverage is afforded for "property damage" to "[t]hat particular part of real property on which you ... are performing operations, if the 'property damage' arises out of those operations[.]" Likewise, exclusion j.(6) precludes coverage for "[t]hat particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it." This exclusion j.(6) "does not apply to 'property damage' included in the 'products-completed operations hazard.' " American Safety also discusses exclusion (l), "Damage to Your ***1098** Work," as excluding coverage for "property damage" to the insured's work "arising out of it or any part of it and included in the 'products-completed operations hazard.' "[5]

5 The policies contain numerous other restrictions that were litigated at trial, but that are not actively pursued as operative in this appeal. These include provisions in an endorsement for a self-insured retention (SIR), and a "sole negligence" requirement. As noted, Pulte received a partial defense from another carrier, Interstate, that is not a part of this lawsuit. We are not required to address the disputes during trial about the applicability of such other insurance, except to a limited extent regarding bad faith, as will be explained (pt. III, *post*).

C. This Action Filed; Series of Summary Judgment Motions

Pulte filed this action in 2013 seeking damages, including awards of unreimbursed defense expenses, *Brandt* fees and punitive damages. Declaratory relief was requested on the duty to defend and/or indemnify, breach of contract damages for the failure to defend and/or indemnify, and further relief for breach of the duty of fair dealing and good faith. As bad faith, Pulte alleges American Safety (1) failed to conduct "a reasonable, timely, and unbiased investigation" to fully evaluate the requests for a full defense; (2) failed to respond in a timely manner; (3) refused to honor its obligations under the policies; (4) misrepresented pertinent policy provisions; (5) based the coverage decisions "on a desire to reduce and/or avoid obligations to Pulte," thus refusing to afford it a defense. This conduct allegedly "purposely deprived ****58** Pulte of the rights and benefits as an insured under the policies." Moreover, it was alleged to be part of a "conscious and deliberate pattern of unfair claims practices" of nonpayment and rejection of tenders of defense and indemnity made by the insureds, thus serving to frustrate Pulte's and other additional insureds' reasonable expectations for coverage under the terms of the liability insurance policies.

Pulte's initial motion for summary adjudication as to a declaration of the duty to defend was denied, and this court denied its petition for a writ of mandate vacating that ruling. (*Pulte Home Corporation v. Superior Court*, Dec. 16, 1984, D067083.)

Later in the action, Pulte and American Safety filed cross-summary judgment/summary adjudication motions. According to Pulte, it was entitled to summary adjudication and declaratory relief that American Safety had a duty to defend both underlying actions, under the Concrete policies.

In contrast, American Safety sought summary judgment that (1) it owed no duty to defend as to any of the subcontractors' policies, and (2) as a matter of law, its position that there was no duty to defend and no coverage potential was reasonable, for purposes of the bad faith claim.

***1099** By June 2015, the trial court issued rulings on both the motions. It granted Pulte's summary adjudication request to find that American Safety had a duty to defend Concrete in the actions. The court determined that American Safety had not established triable issues of material fact on several defenses it was raising, such as a lack of evidence about when work was performed at the defective homes. The court determined that as of the time of tender, American Safety was potentially exposed to liability on Concrete's policies for work performed on the homes on or after the effective date of the AIEs. The court found no triable issues had been raised by American Safety that the work product (faulty workmanship) exclusions might have applied. In reading the language of the policy, the court further determined that the subcontractors' policies provided coverage for completed operations and the AIEs had not excluded such coverage. After Pulte's motion was granted, American Safety did not take up the defense of the still-pending *Large* litigation.

Next, the court denied American Safety's motion for summary judgment or summary adjudication. As previously noted (fn. 5, *ante*), two issues that were dealt with are no longer pursued on appeal, a sole negligence restriction and a SIR requirement.[6] However, the court issued key rulings denying summary judgment to American Safety based on the ongoing operations language in its policies. The court analyzed the authority of *Pardee*, *supra*, 77 Cal.App.4th at pages 1356 through 1357, 92 Cal.Rptr.2d 443, on the related topic of completed operations coverage as arising out of this property damage AIE language, "liability arising out of 'your work.' " The court found that the AIEs' references to ongoing operations had not expressly excluded complete operations coverage, and there were triable issues of fact on a potential for such coverage that would preclude a summary judgment for American Safety. The court also addressed a policy term found only in Foshay's policies, that covered projects had to be "on ****59** file" with the company. The court determined that there were triable issues of material fact as to whether those projects were known to be on file with American Safety, within the meaning of the policy.

6 In ruling against American Safety's request for summary judgment, the court noted that in the present duty to defend context, there was no appropriate reliance on "the genuine dispute doctrine," which precludes bad faith findings where an insurance carrier has a reasonable basis to deny coverage. Even if the doctrine did apply, the trial court said it would not operate in American Safety's favor on the motion.

D. Phase 1 of Court Trial: Rulings on Duty to Defend and Bad Faith

At trial beginning in November 2015, Pulte submitted a motion under section 592 to have certain rulings of law made before factual issues were tried. Pulte referenced the court's ruling that had granted its previous summary adjudication motion to establish as a matter of law that under the ***1100** Concrete policies, American Safety had a duty to defend Pulte in the still ongoing *Large* matter, and likewise had such a duty in the *Schaefer* case (since resolved). Pulte argued that since the other subcontractors, Foshay and Frontier, were also insured by American Safety while they worked on the same homes involved in these underlying actions, during the same time frames, a similar ruling should be issued as to those subcontractors. Pulte reasoned, "Because all factual predicates to the duty to defend as to Foshay and Frontier were admitted by American Safety in its denial letters, and all legal issues have been resolved by the Court's prior ruling in Pulte's favor, the Court should now rule as a matter of law that American Safety owed Pulte a duty to defend under the Foshay and Frontier policies as well."

This motion was opposed by American Safety on several grounds, arguing that some of the material being relied on by Pulte, purported statements of claims adjusters, was insufficient because it amounted to rephrasing hearsay information provided by Pulte in tendering the defense under the policies. American Safety argued that even though Pulte had prevailed on its own motion, it still had to prove there were "ongoing operations of the named insureds" during the effective dates of the endorsements, and it was not enough to submit subcontracts and homeowner matrixes from the underlying actions.

As explained in the court's written decision after trial, the procedure it had followed was to hear Pulte's motion under section 592 (duty to defend under the Foshay and Frontier policies), but to defer decision on it until the end of trial. The court took testimony from Pulte's managing employees about the claims process, and from its construction defects counsel Sharon Huerta. Huerta testified that in such cases, additional defects lists were sometimes supplied after the initial complaints were filed by homeowners and investigations were conducted. Pulte's expert witness, Andrew Waxler, addressed coverage issues and the amounts of fees Pulte incurred to defend the underlying actions, saying they were reasonable in amounts. Although Pulte used a third party claims administrator for litigation and financial management, it paid for its own defense.

Pulte conducted direct examination of adverse witnesses, three of American Safety's claims examiners and their supervisor, corporate claims counsel Jean Fisher. (Evid. Code, § 776.) Fisher explained she began working for American Safety in 2005, until in 2006 she began working for the related American Safety Claims Services, its third party claims administrator. She assisted in drafting the subject AIEs. Although she testified that she did not make decisions directly for American Safety, she also admitted that she did not have to consult with its management in supervising her claims adjusters, who issued denial letters under her guidance.

***1101** As defense witnesses, American Safety presented further testimony from Attorney Fisher and expert testimony on policy ****60** interpretation from insurance expert Julia Molander.

At the close of testimony, the court addressed the reserved issues under section 592, noting that extensive proceedings had taken place to determine the effect of the previous summary adjudication ruling that there had been a duty to defend Concrete. The court was being asked to extend that duty to the other subcontractors, and also to decide whether the noncoverage position taken by American Safety had been reasonable or instead, tortious and in bad faith. The court ruled as a matter of law that, consistent with its previous rulings on summary judgment, American Safety had a duty to defend Pulte under each of the policies. The court reached this conclusion about the effect of the previous summary judgment rulings under the authority of *Montrose Chemical Company v. Superior Court* (1993) 6 Cal.4th 287, 300-301, 24 Cal.Rptr.2d 467, 861 P.2d 1153 (*Montrose I*) (discussing procedural ramifications of summary judgment rulings in duty to defend actions), and (*McMillin Companies, LLC v. American Safety Indemnity Co.* (2015) 233 Cal.App.4th 518, 541, 183 Cal.Rptr.3d 26 (*McMillin*) ["using an in limine motion as a substitute for a potentially dispositive statutory (e.g., summary judgment) motion produces substantial risk of prejudicial error"]; see pt. III.A, *post*).

Based on the court's independent reading of the policy language in light of the analysis in *Pardee, supra,* 77 Cal.App.4th 1340, 92 Cal.Rptr.2d 443, it confirmed that these AIEs did not effectively exclude coverage for "completed operations" or for ongoing operations. Because American Safety was found to have owed a duty to defend Pulte under each policy, the court outlined as the remaining issues whether Pulte had suffered any damages from that conduct and, if so, how much, regarding its claims on breach of the insurance agreements, for the expenses of defending the underlying *Schaefer* and *Large* actions. The court received extensive briefing, attorney declarations and invoices as to the fees Pulte had incurred and the recent change it had agreed to, from a contingency attorney fee arrangement to an hourly one.

In reaching its conclusions on breach of insurance duties and damages, the court noted it had years of experience with construction defect cases. The court made the observation that "construction defect litigation is notoriously fluid. Claims omitted from one defect list pop up on a later defect list. While American Safety is not required to speculate on future claims, the [inspection] reports do not establish there was no potential for coverage after their preparation." In evaluating American Safety's refusal to provide a defense, the court commented that the types of defects being alleged by the homeowners in the underlying cases gave rise to a potential for coverage.

***1102** Based on expert testimony, the court made a finding that the fees Pulte had incurred in defending the *Schaefer* and *Large* actions were reasonable. After making appropriate credits for fees Pulte had received from the other insurer (Interstate), the court made reductions for "(1) the $25,000 SIR [Schaefer], (2) fees incurred pre-tender, and (3) all fees for tendering to American Safety which, if awarded, would be part of the *Brandt* fees." Ultimately, the adjusted and corrected contract damages, with prejudgment interest, totaled $455,238.45.[7]

[7] Although American Safety continues on appeal to challenge any imposition of liability, it evidently does not find fault with the trial court's arithmetic in reaching the contract damages calculations.

****61** The court next addressed whether the denials of defenses had been made in bad faith, so as to entitle Pulte to *Brandt* fees and, if so, the amount awardable. It concluded that American Safety's claims handling and denials of defenses had been conducted in bad faith, in breach of its duty of good faith and fair dealing owed to Pulte. American Safety had interpreted the only available case law by disregarding California federal courts' unpublished cases that were contrary to its noncoverage position. The court relied on several instances of conduct by American Safety representatives as constituting bad faith. However, it determined that the continuing refusal to defend Pulte, after the court issued its summary judgment rulings, was not per se unreasonable, in light of its knowledge and belief that another carrier, Interstate, was providing Pulte some form of defense in the underlying cases.[8]

[8] Pulte argues in its respondent's brief that the trial court erred in ruling that American Safety's failure to defend Pulte in the *Large* action, after Pulte's summary adjudication motion was granted, did not amount to bad faith (since Interstate was providing an alternative defense to Pulte). (See, e.g., *Aerojet-General Corp. v. Transport Indemnity Co.* (1997) 17 Cal.4th 38, 70, 70 Cal.Rptr.2d 118, 948 P.2d 909 [duty to defend evaluated without reference to another carrier's participation].) This factor has been considered as part of the overall picture but is not dispositive here.

The court then reached the issue of the substantive entitlement to punitive damages, in terms of whether Pulte had established by clear and convincing evidence that American Safety was guilty of oppression, fraud or malice. The court found Pulte had made an adequate showing of American Safety's demonstrated pattern and practice of issuing AIEs, then using every conceivable argument to deny coverage, regardless of the merit of the arguments. The evidence showed this conduct had occurred not only in the current case but also in hundreds of denials of other additional insureds' tenders, amounting to misrepresentations about the policy provisions. The court determined that the testimony of Attorney Fisher and the claims adjusters demonstrated that Fisher had exercised substantial independent authority and judgment in claims handling, thus effectively determining corporate policy with the knowledge and cooperation of her managers, who ratified her decisions. All ***1103** that conduct occurred in the context of American Safety's knowledge that both the named insureds and additional insureds intended that they would be receiving a defense if they were sued in construction defect cases. This conduct amounted to clear and convincing evidence of its malice and oppression.

The court accordingly required American Safety to produce evidence about its financial condition, in connection with the punitive damages requests. A second phase of trial on punitive damages and *Brandt* fees was required.

E. Phase Two of Trial: Punitive Damages and Attorney Fees

Pulte submitted declarations dated February 9, 2016, after trial, from its house counsel Michael Laramie and its third party claims administrator, John Macy, about why Pulte had changed its contingency fee agreement to an hourly one, believing that more compensation for counsel was needed in response to the hard fought nature of the trial. Following further briefing and

oral argument, the court issued a separate decision on punitive damages and all of the attorney fees issues. In the discussion portion of this opinion, we will set forth its specific reasoning and awards. Pulte's base award of defense fees and costs, plus prejudgment interest, for the defense of the *Schaefer* and *Large* actions amounted to ****62** $455,238.45. In addition, it received a separate award of attorney fees and costs pursuant to *Brandt*, *supra*, 37 Cal.3d 813, 210 Cal.Rptr. 211, 693 P.2d 796, in an amount intended to be equivalent to what Pulte had actually incurred and paid, subject to reductions by the court for ineligible fees (those incurred pre-tender, those incurred in pursuit of a defense, and the applicable self-insured retention amount). Pulte was thus awarded its unreimbursed defense fees and costs incurred, as *Brandt* attorney fees of $471,313.52, together with associated costs of $38,587. The court determined that punitive damages should be awarded against American Safety, on a one-to-one ratio to the *Brandt* fees, as appropriate for this type of case.

In total, the judgment entered against American Safety was for $1,478,288.37, with interest.[9] Its new trial motion on excessive damages grounds was denied and it appeals.[10]

9 The breakdown of the judgment is as follows: *Schaefer* defense fees and costs, $217,280.01; *Large* defense fees and costs, $114,842.98; *Schaefer* prejudgment interest to February 19, 2016, $101,353.79; *Large* prejudgment interest to February 19, 2016, $21,761.67; *Brandt* fees, $471,313.52; *Brandt* costs, $38,587; punitive damages, $500,000.

10 On June 5, 2017, this Court denied Pulte's request for judicial notice on appeal of an unpublished case report and of various trial court orders that were issued in unrelated cases in which American Safety was also a party. (Evid. Code, §§ 452, 453, 459.)

***1104** DISCUSSION

Here, as in *Pardee*, *supra*, 77 Cal.App.4th at page 1356, 92 Cal.Rptr.2d 443, the initial issue for policy interpretation "is whether the additional insured endorsements explicitly *exclude* coverage for the subcontractors' completed operations." American Safety chiefly contends that its coverage exposure was limited to the time frame of the subcontractors' ongoing operations at the project sites, and that since the homes were sold as completed units, such ongoing operations had long been concluded. It also argues the faulty workmanship policy exclusions applied, in connection with its position that its noncoverage determinations were reasonable and not in bad faith.

In response, Pulte claims that as an additional insured, the tenders of defense that it provided to American Safety contained sufficient information to demonstrate its entitlement to a defense, based on potential completed operations coverage that should have been available under the policies. Pulte argues this grant of coverage "for liability arising out of 'your work' " was not inconsistent with the "ongoing operations" language. To address these issues and whether there is support in the record for the different forms of relief awarded by the trial court, we first outline policy interpretation standards in this factual context. (*Griffin Dewatering Corp. v. Northern Ins. Co. of New York* (2009) 176 Cal.App.4th 172, 208, 97 Cal.Rptr.3d 568 (*Griffin Dewatering Corp.*) [reasonableness of insurer's contractual position depends on both the factual context in which the dispute arose and the rules of contract interpretation].)

I

POLICY INTERPRETATION

A. Duty to Defend

[1] [2] [3] [4] [5]Both parties agree that the trial court's basic policy interpretation rulings are subject to de novo review. (*Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 18, 44 Cal.Rptr.2d 370, 900 P.2d 619 (*Waller*); ****63** *Pardee*, *supra*, 77

Cal.App.4th at p. 1349, fn. 3, 92 Cal.Rptr.2d 443.) "The determination whether an insurer owes a duty to defend is made in the first instance by comparing the terms of the policy with the allegations of the complaint. Facts extrinsic to the complaint give rise to a duty to defend when they reveal the possibility the claim may be covered by the policy. Conversely, where such facts eliminate the potential for coverage, the insurer may decline to defend even where the bare allegations of the complaint suggest potential liability. This is so because the duty to defend, although broad, is not unlimited, but rather measured by the nature and kinds of risks covered by the policy. An insurer ***1105** may have a duty to defend even though it ultimately may have no obligation to indemnify.... Finally, the duty to defend is a continuing one, arising upon tender and lasting until the underlying litigation is resolved, or until the insurer has established there is no potential for coverage." (*Id*. at p. 1350, 92 Cal.Rptr.2d 443.)

[6] [7] [8]"The fundamental rules governing the interpretation of contracts apply equally to the construing of insurance contracts. They are premised on the primary goal of giving effect to the mutual intention of the parties at the time the contract is formed. That intent is to be inferred, if possible, solely from the written provisions of the contract. If the language of the insurance contract is clear and explicit, it governs. [¶] ... [¶] ... [B]ut in order to protect the objectively reasonable expectations of the insured, the courts endeavor to interpret the ambiguous language in the sense in which the insurer believed, at the time of making it, the insured understood it. Only if this approach does not resolve the ambiguity, do the courts then resolve it against the insurer." (*Pardee*, *supra*, 77 Cal.App.4th at p. 1352, 92 Cal.Rptr.2d 443; *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1264-1265, 10 Cal.Rptr.2d 538, 833 P.2d 545.)

[9]"Since construction defect litigation is typically complex and expensive, a key motivation in procuring an additional insured endorsement is to offset the cost of defending lawsuits where the general contractor's liability is claimed to be derivative." (*Maryland Casualty Co. v. Nationwide Ins. Co.* (1998) 65 Cal.App.4th 21, 33, 76 Cal.Rptr.2d 113.) " 'Endorsements on an insurance policy form a part of the insurance contract [citation], and the policy of insurance with the endorsements and riders thereon must be construed together as a whole [citation].' " (*Narver v. California State Life Ins. Co.* (1930) 211 Cal. 176, 181, 294 P. 393.)

B. Potential for Coverage Regarding Additional Insureds

The subcontractors' base agreement with Pulte required them to "add Pulte [ ]as an Additional Insured on the above general liability policy by having the insurance carrier issue a CGL-2010 Endorsement, Additional Insured-Endorsement Edition date 10/93, or its equivalent as determined by Pulte. This endorsement shall apply to the full extent of the actual limits of Contractors' coverage...."

[10]As to any AIE, "in resolving whether the allegations in a complaint give rise to coverage under a CGL policy, we must consider the occurrence language in the policy, as well as the endorsements, if any, that broaden coverage included in the policy terms." (*Pardee*, *supra*, 77 Cal.App.4th at p. 1351, 92 Cal.Rptr.2d 443.) *Pardee* contains extensive analysis of the different versions of AIEs ***1106** used in the industry, as drafted by the ISO (e.g., a sample AIE, the "2010" form; see Cal. Practice Guide: Insurance Litigation (The Rutter Group 2016) ¶ 7:1407.5, pp. 7E-3 to 7E-4.) Construction defect claims may ****64** arise long after completion of the project. *Pardee's* discussion references the commercial reality of the CGL market as giving contour to the reasonable expectations of policyholders and additional insureds in this context, as follows:

> "Damage resulting from a subcontractor's work often does not arise for years. It is thus prudent for general contractors to obtain completed operations coverage as additional insureds from their subcontractors' insurers.... [A]dditional insured coverage is intended by the insurance industry to cover vicarious liability that an additional insured may incur due to operations of the originally named insured. Nor is there any dispute the endorsements were purchased so as to protect the general contractor against potential construction defect litigation." (*Pardee*, *supra*, 77 Cal.App.4th at pp. 1360-1361, 92 Cal.Rptr.2d 443.)

It is well recognized that "*property damage resulting from defective construction may occur over an extended period of time, spanning several policy periods.* [Citation.] Consequently, it is common for a general contractor or developer to be insured under several separate policies for the same construction liability. In such cases, the several insurers on the risk may be required to share the costs of defense and indemnification." (Cal. Practice Guide: Insurance Litigation, *supra*, ¶ 7:1408.7, p.

7E-5; italics added.) It is in this context that *Pardee, supra*, 77 Cal.App.4th at pages 1355 to 1359, 92 Cal.Rptr.2d 443 addresses whether "completed operations" coverage under the subcontractor's policy, for its negligence, extends to the vicarious liability of an additional insured developer. The conclusion to be reached depends on the wording of the additional insured endorsement. (*Ibid.*; Cal. Practice Guide: Insurance Litigation, *supra*, ¶¶ 7:1409.15-7:1409.16, pp. 7E-13 to 7E-14.)

[11]Where, as here, the insurer has drafted the policy language, it is usually held responsible for ambiguous policy language, through the rule of construction in favor of the insured's reasonable expectations. (*AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 822–223, 274 Cal.Rptr. 820, 799 P.2d 1253.) If it is clear that an insurance policy was actually negotiated and jointly drafted, less attention is paid to protecting the insured from ambiguous or highly technical drafting. (*Ibid.*) American Safety wrote its own "manuscript" AIEs, which the named insurers obtained for Pulte. That sequence of events does not indicate there was approximately equal bargaining power in this case. This leaves us with the usual rule for resolving ambiguities against the insurer, to interpreting the potential scope of coverage under these specialized AIEs, as it relates to a duty to defend.

***1107** II

DUTY TO DEFEND UNDER ADDITIONAL INSURED ENDORSEMENTS

A. Effect of Summary Judgment/Adjudication Rulings

At the outset of trial, Pulte's section 592 motion sought a preliminary legal ruling that the denial of American Safety's motion for summary judgment served to establish a duty to defend as a matter of law. Pulte also relied on its own previous summary adjudication motion, granted as to Concrete's entitlement to a defense. Pulte sought a legal ruling at trial to extend that duty to the two other subcontractors.[11] ****65** Pulte cited to the American Safety denial letters as to the Foshay and Frontier policies, in which American Safety had reviewed the documentation provided and acknowledged the dates of the subcontracts, job file documents, and the AIEs, as well as the close of escrow dates for Pulte's sales of the allegedly defective homes.

11 When denying American Safety's summary judgment motion, the court declined to resolve it on procedural issues such as noncompliance with the requirements of the rules of court on the format of the papers. Instead, the court expressed a preference to reach the merits of the motion. The fact that trial was still required to go forward at that point shows that some of the merits of the policy interpretation issues were still in flux.

Using those exemplars of American Safety's denial letters, Pulte's section 592 motion contended American Safety's correspondence admitted that there was a potential that the work performed by the named insureds had occurred within the identified policy periods, by setting forth the relevant close of escrow dates of sales of the completed homes. Opposition by American Safety was filed, the matter was deferred, and the court proceeded to hear several days of testimony from each side.

In ruling on the section 592 motion at the conclusion of trial, the court observed, "We had a lot of evidence, a lot of testimony, documents, and everything else about ongoing operations, about sole negligence and those issues. I am assuming the relevance of those in hindsight is whether it was reasonable or not for American Safety not to defend." The court explained that American Safety had been unsuccessful throughout in seeking to implement its substantive interpretation of the policy language, and then ruled from the bench:

> "In the motion filed by [American Safety], the argument, at least as addressed in the summary adjudication, was not that there were not, in fact, operations, but rather the interpretation of the policy. And the ruling was not a factual ruling, but a legal rule. But nothing would change on that. The facts

> are still the same on that. Nothing changes. The policy is still the same. [¶] ... [¶] So some of the issues were denied on questions of fact, material ***1108** issues of fact.... I went into the arguments on both sides as opposed to simply saying that there was a failure on the initial burden of proof. [¶] So I think the traditional rule of *Montrose* [*I, supra*, 6 Cal.4th 287, 300-301, 24 Cal.Rptr.2d 467, 861 P.2d 1153; citations] applies. And the effect of the denial of American Safety indemnity's motion for summary judgment and summary adjudication established the duty to defend. And therefore, the issue I have to decide is whether or not the denials were reasonable or in good faith. [¶] ... [¶] I think all of the facts adduced at trial are still relevant as to reasonableness. [¶] ... [¶] So go ahead...."

Although we accept that the trial court's summary adjudication ruling establishing there was a duty to defend (as to Concrete) served to limit the legal issues presented at trial, we also acknowledge that other arguments on the potential for coverage were developed during trial. After it heard the evidence, the court essentially confirmed its previous rulings on the pretrial motions, consistent with its understanding of the explanation in *Montrose I, supra*, 6 Cal.4th at pages 300 through 301, 24 Cal.Rptr.2d 467, 861 P.2d 1153, of the extent of the binding effect of a summary judgment ruling in this context. (See *McMillin, supra*, 233 Cal.App.4th 518, 541, 183 Cal.Rptr.3d 26.) The court accordingly told counsel that the evidence already presented about the coverage and exclusions issues was now to be considered on the bad faith questions, as part of the evaluation of the reasonableness of the denials of defenses.

****66** To some extent, this appeal reargues the same policy interpretation issues on the potential for coverage, under its completed operations and ongoing operations language. However, many of the issues for which the trial court found the existence of triable material facts have essentially been dropped out of the appeal (e.g., the self-insured retention, other insurance, and sole negligence). The better approach now is to assess the merits of the trial court's various, consistent coverage rulings on a de novo basis, concerning the duty to provide a defense, and then to decide the closely related reasonableness issues on the bad faith claims (pt. III, *post*).

B. Nature of Potential Coverage under Policies

[12]The terms of the AIEs must be read in light of the definitions and coverage provisions of the policies. Pulte was named as an additional insured "but only with respect to liability arising out of 'your work' *and only as respects ongoing operations* performed by the Named Insured for the Additional Insured on or after" the endorsement's effective date. (Italics added.)[12] Another typical version states:

> "WHO IS AN INSURED (SECTION II) is amended to include as an insured the person or organization shown in the ***1109** Schedule, *but only with respect to liability arising out of 'your work' which is ongoing* and which is performed by the Named Insured for the Additional Insured on or after the effective date of this Endorsement." (Italics added.)

12 As noted, some of the policies replace the italicized "*and*" in these AIEs with "*but*."

" 'Your work' " includes warranties as to fitness and quality. Within the " 'products–completed operations hazards' " definitions, " 'your work' " is deemed complete either when the work (a) called for in the contract is complete; (b) at a particular job site is complete; or (c) is put to its intended use.

The reader will recall that the declarations pages offer coverage for "products–completed operations hazard," defined as including all property damage occurring away from the insured's premises, "arising out of 'your product' or 'your work' " (except for incomplete or abandoned work; not applicable here).

1. Respective Arguments

American Safety argued the underlying construction defect complaints failed to allege any ongoing operations as of the time the homeowners bought the homes, and therefore no potential for coverage existed. (But see *D.R. Horton Los Angeles Holding Co., Inc. v. American Safety Indem. Co.* (S.D.Cal., Jan. 5, 2012, No. 10CV443WQH), 2012 WL 33070, at p. *17, 2012 U.S. Dist. LEXIS 1881, at pp. *53-*54 (*D.R. Horton*) [additional-insured coverage could exist for ongoing operations, if work on other phases of the development continued after completion of the particular homes sued upon].) American Safety claims that once the defective homes were sold, only completed operations coverage could have applied, but it was successfully excluded by including their ongoing operations language in the AIEs. It believes its AIEs had complied with the "roadmap for carriers" created by *Pardee*, *supra*, 77 Cal.App.4th 1340, 92 Cal.Rptr.2d 443 on how to insure named insureds, but without granting coverage for completed operations to additional insureds. This was done through its "project on file" restriction (Foshay only, through 2004 only) and its "ongoing operations" language, which American Safety used as tools to limit its coverage exposure.

****67** American Safety's trial attorney contended that in the AIEs, " 'ongoing operations' immediately follows 'your work.' So it has to be read as a limitation upon 'your work.' 'Your work' cannot be read without the limit of 'ongoing operations.' " On the issue of ongoing operations, American Safety took the position that its "ongoing operations" language contained in the AIEs should be read as a restricted grant of coverage, not an exclusion, but part of the actual grant. It further argued Pulte had failed to establish that it was an insured under this grant of coverage, because "construction defect ***1110** claims by their very nature are completed operations claims as the product has been completed and put to its intended purpose; namely, it's been sold to homeowners who are now suing."

Next, to the extent that a subcontractor caused damage to the project itself during its ongoing operations, American Safety argued that the faulty workmanship exclusions (j.(5)) and (j.(6)) applied to preclude any duty to defend.

For purposes of discussion, the trial court summarized Pulte's position as claiming that its reasonable expectation, in requiring its subcontractors to obtain their own completed operations coverage and to provide it with additional insured status, was to obtain the same coverage for itself. The court surmised that when the subcontractors went to American Safety, they obtained and provided "something and it says 'your work' and it says something about completed operations. It's kind of confusing. [Pulte says], 'Well, that probably satisfies, so we're okay.' We don't find out until—that's the argument." Pulte was thus arguing that if the American Safety AIEs had expressly stated there would be no completed operations coverage, then the developer would have understood that, and would have told the subcontractors, "Go back and try again," to obtain more complete additional insured coverage.

2. Distinctions on Appeal: Completed Operations and Ongoing Operations

Pulte's request for a defense arose out of the named insureds' participation in construction work that was done over a period of time, in several phases. American Safety contends that the AIEs it drafted contain language that expressly limited the time frame of such coverage to the time of the ongoing operations of the named insureds (i.e., before completion). (See *Pardee*, *supra*, 77 Cal.App.4th at p. 1356, 92 Cal.Rptr.2d 443.) It argues we must give each term in the endorsement its proper effect, and to do so, the ongoing operations reference in the AIEs should be read as a limitation upon "your work," and as to when it occurred.

In its reply brief, American Safety represents that the issues at trial were mainly litigated in terms of the existence of any completed operations coverage, but that on appeal, Pulte's respondent's brief seems to argue that there was a potential for coverage under either type of coverage, completed operations and/or ongoing operations. American Safety contends that the policy clearly distinguishes between liability for ongoing versus "completed operations" coverage. It says these coverages are time sensitive and "complementary and not overlapping." (See *Fibreboard Corp. v. Hartford Accident & Indemnity Co.* (1993) 16 Cal.App.4th 492, 499-506, 20 Cal.Rptr.2d 376 ***1111** (*Fibreboard Corp.*) [addressing coverage under a "products hazard" clause containing a special asbestos exclusion in a policy issued to a manufacturer of asbestos-containing products].) As explained in *Fibreboard Corp.*:

"[A] manufacturer or person who performs a service can incur liability in a ****68** number of ways, including '(1) while

work is in progress, [and] (2) after completion.... An injury or loss may result while an activity is in progress, and prior to the completion thereof, either as a result of an act of negligence or an omission. Such liability is embraced within the ordinary liability aspect of a public liability policy under coverage for premises-operations. [¶] ... [O]nce a product has been completed and sent to market ... liability may be incurred by reason of a defect in merchandise or improper workmanship. It should be clear that the premises-operations coverage is not appropriate coverage and the individual now needs 'products liability' or 'completed operations' coverage. The coverages are complementary and not overlapping....' [Citation.] Thus, as a matter of sequencing, 'it is well to recognize that products liability is a coverage that takes over where premises-operations leaves off....' " (*Fibreboard Corp., supra*, 16 Cal.App.4th 492, 500-501, 20 Cal.Rptr.2d 376.)

This authority indicates that there may be a clear distinction among products liability claims concerning a completed product, compared to other liability claims for work in progress. (*Fibreboard Corp., supra*, 16 Cal.App.4th at pp. 500-501, 20 Cal.Rptr.2d 376.) That is a different context and type of work from the case before us, arising in the context of construction defects in which one faulty component or portion of a subcontractor's work could allegedly have caused physical injury to nearby work. Since we are evaluating only a potential for coverage, as related to a duty to defend and on a de novo basis, we must consider the language of the AIEs for any or all type of coverage they may afford. (*Pardee, supra*, 77 Cal.App.4th at p. 1351, 92 Cal.Rptr.2d 443 [court considers occurrence language in the policy with the endorsements to determine whether coverage included in the policy terms is broadened].)

3. Timing of Alleged Property Damage

[13] [14]A standard occurrence based CGL policy potentially provides coverage for injury or damage even if it may not have been discovered or manifested until after the policy period ended. (*Century Indemnity Co. v. Hearrean* (2002) 98 Cal.App.4th 734, 743, 120 Cal.Rptr.2d 66.) American Safety's initial argument seems to be that we should evaluate the construction defect complaints as alleging injury that did not occur until the date of purchases by the individual home buyers, of completed homes. It is claiming that there were no longer any ongoing operations by the subcontractors, once the homes were completed.

When Pulte tendered its defense, American Safety was notified of allegations that the subject homes contained violations of construction standards, ***1112** leading to existing and anticipated property damage from moisture that was invading the faulty concrete, electrical, or waterproofing work. With regard to the timing of alleged property damage, the *Schaefer* action alleged that within the past 10 years, the defendants, as original owners or developers of the project, had constructed the homes, which since their completion, "have become known to be defective as herein alleged," in that they are not adequately constructed to prevent water intrusion. Such construction was alleged to have been done in an improper fashion, resulting in the homes' water damage as a direct and proximate consequence.

The *Large* complaint alleged that Pulte had performed construction and development of the homes, which were substantially completed within the last 10 years. *Large* alleged that the defendant real estate ****69** developers and their agents had failed to meet residential construction standards for components such as waterproofing systems, electrical systems, and concrete, and that many of the violations were causing property damage to their homes.

[15]Exposure to liability under a policy is evaluated according to the specific language under review, to reconcile the effect of related elements in the CGL policy. (*Baker v. National Interstate Ins. Co.* (2009) 180 Cal.App.4th 1319, 1337-1339, 103 Cal.Rptr.3d 565 (*Baker*).) Under these policies, " 'Occurrence' means an accident, including continuous or repeated exposure to substantially the same general harmful conditions." "Property damage" includes: "a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it...." None of this language requires "that the eventual claimant own the property at the time the property is damaged for coverage to ensue." (*Garriott Crop Dusting Co. v. Superior Court* (1990) 221 Cal.App.3d 783, 791, 270 Cal.Rptr. 678.) In any event, there was a lack of evidence about when the subcontractors' work was performed at the defective homes.

These policy terms may be read to cover construction work that creates "physical injury to tangible property," such as from exposure to moisture leakage, due to the nature of concrete or electrical work that was performed during the effective periods stated in the AIEs. Physical injury to the homes' foundations and walls, as established by inspections, is clearly alleged in the

underlying construction defect complaints, and is not tied to the current owners' finances. Attorney Huerta generally testified that defects lists could be updated during litigation. The trial court agreed, "construction defect litigation is notoriously fluid. Claims omitted from one defect list pop up on a later defect list. While [American Safety] is not required to speculate on future claims, the [inspection] reports do not establish there was no potential for coverage after their preparation." The creation of reported defects in the ***1113** concrete and electrical work performed, as an occurrence during the policy period, could have allowed continuous or repeated exposure to harmful conditions elsewhere.

[16] [17]" ' "[T]he existence of a duty to defend turns not upon the ultimate adjudication of coverage under its policy of insurance, but upon those facts known by the insurer at the inception of a third party lawsuit. [Citation.] Hence, the duty 'may exist even where coverage is in doubt and ultimately does not develop.' " ' " (*Atlantic Mutual Ins. Co. v. J. Lamb, Inc.* (2002) 100 Cal.App.4th 1017, 1033, 123 Cal.Rptr.2d 256 (*Atlantic Mutual*).) Where insuring agreements provide coverage for property damage occurring during the policy periods, a construction defect complaint alleging progressive damage gives rise to the potential " 'that there existed—at least potentially—a covered event, i.e., a continuing and progressively deteriorating process which began with defective design and construction ... within the pertinent policy period.' " (*Century Indemnity Co. v. Hearrean*, *supra*, 98 Cal.App.4th 734, 740, 120 Cal.Rptr.2d 66.) American Safety incorrectly focuses on when the current property owners became financially damaged through purchases. This begs the question of when the subject property damage occurred from the work of the subcontractors. The coverage potential depends on when the property became physically damaged. (*Standard Fire Ins. Co. v. Spectrum Community Assn.* (2006) 141 Cal.App.4th 1117, 1132, 46 Cal.Rptr.3d 804; *Garriott v. Crop Dusting Co.*, *supra*, 221 Cal.App.3d 783, 791, 270 Cal.Rptr. 678.)

****70** From the circumstances shown in the tenders of defense, in which property damage became evident after the work was completed, American Safety was placed on sufficient notice that some of the subcontractors' work could have been ongoing and/or completed during its policy periods, since the homes were constructed in phases. At that time, the mechanisms of the alleged property damage remained unknown, as did the timing of the damage in relation to the dates of purchase. As the trial court's decision correctly observed, the damage or occurrence might have occurred "while the subcontractor's operations were ongoing but after the house had been sold to one of the plaintiffs." We disagree with American Safety's claim that it should not have had to respond to these defense demands, without a greater showing that its policy applied, based on the subcontractors' work and Pulte's potential vicarious liability for it.

[18]As explained in *Montrose I*, in the comparable legal context of a declaratory relief action, "[t]o prevail [ ] the insured must prove the existence of a potential for coverage, while the insurer must establish the absence of any such potential. In other words, the insured need only show that the underlying claim may fall within policy coverage; the insurer must ***1114** prove it cannot. Facts merely tending to show that the claim is not covered, or may not be covered, but are insufficient to eliminate the possibility that resultant damages (or the nature of the action) will fall within the scope of coverage, therefore add no weight to the scales. Any seeming disparity in the respective burdens merely reflects the substantive law." (*Montrose I*, *supra*, 6 Cal.4th at p. 300, 24 Cal.Rptr.2d 467, 861 P.2d 1153; *Pardee*, *supra*, 77 Cal.App.4th at p. 1351, 92 Cal.Rptr.2d 443 [" 'when a suit against an insured alleges a claim that potentially or even possibly could subject the insured to liability for covered damages, an insurer must defend unless and until the insurer can demonstrate, by reference to undisputed facts, that the claim cannot be covered.' "].)

Under this authority, American Safety cannot show that Pulte, as its additional insured, "failed to timely provide information to an insurer that would have established the potential for coverage in the first instance." (*Atlantic Mutual*, *supra*, 100 Cal.App.4th 1017, 1040, 123 Cal.Rptr.2d 256.)

4. "Ongoing Operations" as a "Limiting Term" or Exclusion?

[19]American Safety next argues there was no possibility of products-completed operations hazard coverage applying here, because it had inserted the following italicized qualifier into the AIEs, that policy benefits would be afforded for "liability arising out of 'your work,' '*but only as respects ongoing operations.*' " It calls this "ongoing operations" language "a limiting term *excluding* completed-operations coverage," and argues that its use of different terms in the policy was evidently intended to afford different meanings for them. (See *Weitz Company, LLC v. Mid-Century Insurance Co.* (Colo. App. 2007) 181 P.3d 309, 313 [interpreting policy term "completed operations" as extending such coverage to named insured/subcontractor, but finding the term "ongoing operations," used in conjunction with "only" in the endorsement, served to limit the coverage provided to general contractor/additional insured].)

Attorney Fisher testified that she knew of one contracting company that had paid as much as $100,000 to obtain more completed operations coverage than was afforded in its AIEs. American Safety now argues it can be inferred (apparently from the lower price of the AIEs, which is unclear ****71** from the briefing) that it did not intend to provide completed operations coverage to Pulte. It relies on language in *Baker*, *supra*, 180 Cal.App.4th 1319, 103 Cal.Rptr.3d 565, that describes the costly nature of products-completed operations hazard coverage: " 'The modern CGL policy provides basic "premises and operations" coverage. This coverage insures for damages arising out of an occurrence at the insured's place of business as a result of the insured's ongoing business activities. The risk covered by the CGL premises and operations coverage ***1115** differs from the risk posed once an insured relinquishes its products to third parties or completes its work. This latter risk is insured, *for an additional hefty premium*, under the products-completed operations hazard coverage. The purpose of the products-completed operations hazard coverage is to insure against the risk that the product or work, if defective, may cause bodily injury or damage to property of others after it leaves the insured's hands.' " (*Id.* at p. 1337, 103 Cal.Rptr.3d 565, italics added.)

American Safety's interpretation fails to demonstrate any coverage is potentially limited to ongoing operations. The AIEs' language allowing coverage for "liability arising out of 'your [the named insured subcontractor's] work' " can reasonably be read as a grant of coverage for the insured's completed operations, if property damage ensued from them. As noted in *Pardee*, *supra*, 77 Cal.App.4th at page 1356, 92 Cal.Rptr.2d 443, " 'your work' is further defined in the policies as including warranties and representations. Liability arising out of such inherently involves completed work, not work in progress."

It is well accepted as a commercial reality that construction work performed at one time may deteriorate or manifest injury or damage, possibly to adjacent work, at a later time or after completion. (*Pardee*, *supra*, 77 Cal.App.4th at pp. 1360-1361, 92 Cal.Rptr.2d 443.) Unlike in *Pardee*, where the policies were issued postconstruction, the subject AIEs were issued during construction, while the subcontractors were still working on different phases of the projects. Both sets of insureds could reasonably have expected that if the subcontractors had bought completed operations coverage for the work, it also applied to vicarious liability of the developer, if property damage problems appeared. (*Id.* at p. 1350, 92 Cal.Rptr.2d 443.) These AIEs do not clearly restrict coverage to only ongoing operations, simply by linking the ongoing operations phrase to the "liability arising out of the work" clause. (*Id.* at pp. 1359-1360, 92 Cal.Rptr.2d 443.) We should give effect to each of the phrases defining the scope of coverage.

The court's decision stated that American Safety had failed to clearly state in the AIEs that completed operations are not covered, and failed to restrict coverage as applicable only to ongoing operations. Instead, "*ASIC has taken a middle-ground and left the language in that the endorsement applies to 'your work' but limited to ongoing operations and therefore creating an ambiguity*. Had ASIC wished to make it clear to Pulte that it was not covering completed operations for the additional insured (which its policy covers for the named insured), ASIC could have clearly said so." (Italics added.) We agree that the AIEs are ambiguous in combining these two types of coverage in one clause. They "failed to expressly limit covered completed operations as to time or particular project in their policy and endorsement language." (*Pardee*, *supra*, 77 Cal.App.4th at p. 1357, 92 Cal.Rptr.2d 443.) They are not "expressly limiting the time frame of the additional insured coverage to the time ***1116** of the ongoing operations of the named insured." (*Id*. at p. 1356, 92 Cal.Rptr.2d 443.) ****72** They do not adequately define " 'your work' as work 'now being performed or to be performed during the term of this policy.' " (*Ibid.*)

If this "ongoing operations" language is meant as an exclusion, it must be narrowly construed. (*Waller*, *supra*, 11 Cal.4th at p. 16, 44 Cal.Rptr.2d 370, 900 P.2d 619.) Assuming that the subcontractors carried out ongoing operations "*on or after the effective date of the endorsement*," their work was performed during the policy period and coverage was not clearly excluded.

For purposes of determining a defense duty, the AIEs seem to allow completed operations coverage, based on potential liability that might yet arise from the subcontractors' completed work. Next, the policies add another form of coverage, for "ongoing operations ... on or after the effective date of this Endorsement." We do not understand that purported "ongoing" limitation to be clearly undoing a grant of coverage against liability arising from work completed during the effective dates of the AIEs. If the "ongoing operations" language was meant by American Safety to preclude coverage for completed operations losses, it had to expressly state "that coverage was limited to claims arising from work performed during the policy period." (*Pardee*, *supra*, 77 Cal.App.4th at p. 1358, 92 Cal.Rptr.2d 443.) We cannot say the underlying complaints pleaded zero facts bringing Pulte within potential policy coverage. Assuming there was doubt as to whether the duty to

defend existed, it should have been resolved in favor of the additional insureds.

C. Effect of Faulty Workmanship Exclusions

[20]American Safety's alternative grounds for denying a defense to Pulte included its faulty workmanship exclusions. In exclusion j.(5), the subcontractors' policies state that no coverage is afforded for "property damage" to "[t]hat particular part of real property on which *you ... are performing operations*, if the 'property damage' arises out of those operations [.]" (Italics added.) In exclusion j.(6), coverage is precluded for "[t]hat particular part of any property that must be restored, repaired or replaced *because 'your work' was incorrectly performed on it*." This exclusion j.(6) "does not apply to 'property damage' included in the 'products-completed operations hazard.' " (Italics added.)

[21]"[A]n insurer may only defeat an existing potential for coverage by undisputed facts that conclusively negate such coverage. This is particularly true where the insurer seeks to defeat coverage by reliance on an exclusion. An insurer may rely on an exclusion to deny coverage only if it provides conclusive evidence demonstrating that the exclusion applies." (*Atlantic Mutual, supra*, 100 Cal.App.4th at pp. 1039-1040, 123 Cal.Rptr.2d 256; *Waller, supra*, 11 Cal.4th at p. 16, 44 Cal.Rptr.2d 370, 900 P.2d 619 [exclusions will be narrowly construed].)

[22] [23] ***1117** "Where a term used in an insurance policy is not defined, it must be interpreted in its ' "ordinary and popular sense." ' [Citation.] Although exclusions are generally viewed through a more critical prism, the principle that words are considered in their 'ordinary and popular sense' is not discarded, and, thus, in interpreting a word in an insurance policy, including a word in an exclusion, a court may consult and consider definitions found in a common dictionary, provided the court does not disregard the policy's context, and maintains an eye on the fundamental goal of deciding how a layperson policyholder might reasonably interpret the exclusion's language." (*Baker, supra*, 180 Cal.App.4th at p. 1340, 103 Cal.Rptr.3d 565.)

****73** American Safety cites to authority that a general contractor or developer's work product includes all work at the site, including that of the subcontractors. (E.g., *Diamond Heights Homeowners Assn. v. National American Ins. Co.* (1991) 227 Cal.App.3d 563, 573, 277 Cal.Rptr. 906; *George F. Hillenbrand, Inc. v. Insurance Co. of North America* (2002) 104 Cal.App.4th 784, 805, 128 Cal.Rptr.2d 586 ["In the case of a general contractor, all the work at the project is considered its work product, whereas in the case of a subcontractor, ... only its portion of the work, such as siding, is the work product and damage to other parts of the project is considered damage to other property."].)[13] This approach disregards the pleaded facts in the underlying complaints, that some of the numerous subcontractors' work was allegedly defective and therefore caused problems with other interrelated and adjacent construction work at the projects. American Safety did not justify its denial of the defense by establishing the precise timing of the subcontractors' work or consequently, the nature of the alleged construction defect property damage.

13 American Safety quotes another exclusion, j.(l), "Damage to Your Work," as excluding coverage for "property damage" to the insured's work "arising out of it or any part of it and included in the 'products-completed operations hazard.' " On appeal, it does not actively argue the applicability of this exclusion.

The trial court expressed concerns that when the coverage and exclusionary terms of the AIEs were combined, only an illusory degree of coverage would be available. (See *Scottsdale Ins. Co. v. Essex Ins. Co.* (2002) 98 Cal.App.4th 86, 94-95, 119 Cal.Rptr.2d 62 [coverage not illusory even where a special coverage condition might not arise].) American Safety disagrees, interpreting its own policy as supplying an additional insured with ongoing operations coverage that could have arisen during the work, but only as follows: "Thus, Pulte would have been covered, for instance, if a piece of improperly-secured plywood blew off and hit a passerby or damaged an adjacent already-sold and occupied home, or grading work caused earth movement and landslides in an adjacent development. Although not illusory, the coverage is limited; it is drafted and priced that way and it is exactly what the subcontractors and Pulte bargained for." Because of these cited policy exclusions, American ***1118** Safety argues there could be no coverage "for injuries arising out of the work itself, e.g., construction defects."

The problem with these exclusionary arguments is that the record does not contain a showing by the insurer that all of the

damage the homeowners were claiming was limited to the particular location where one or another of the subcontractors was performing their work, such that these policy exclusions would clearly apply. (*Roger H. Proulx & Co. v. Crest-Liners, Inc.* (2002) 98 Cal.App.4th 182, 201-203, 119 Cal.Rptr.2d 442 (*Roger H. Proulx & Co.*); *Montrose I, supra,* 6 Cal.4th 287, 298, 24 Cal.Rptr.2d 467, 861 P.2d 1153.) As far as the construction defect complaints disclose, there were potentially overlapping forms of damage among the different locations of concrete, electrical and other types of work, all of which had permitted some kind of moisture damage to occur over time. It was factually unclear under exclusion j. (5) that no coverage was possible for property damage located at the site of each named insured's operations, or if the alleged damage arose solely out of those particular operations.

With respect to exclusion j.(6), coverage would be precluded for damage to portions of property "that must be restored, repaired or replaced *because 'your work' was i* ****74** *ncorrectly performed on it*." The construction defect complaints broadly allege that both work and materials were defective, and American Safety did not supply a showing that each of the named insureds' work was incorrectly performed such that no possible basis for coverage could have existed, on a vicarious liability basis. Once again, there was no reliable way shown for determining, at the outset of the construction defect matters, which subcontractors' work had been substandard or whether it had damaged its own or another's adjacent work. As of the time of tender, those claims could have involved damage from one or more types of work done at the projects. The faulty workmanship exclusions did not clearly apply to preclude a duty to defend. (*Roger H. Proulx & Co. Inc., supra,* 98 Cal.App.4th at pp. 202-203, 119 Cal.Rptr.2d 442, 98 Cal.App.4th 933B at pp. 202-203.)

III

RELATED FINDINGS ON BAD FAITH LIABILITY

A. Requirements for Liability

[24] [25]Having determined there was a breach of the duty to defend from which Pulte was damaged, the trial court's decision after trial next addressed the question of whether American Safety had "unreasonably and without proper cause" failed to defend Pulte in the construction defect matters. Citing to various forms of evidence presented at trial on American Safety's claims handling practices, the court concluded the company had breached the ***1119** policy's implied covenant of good faith and fair dealing in numerous ways. To the extent factual findings were made on conflicting evidence about the insurer's conduct and motives, we must evaluate this challenged portion of the judgment for any substantial support in the evidence. (*Dalrymple v. United Services Auto. Assn.* (1995) 40 Cal.App.4th 497, 511, 46 Cal.Rptr.2d 845 (*Dalrymple*).) "Bad faith in this context is said to be conduct violating community standards of decency, fairness or reasonableness." (*Ibid.*)

[26]To the extent the trial court drew legal conclusions about policy obligations, de novo review is appropriate. "Although an insurer's bad faith is ordinarily a question of fact to be determined by a jury by considering the evidence of motive, intent and state of mind, '[t]he question becomes one of law ... when, because there are no conflicting inferences, reasonable minds could not differ.' " (*Dalrymple, supra,* 40 Cal.App.4th 497, 511, 46 Cal.Rptr.2d 845; *Morris v. Paul Revere Life Ins. Co.* (2003) 109 Cal.App.4th 966, 973, fn. 1, 135 Cal.Rptr.2d 718 [reasonableness of an insurer's legal position depends on precedent and statute, posing questions of law].)

[27] [28]The determination of the reasonableness of an insurer's contractual position takes into account not only the rules of contract interpretation (e.g., construing ambiguity in favor of insured), but also the given factual context in which the dispute arises. (*Griffin Dewatering Corp., supra,* 176 Cal.App.4th 172, 208, 97 Cal.Rptr.3d 568; *Bank of the West v. Superior Court, supra,* 2 Cal.4th 1254, 1265, 10 Cal.Rptr.2d 538, 833 P.2d 545 [language must be construed in context].) "However, the question of whether there is an ambiguity in the first place is different. [N]othing obligates insurance companies to pay 'noncovered' claims just because such a payment will (obviously) benefit the policyholder." (*Griffin Dewatering Corp., supra,* at p. 208, 97 Cal.Rptr.3d 568; *Love v. Fire Ins. Exchange* (1990) 221 Cal.App.3d 1136, 1148, 271 Cal.Rptr. 246 [insurance companies do not stand in a fiduciary relationship with policyholders, but that relationship may be "akin" to a fiduciary one].)

[29] [30] **75 It is well settled that "an insurer's erroneous failure to pay benefits under a policy does not necessarily constitute bad faith entitling the insured to recover tort damages. '[T]he ultimate test of [bad faith] liability in the first party cases is whether the refusal to pay policy benefits was unreasonable.' [Citations.] In other words, 'before an [insurer] can be found to have acted tortiously, i.e., in bad faith, in refusing to bestow policy benefits, it must have done so "without proper cause." ' " (*Opsal v. United Services Auto. Assn.* (1991) 2 Cal.App.4th 1197, 1205, 10 Cal.Rptr.2d 352 (*Opsal*); *Dalrymple*, *supra*, 40 Cal.App.4th 497, 513, 46 Cal.Rptr.2d 845.) The issues include the reasonableness of American Safety's policy interpretation, and the effect of its claims handling that resulted in withholding of benefits due under the policy.

***1120** B. Initial Legal Issue: Erroneous Policy Analysis

[31]We first take note that the trial court did not find it was dispositive that even after the summary adjudication ruling on the Concrete policy (i.e., that a defense duty was owed to Pulte as an additional insured), American Safety continued to withhold a defense as to each of the policies. However, the court did observe that American Safety had not filed an appellate challenge to that ruling, which was consistent with Attorney Fisher's testimony about its apparent overall strategy to pursue its own policy interpretation, without obtaining further guidance from the courts (avoiding it by settling cases). The court expressed a belief that such a continuing policy of denying a defense could be viewed as putting the insurer's interests above those of the insured, by avoiding adverse legal precedents. Here, as in *McMillin*, *supra*, 233 Cal.App.4th 518, 542, footnote 31, 183 Cal.Rptr.3d 26, we need not address the availability of the "genuine dispute doctrine" as a defense for the insurer in a third party duty to defend context. (See *Opsal*, *supra*, 2 Cal.App.4th 1197, 1205-1206, 10 Cal.Rptr.2d 352; *Mt. Hawley Ins. Co. v. Lopez* (2013) 215 Cal.App.4th 1385, 1424, 156 Cal.Rptr.3d 771 [law is unclear on this point].)

In any event, the most basic policy interpretation questions in this case had already been fully addressed in the breach of contract phase of trial, on the effect of the policy language, both "liability arising from 'your work' " and " 'ongoing operations.' " The court did not accept American Safety's contractual no coverage position, and it was additionally required to examine whether that interpretation had been reasonable, for purposes of determining the remaining bad faith liability issues. The court found it significant that American Safety knew there were trial court decisions against its position on the interpretation of ongoing operations (e.g., *D.R. Horton*, *supra*, 2012 WL 33070, 2012 U.S. Dist. LEXIS 1881; *Tri-Star Theme Builders, Inc. v. OneBeacon Insurance Co.* (9th Cir. 2011) 426 Fed.Appx. 506 [Arizona case]; *McMillin Construction Services, L.P. v. Arch Specialty Insurance Company* (S.D.Cal. 2012) 2012 U.S. Dist. LEXIS 8339; and *Jaynes Corp. v. American Safety Indem. Co.* (D. Nev. 2012) 925 F.Supp.2d 1095, vacated Dec. 2, 2014).

For example, in *D.R. Horton*, *supra*, 2012 WL 33070, 2012 U.S. Dist. LEXIS 1881, an unreported case arising out of federal court in San Diego, American Safety was the defendant and was well aware of its holding. The trial court's decision outlined the logical reasoning of *D.R. Horton*, and its applicability in this factual context, as follows:

> "Thus, if [the *D.R. Horton]* homes were built in a series so that one home was completed and then the subcontractor's ongoing operations continued on another ****76** house, and if there was an occurrence causing damage to the already-completed houses, then the occurrence potentially was during ongoing operations. This potential existed in the *Large* and *Schaefer* cases. The information available to ASIC at the time of the ***1121** denials was that the work could have been ongoing at the time some of the houses were completed. Therefore, there was the possibility that the damage or occurrence occurred while the subcontractor's operations were ongoing but after the house had been sold to one of the plaintiffs."

In addition, the trial court relied on *Pardee*, *supra*, 77 Cal.App.4th 1340, 92 Cal.Rptr.2d 443, and ruled that American Safety's interpretations were incorrect, as follows: "If ASIC's position is correct, there would never be property damage coverage under the additional insured endorsement, whether the occurrence happened during ongoing operations or after completed operations." (*Id.* at p. 1359, 92 Cal.Rptr.2d 443.) The court ruled that the policy was ambiguous in referring to property damage, and the interpretation American Safety was using did not properly account for the reasonable expectations of an additional insured. Moreover, "ASIC was aware at the time it issued the endorsement that the contracts between Pulte and the named insureds required that the named insureds name Pulte as an additional insured, including completed operations.... The information available to ASIC at the time of the tender of the claim was that Pulte had been named as an

additional insured and that the contract with the named insured required that the additional insured endorsement cover completed operations. With that in mind, ASIC should have taken into account the reasonable expectations of the additional insured in interpreting its policy. ASIC did not do this and did not give equal consideration to its interests and its insureds' interests."

With regard to bad faith, the trial court found it significant that American Safety, by referring to the dates of the close of escrow for the homes and the policy periods, had essentially conceded that the subcontractors had performed work on the project during the effective periods of its own policies. Although many out-of-state authorities had been discussed at trial on whether "ongoing operations" excluded coverage, American Safety had not produced any California case that ruled in its favor. Also, when Fisher testified about American Safety eventually prevailing in *McMillin Construction Services, L.P. v. Arch Specialty Insurance Company, supra*, 2012 U.S. Dist. LEXIS 8339, she did not reveal that the company succeeded because of its "project on file" clause there, not on ongoing operations.

As to American Safety's reiterated claim that no relevant work had been done during a relevant policy period, the trial court found it had unjustifiably ignored "the possibility of an occurrence during the insured's ongoing operations as in *D.R. Horton*[, *supra*, 2012 WL 33070, 2012 U.S. Dist. LEXIS 1881]." That approach, combined with the company deciding to ignore "other adverse court decisions from Federal Courts in California and Nevada and the reasoning of the Ninth Circuit, is not reasonable and is bad faith." As a matter of policy interpretation, we conclude that the trial court's legal ruling that ***1122** American Safety did not have legitimate reasons for denying a defense to this additional insured is well supported.

C. Evidence Regarding Claims Handling; No Proper Cause to Deny a Defense

[32]The trial court's written decision from this phase of trial cited to numerous ****77** factors that played a part in American Safety's decision to deny Pulte a defense to the construction defect actions. These were drawn from testimony from its claims representatives and corporate claims counsel, about how hundreds of additional insureds' claims were routinely denied based on the restrictive policy interpretations offered. The court observed, "The three adjusters who testified did not recall ever accepting an additional insured tender." One of the claims adjusters testified that even if the property damage occurred during ongoing operations, "ASIC still would not provide a defense because there would be no coverage and no duty to defend because the suits were filed after completion." Attorney Fisher testified about uniformly denying any AIE coverage requests, based on "ongoing operations" only.

Documentary evidence was submitted about the refused tenders, showing the terms of the various denial letters. Examination of those denial letters on the various policies shows the trial court had ample reasons for concluding they are form letters, rather than the product of any appropriate case-by-case analysis. For example, the letters deny coverage on the basis of a supposed requirement that only "projects on file with the Company" may be covered, even though only some of the Foshay policies and none of the Concrete or Frontier policies contain any such language. The court said, "This shows that claims were not being reviewed carefully, if at all. This is further evidence of bad faith."

Although American Safety no longer argues the applicability of its policy requirements on sole negligence, that reason was given for denials of the tenders. The court found that was not a good faith ground to assert there was no potential for coverage, because the standard construction defect action names many defendants and cross-defendants and therefore sole negligence was not normally alleged in such an underlying complaint. The court stated, "[t]o provide coverage of sole negligence only if sole negligence is alleged, effectively means that no coverage would ever be provided under an additional insured endorsement." Moreover, the court noted that a jury could find that although many defects in the development were alleged, only one named insured's work was actually defective and negligent. Accordingly, "the routine denial of coverage for hundreds of tenders based on sole negligence shows a complete lack of analysis and is evidence of bad faith. Such a ***1123** conclusion is not reasonable if one were to analyze the claims made in the [underlying construction defect] cases."[14]

14 The court only generally discussed American Safety's assertion of the self-insured retention grounds for denial of a defense, and the confusion about how much of a defense Interstate was providing Pulte. American Safety also argued that no valid AIEs could be issued by brokers for the named insureds, but the court said that did not make any difference to a coverage determination. We need not discuss those issues as they are not dispositive with respect to the bad faith findings.

As already discussed, American Safety made an unreasonable reading of its policy language by focusing on the ongoing operations language, to the exclusion of other relevant policy terms in the AIEs it drafted. The policy's ambiguous terms had to be construed in favor of the reasonable expectations of the insureds. American Safety inexplicably disregarded case law known to it, such as *D.R. Horton, supra*, 2012 WL 33070, 2012 U.S. Dist. LEXIS 1881, which the court found would indicate there was a potential for coverage even on a completed operations basis, because "[t]he information available to ASIC at the ****78** time of the denials was that the work could have been ongoing at the time some of the houses were completed. Therefore, there was the possibility that the damage or occurrence occurred while the subcontractor's operations were ongoing but after the house had been sold to one of the plaintiffs."

To the extent the denial letters claimed the faulty workmanship/work product exclusions must apply, they were not supported by a reasonable policy interpretation. There could have been a potential for coverage to damaged adjacent work or other building components, compared to the work of Concrete, Frontier, or Foshay.

From all of the evidence, the court concluded American Safety's corporate claims counsel and representative at trial, Jean Fisher, appeared to function as the final authority for its decisions to deny coverage. The court evaluated her evidence as follows: "Although she worked for companies controlled by ASIC and not directly for ASIC, no one from ASIC ever disagreed with any of her decisions. [¶] Ms. Fisher was aware that subcontractors used the additional insured endorsement to get work and that developers require completed operations coverage. Nevertheless, it was her intent to deny completed operations coverage with the language she drafted. She testified that developers are unreasonable in believing they would receive a defense from ASIC under the additional insured endorsement. [¶] The Court did not find Ms. Fisher candid. When asked whether any court had ever ruled in ASIC's favor on ongoing operations, Ms. Fisher replied that she could not recall. Obviously, had there been such a decision, Ms. Fisher would have remembered it and ASIC would have used it to its benefit. [¶] ... [¶] Ms. Fisher stated that the adjusters were well trained and constantly given ***1124** updates on the law. The testimony of the three adjusters called in this case indicates otherwise, for example, none of them understood Project on File, yet they used that term to deny coverage even when it was not in the policy. [¶] When examined on the use of Project on File, especially given that the adjusters were using that as a basis of denial in letters supposedly approved by her and since the adjusters did not even know how to determine if the project was on file, Ms. Fisher's testimony became very evasive."

The court made reasonable conclusions from all of the evidence that American Safety was primarily looking out for its own interests in refusing to defend its additional insureds. "Whether the Court considers the multiple tenders by Pulte, the hundreds of denials of other additional insureds, as testified to by the adjusters, or merely the tenders in this case, there is a clear pattern and practice of refusing to defend additional insureds in construction defect cases." In light of Pulte's additional insured status and the notice it gave to American Safety that it had been sued on wide ranging construction defect theories, the failure to provide Pulte with a defense was unreasonable and without proper cause. These actions were properly found to be in bad faith.

The court additionally evaluated the same evidence as providing a clear and convincing showing of malice and oppression, and proceeded on the punitive damages claims, as next discussed. (Civ. Code, § 3294.)

IV

PUNITIVE DAMAGES: ENTITLEMENT ISSUES ONLY

A. Applicable Standards

[33]In this phase of trial, the court was considering whether the breach of the ****79** insurer's duty to defend was not only unreasonable, so as to warrant tort damages, but also if the breach was "so egregious that there is evidence of 'oppression, fraud or malice' " to warrant a punitive damages award. (*Griffin Dewatering Corp., supra*, 176 Cal.App.4th 172, 194-195, 97 Cal.Rptr.3d 568.)

[34]Under section 3294, subdivision (b), punitive damages can properly be awarded against a corporate entity as a principal, because of an act by its agents, if the corporate employer authorized or ratified wrongful conduct. Ratification is shown if an officer, director, or managing agent of the corporation has advance knowledge of, but consciously disregards, authorizes, or ratifies an act of oppression, fraud, or malice. " 'The determination whether employees act in a managerial capacity [i.e., are managing agents] does not necessarily hinge on their "level" in the corporate hierarchy. Rather, ***1125** the critical inquiry is the degree of discretion the employees possess in making decisions that will ultimately determine corporate policy.' " (*Kelly-Zurian v. Wohl Shoe Co.* (1994) 22 Cal.App.4th 397, 421, 27 Cal.Rptr.2d 457.)

[35] [36]The definitions in Civil Code section 3294, subdivision (c)(2) include the following: " 'Oppression' means despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights." For an award of punitive damages to withstand review, it must be supported by substantial evidence. (*Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.* (2000) 78 Cal.App.4th 847, 891, 93 Cal.Rptr.2d 364.) "As in other cases involving the issue of substantial evidence, we are bound to 'consider the evidence in the light most favorable to the prevailing party, giving him the benefit of every reasonable inference, and resolving conflicts in support of the judgment.' [Citation.] But since the [factfinder's] findings were subject to a heightened burden of proof, we must review the record in support of these findings in light of that burden. In other words, we must inquire whether the record contains 'substantial evidence to support a determination by clear and convincing evidence....' " (*Ibid.*)

"It is important to recognize the reason for the possibility of tort, and perhaps even punitive damages on top of regular tort damages, for an insurance company's unreasonable breach of an insurance contract. Insurance contracts are unique in that, if the insurance company breaches them, the policyholder suffers a loss (often a catastrophic loss) that cannot, by definition, be compensated by obtaining another contract. [Citations.] [¶] Thus, without the possibility of tort damages hanging over its head when it makes a claims decision, an insurance company may choose not to deal in good faith when a policyholder makes a claim. The insurance company could arbitrarily deny a claim, thus gambling with the policyholder's 'benefits of the agreement.' [Citation.] If the insurance company gambled wrong, it would be no worse off than it would have been if it had honored the claim in the first place. In effect, if the law confined the exposure of the insurance company under such circumstances to only contract damages, it would be pardoned and still retain the fruits of its offense." (*Griffin Dewatering Corp.*, *supra*, 176 Cal.App.4th 172, 195-196, 97 Cal.Rptr.3d 568.)

B. Analysis

In ruling that an award of punitive damages was justified, the trial court's decision stated that American Safety had demonstrated its "pattern and practice" of using every conceivable argument to deny coverage, whether the arguments are weak or ****80** strong, valid or invalid. Such conduct showed the company was primarily protecting its own interests in refusing to defend its ***1126** additional insureds in construction defect cases. Based on the evidence given by Attorney Fisher and the adjusters she supervised in issuing hundreds of other denial letters in this context, the court found that the company's upper management and general counsel did not need to be consulted on these denials of tenders. Rather, the evidence showed Ms. Fisher's "decisions ultimately determined corporate policy in the area of additional insured endorsements and tenders of coverage under such endorsements. Even though Ms. Fisher was not employed directly by ASIC, this authority had been given to her by ASIC. ASIC cannot avoid responsibility by creating a company to handle claims and allowing the company and its managing agent, Ms. Fisher, to deny all AI claims. [¶] ASIC through its general counsel must have known of Ms. Fisher's conduct and adopted and approved her conduct after it occurred. The pattern of not accepting additional insured tenders has gone on for years and clearly was known to the officers and managing agents of ASIC." (Civ. Code, § 3294, subd. (b).)

Effectively, American Safety had been issuing AIEs while "knowing that coverage would never be honored and knowing that the additional insureds intended that they would be receiving a defense if they were sued in construction defect cases." The court concluded that this conduct was evidently done with the intent to cause injury to Pulte and amounted to despicable actions that were done with a willful and knowing disregard of Pulte's rights. Pulte was therefore required to use its own resources to defend itself in construction defect cases. There were admissions at trial that other such additional insureds had been provided a defense with a reservation of rights, while American Safety was filing declaratory relief actions to determine

the correctness of its position and seeking return of the fees paid. This happened even though the financial condition evidence showed American Safety had a surplus of over $1 million.

The court accordingly found there was clear and convincing evidence, as stated in the judgment, that American Safety had inflicted economic harm on Pulte and this harm "was the result of intentional malice, trickery, or deceit." The court found the standards of Civil Code section 3294 had been satisfied, in that the denial letters included misrepresentations about applicable or inapplicable policy provisions that amounted to clear and convincing evidence of malice and oppression, and inexcusably showed "a pattern of using exactly the same language in the letters whether the provisions applied or not."

These substantive conclusions on Pulte's entitlement to receive punitive damages from American Safety are supported by substantial evidence. However, after the following discussion of the basis given for awarding *Brandt* fees in the amount of $471,313.52, we shall turn to the related issues about the amount of punitive damages awarded, $500,000. (Pt.VI, *post*.)

***1127** V

BRANDT *FEES*

The trial court issued its decision awarding Pulte *Brandt* fees of $471,313.52, plus *Brandt* costs of $38,587. (*White v. Western Title Ins. Co.* (1985) 40 Cal.3d 870, 890, 221 Cal.Rptr. 509, 710 P.2d 309 [such costs also allowable].) The judgment expressly states, "the law is clear that fee agreements can be changed and the modification to the fee agreement between Plaintiff and ****81** its counsel serves as the basis for the award of *Brandt* fees."

We emphasize that as to the contract damages we have previously discussed, the trial court did not refer in the judgment or its decisions to the differing fee agreements that Pulte had reached with its counsel. American Safety challenges only the amount of the *Brandt* award as impermissibly based on a strategic or tardy posttrial modification of the original contingency fee agreement.

A. Applicable Standards

[37]*Brandt* allows an insured to recover attorney fees expended to enforce the policy, when the insurer has withheld policy benefits in bad faith. Such recoverable fees may not exceed the amount attributable to obtaining benefits due under the contract. (*Brandt, supra*, 37 Cal.3d at pp. 817, 819, 210 Cal.Rptr. 211, 693 P.2d 796.) Fees attributable to obtaining any portion of the award in excess of the amount due under the policy are not recoverable. (*Ibid.*) *Cassim*, *supra*, 33 Cal.4th 780, 16 Cal.Rptr.3d 374, 94 P.3d 513 requires such an allocation between *Brandt* and non-*Brandt* work, even where there is a contingency fee agreement.

[38] [39]As explained in *Track Mortgage Group, Inc. v. Crusader Ins. Co.* (2002) 98 Cal.App.4th 857, 867-868, 120 Cal.Rptr.2d 228, the practical effect of these rules is that the trial court can only award such *Brandt* fees as were expended in enforcing the policy, but not those expended in proving the insurer's bad faith. The parties must provide showings to aid the court in segregating the fees and determining which were expended to compel payment of policy benefits. (*Ibid*.) In that case, the billings could not be easily segregated, and the court instead made a proportional estimate of what the case was worth "based upon the results, based upon the complexity of the case, based upon the experience of counsel, and having tried the case ... and recognizing the issues and the sophistication that those issues demanded...." (*Id.* at p. 867, 120 Cal.Rptr.2d 228.)

[40] [41] [42]*Cassim* teaches us, "Defendants are protected from excessive *Brandt* fees in two ways. First, as in any tort case, the plaintiff bears the burden of ***1128** proving by a preponderance of the evidence both the existence and the amount of damages proximately caused by the defendant's tortious acts or omissions. [Citation.] Accordingly, on remand, plaintiffs will bear the burden of demonstrating how the fees for legal work attributable to both the contract and the tort recoveries should

be apportioned. [Citation.] [¶] Second, trial courts retain discretion to disregard fee agreements that appear designed to manipulate the calculation of *Brandt* fees to the plaintiff's benefit. For example, a client who enters a fee agreement in an insurance bad faith case in which an attorney will take 40 percent of the entire compensatory damage award as his fee for working to obtain the contract recovery, and agrees to work on the tort recovery pro bono, cannot expect to receive *Brandt* fees of 40 percent of the entire compensatory award." (*Cassim, supra*, 33 Cal.4th 780, 813, 16 Cal.Rptr.3d 374, 94 P.3d 513.)

[43]In the case of a contingency fee arrangement, *Cassim, supra*, 33 Cal.4th 780, 16 Cal.Rptr.3d 374, 94 P.3d 513, explains the proper method of calculating *Brandt* fees. The trier of fact must determine the percentage of the legal fees paid to the attorney that reflects the work attributable to obtaining the contract recovery:

> "Some outer limits are immediately discernible. First, no portion of legal fees attributable to the punitive damage ****82** award can be recovered as *Brandt* fees. *Brandt's* focus was solely on ensuring that attorney fees for contract recovery did not diminish a plaintiff's compensatory damages award, and did not concern diminution of the punitive damages award, which is essentially a windfall for plaintiffs that the law permits for public policy reasons. Second, the *Brandt* fees can never exceed the legal fees for the combined tort and contract recovery; in most cases the amount will be far less. [¶] To determine the percentage of the legal fees attributable to the contract recovery, the trial court should determine the total number of hours an attorney spent on the case and then determine how many hours were spent working exclusively on the contract recovery. Hours spent working on issues jointly related to both the tort and contract should be apportioned, with some hours assigned to the contract and some to the tort. This latter figure, added to the hours spent on the contract alone, when divided by the total number of hours worked, should provide the appropriate percentage." (*Cassim, supra*, 33 Cal.4th at p. 812, 16 Cal.Rptr.3d 374, 94 P.3d 513.)

[44]In general on attorney fee agreements, "[i]t is axiomatic that the parties to an agreement may modify it. The precise meaning of terms used in a contract is that which is understood by the parties to the contract. The court will not impose its own interpretation at variance with the parties' intention. Here, there is no dispute between plaintiff and her attorney concerning what they both intended when the contract was written. A contingency fee contract may be modified by the parties at any time during the subject litigation." (*Vella v. Hudgins* (1984) 151 Cal.App.3d 515, 519, 198 Cal.Rptr. 725.)

***1129** In *Track Mortgage Group, Inc., supra*, 98 Cal.App.4th at pages 867 to 868, 120 Cal.Rptr.2d 228, the appellate court applied an abuse of discretion standard and upheld the trial court's determination on what was a reasonable *Brandt* fee for enforcing the contract, based upon stated factors and the result. (*Id*. at p. 868, 120 Cal.Rptr.2d 228.) It relied on familiar principles, " 'The trial court is the best judge of the value of professional services rendered in its court....' [Citation.] The only proper basis for reversal of a fee award is an award so large or small that it shocks the conscience and suggests that passion or prejudice influenced the result." (*Ibid*.)

B. Proceedings at Trial

The *Brandt* fees were vigorously litigated. It was not disputed that Pulte's original fee arrangement from 2013 was to pay its attorneys on a contingency basis. The trial court held several hearings at which *Brandt* fees were discussed in terms of American Safety's argument the Pulte fee agreement was manipulated posttrial. In December 2015, shortly after the court issued its substantive decision on entitlement to contract damages and to bad faith recovery, the court held a scheduling hearing and admitted the Pulte contingency fee agreement (a letter of April 5, 2013) into evidence.

At a subsequent hearing on January 15, 2016, the court estimated that as of that time, Pulte's contract damages had been proven to be about $400,000 ($421,878.15 was being claimed, including prejudgment interest). The court inquired whether a one-third contingency fee would accordingly amount to a de minimis award (about $150,000). Pulte's counsel responded that the actual figure it was claiming for the expense of pursuing the contract claims, as shown by its billing records, was more like $680,000 in attorney fees, and argued that ****83** none of the trial witnesses had said that the amount was unreasonable. American Safety's attorney responded that the court would still be applying two ratios: the one-third contingency ratio set by the fee agreement, and the second ratio as set by allocating the tort versus contract recovery. The court agreed that "whatever I found would impact it if I use a *Cassim* formula."

At that point, American Safety's calculations were that Pulte could obtain only $174,401.44 in fees incurred directed toward obtaining benefits under the contract. That would also be its proposed base amount for calculation of punitive damages purposes. Later in the proceedings, American Safety revised its calculations to state that the *Brandt* fees should be around $371,000.

Next, at the January 15, 2016 hearing, the court observed that this was not a case in which an individual insured would be recovering large emotional distress damages, but instead it was focused on corporate conduct. The court ***1130** outlined the procedure to be followed for the remaining portion of trial: "Notwithstanding my findings of what the insurance company did, I'm only focusing on the damages part.... And so I'm just—I'm struggling with how to make—to, as I must, follow the direction of the Supreme Court [*Cassim*] and figure out how it applies in this case. [¶] So I need to take it under submission because I need to look at allocations. And then after I do that, I need to decide whether I'm going to use the *Cassim*-type formula or some other basis for the calculation."

Pulte then filed, along with its trial brief filed February 9, 2016, declarations from its house counsel and third party claims administrator about its recent agreement to modify the prior attorney fee arrangement, such that "Pulte has now incurred and paid all attorneys' fees and costs in this action through January 31, 2016, on an hourly basis at the rates reflected on the invoice submitted to the Court during trial (Exhibit 453) and pursuant to the supplemental invoices submitted herewith." Pulte contended that such a modification to the fee agreement was necessary "[in] order to avoid having Pulte and/or its counsel deprived of the full measure of the reasonable fees and costs actually required to pursue this contentious action." Pulte cited to cases that had recognized some parties' rights to modify a prior contingent fee arrangement, such that a subsequent award based on a reasonable hourly rate is allowable. (*Merced Irrigation Dist. v. Woolstenhulme* (1971) 4 Cal.3d 478, 505, 93 Cal.Rptr. 833, 483 P.2d 1 [where a modified agreement was reached, "the trial court could properly find that the arrangement was no longer a purely contingent one"]; *Vella v. Hudgins*, *supra*, 151 Cal.App.3d 515, 519, 198 Cal.Rptr. 725.) Pulte now claimed its total attorney fees and costs incurred were $769,101.80, as shown by its records of billings. Once the bad faith attorney fees and costs portion ($123,589.20) was properly deleted, Pulte argued the *Brandt* fees and costs should amount to $645,463.10. American Safety objected that the new declarations were posttrial evidence and should not be considered.

The trial court began the February 11, 2016 hearing by characterizing the issues surrounding the *Brandt* fees. "I guess the elephant in the room to address first is the change in the fee agreement. So let's talk about that." After some colloquy, the court determined that the respective calculations and proposals by the parties were as follows. American Safety suggested that the *Brandt* fees should be about $371,000, while Pulte requested $645,000 and had submitted invoices to show the time spent ****84** between May 2013 and October 2015. With those two positions in mind, the trial court stated that it understood the arguments and principles in *Cassim*, "but I'm going to allow the actual fees incurred." The court observed that trial took place in phases: ***1131** "And I don't think that the evidence in the punitive damage portion or the arguments would be different depending on whether I award 300-or 600,000 because you're arguing about ratios and that sort of thing."

The court rejected American Safety's argument that the recent change in Pulte's fee agreement was "nothing but a manipulation of the process, and neither Pulte nor [it's law firm] should be rewarded for it." The court responded with this ruling, "All right. I think the law is clear that fee agreements can be changed. There are ethical issues. And typically it's the client that challenges and typically the change is from an hourly to a contingency at the last minute by the lawyer and that's challenged, but when there's an anticipation of a very large settlement or verdict. That is not before me. And it looks like Mr. Laramie is an attorney; so that does seem proper. [¶] The courts consistently talk about the fees incurred, which is the dilemma, or whatever you want to call it, addressed by *Cassim* and some of the other cases where the issue is what fees are or will be incurred by the plaintiff to obtain the contract benefits. It is before the Court, and admittedly late, but it's now clear that Pulte has incurred these fees, whatever it is, $645,000 of fees, and I think I have to therefore consider that. So I'm going to base my award of *Brandt* fees on the fees incurred. What I want to talk about now is allocation."

Following the hearing, the court issued its decision on *Brandt* attorney fees and punitive damages. The trial court found that neither of the proposed tort/contract allocations offered by the parties was reliable and the court was going to make its own percentage allegations, based on the hourly billings. The court was able to reach a determination that the *Brandt* fees due for the pretrial portion of trial ($480,000 billed) amounted to approximately $396,875 in *Brandt* fees, once appropriate deductions were made. Since most of the trial period had been spent on tort matters, only $75,000 out of the $200,000 billed for trial was recoverable as *Brandt* fees. The total to be awarded was $471,313.52.

C. Analysis of Award

[45]American Safety objects to the conclusions reached by the trial court. Under its preferred analysis, American Safety would itemize as follows: Using a weighted average of 72 percent of all fees as attributable to contract claims (the *Brandt* fee work, for both pretrial and trial services), the court should have set the total contingent fee at $428,840. On that basis, American Safety would apply *Cassim, supra*, 33 Cal.4th 780, 16 Cal.Rptr.3d 374, 94 P.3d 513, and reduce the total ***1132** contingent fee in the same contract/tort proportion, which would translate to *Brandt* fees of $308,765. American Safety denotes the existing award to be a $162,549 increase over the contingent fee calculation.

We are aware that the trial court's award of *Brandt* fees was made after extensive briefing and argument between December 2015 and February 2016, about the reasonable value of services attributed to the causes of action for which *Brandt* attorney fees were allowed. Pulte did not explain exactly when it decided to modify its fee agreement with counsel, except for providing declarations dated February 9, 2016, after trial, from its house counsel Laramie and its third party claims administrator Macy. Laramie stated Pulte had decided more compensation for counsel was needed, in response to significant ****85** work made necessary by the opponent's "sharp tactics" throughout the litigation, and the results achieved by counsel. Macy reviewed invoices and wrote the checks.

We have serious concerns that this change in Pulte's fee agreement was apparently "designed to manipulate the calculation of *Brandt* fees to the plaintiff's benefit." (*Cassim, supra*, 33 Cal.4th at p. 813, 16 Cal.Rptr.3d 374, 94 P.3d 513.) Even accepting that the trial court has broad discretion in the area of fee awards, this was not a case in which the type of contractual negotiations between attorney and client is the main concern. For example, the court in *Vella*, in approving a renegotiated fee agreement, was focusing on the understanding of the parties to the contract, and stated, "[t]he court will not impose its own interpretation at variance with the parties' intention," measured by the time that the contract was written. (*Vella v. Hudgins, supra*, 151 Cal.App.3d at p. 519, 198 Cal.Rptr. 725.) The outcome of allowing this contingency fee contract to be modified by the parties, after trial, primarily affects not their own understandings but instead American Safety, which is now on the hook for more than it anticipated.

The trial court's understanding that fee arrangements can normally be changed did not accurately take into account the strict principles of *Brandt*, which are to ensure that such a fee award reflects only those fees "attributable to the attorney's efforts to obtain the rejected payment due on the insurance contract." (*Brandt, supra*, 37 Cal.3d at p. 819, 210 Cal.Rptr. 211, 693 P.2d 796, cited in *Cassim, supra*, 33 Cal.4th at p. 813, 16 Cal.Rptr.3d 374, 94 P.3d 513.) *Brandt* fees, as tort damages against the insurer, are premised on the unreasonable denial of policy benefits and the consequent fees incurred. (*Griffin Dewatering Corp., supra*, 176 Cal.App.4th at p. 220, 97 Cal.Rptr.3d 568.) Because of the extent of exposure American Safety had to any kind of liability throughout trial, the fee arrangement in effect during trial should have controlled over the recent changes to it. Under these standards, we cannot find the trial court took all the appropriate factors into account in awarding *Brandt* fees. Although its decision to award fees as damages ***1133** pursuant to *Brandt* was substantively justified, we must remand the case to the trial court for recalculation of the proper amount on the original contingency basis.

VI

PUNITIVE DAMAGES AWARD: AMOUNT ONLY

[46]In determining whether a punitive damages award is excessive under California law, the courts consider factors such as the reprehensibility of the defendant's conduct, the amount of compensatory damages or actual harm suffered by the plaintiff, and the financial condition of the defendant. (*Bullock v. Philip Morris USA, Inc., supra*, 159 Cal.App.4th at p. 690, fn. 18, 71 Cal.Rptr.3d 775; *Corenbaum v. Lampkin* (2013) 215 Cal.App.4th 1308, 1337, 156 Cal.Rptr.3d 347.) The court addressed each of these factors in its decision, and awarded $500,000 in punitive damages, noting this was a roughly proportional amount on a one-to-one ratio to the compensatory damages (calculated by the court as the *Brandt* fees in the amount of

$471,313.52, together with *Brandt* costs of $38,587). We find no fault with the court's consideration of the appropriate punitive damage factors, as above.

However, in view of the factual showing about the nature of the fee arrangement in effect during trial, a differently calculated award of *Brandt* fees should be rendered ****86** on remand. Under the principles discussed above, the trial court must adjust the punitive award accordingly to maintain the approximate one-to-one ratio. (See *Nickerson v. Stonebridge Life Ins. Co.* (2016) 63 Cal.4th 363, 368, 203 Cal.Rptr.3d 23, 371 P.3d 242 ["In determining whether a punitive damages award is unconstitutionally excessive, *Brandt* fees may be included in the calculation of the ratio of punitive to compensatory damages, regardless of whether the fees are awarded by the trier of fact as part of its verdict or are determined by the trial court after the verdict has been rendered."].)

DISPOSITION

The judgment is reversed in part, solely with respect to the order awarding *Brandt* fees and the resultant punitive damages award, with directions to the trial court to allow such further proceedings as necessary to recalculate the award in accordance with Pulte's originally effective contingency fee agreement, and then to impose a like amount of punitive damages; the balance of ***1134** the judgment is affirmed, including the entitlement orders on compensatory and punitive damages. Costs on appeal to Pulte.

WE CONCUR:

O'ROURKE, J.

DATO, J.

All Citations

14 Cal.App.5th 1086, 223 Cal.Rptr.3d 47, 17 Cal. Daily Op. Serv. 8742, 2017 Daily Journal D.A.R. 8507

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EXHIBIT E

17 Cal.App.5th 187
Court of Appeal,
Fourth District, Division 1, California.

MCMILLIN MANAGEMENT SERVICES, L.P. et al., Plaintiffs and Appellants,
v.
FINANCIAL PACIFIC INSURANCE COMPANY et al., Defendants and Respondents.

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Filed 11/14/2017
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Certified for Partial Publication.*

Synopsis

Background: Developer of residential development sued subcontractors' comprehensive general liability (CGL) insurers for declaratory relief, breach of contract, and breach of the implied covenant of good faith and fair dealing, alleging that insurers breached their duty to defend developer pursuant to various CGL policies issued to subcontractors that named developer as an additional insured in underlying construction defect action brought by homeowners within the project. The Superior Court, San Diego County, No. 37-2012-00104981-CU-IC-CTL, Katherine Bacal, J., granted insurers summary judgment. Developer appealed.

Holdings: The Court of Appeal, Aaron, J., held that:

[1] nonexistence of homeowners within project at time subcontractors ceased ongoing operations did not establish lack of potential coverage for developer;

[2] lack of homeowners did not demonstrate that homeowners' claims constituted claims for completed operations for which developer was not covered; and

[3] memorandum stating that additional insured coverage ended when subcontractors' work was finished did not demonstrate that developer understood CGL policy would not provide coverage.

Affirmed in part and reversed in part.

****223** (Super. Ct. No. 37-2012-00104981-CU-IC-CTL)
APPEALS from judgments of the Superior Court of San Diego County, Katherine Bacal, Judge. Reversed as to respondent Lexington Insurance Company; affirmed as to respondent Financial Pacific Insurance Company.

Attorneys and Law Firms

Ryan & Associates and Greg J. Ryan, San Diego, for Plaintiffs and Appellants.

Gordon & Rees, Arthur Schwartz, and Randall P. Berdan, San Francisco, for Defendant and Respondent Financial Pacific Insurance Company.

Lewis Brisbois Bisgaard & Smith, Rebecca R. Weinreich, Christine Magarian, Los Angeles; Herold & Sager, Andrew D. Herold, Encinitas, and Kendall Dulich, San Diego, for Defendant and Respondent Lexington Insurance Company.

Opinion

AARON, J.

***191** I.

INTRODUCTION

McMillin Management Services, L.P. and Imperial Valley Residential Valley Residential Builders, L.P. (collectively "McMillin")[1] filed this action against numerous insurance companies, including respondents Lexington Insurance Company (Lexington) and Financial Pacific Insurance Company (Financial Pacific). In its complaint, McMillin alleged that it had acted as a developer and general contractor of a residential development project in Brawley (the Project) and that it had hired various subcontractors to help construct the Project. As relevant to this appeal, McMillin alleged that Lexington and Financial Pacific breached their respective duties to defend McMillin in a construction defect action (underlying action) brought by homeowners within the Project. McMillin alleged that Lexington and Financial Pacific each owed a duty to defend McMillin in the underlying action pursuant to various comprehensive general liability (CGL) insurance policies issued to the subcontractors that named McMillin as an additional insured.

[1] [2]Whether an insurer owes an insured a duty to defend a third party's lawsuit depends, in the first instance, on a comparison of the allegations of the third party's complaint and the terms of the insured's policy. (*Scottsdale Ins. Co. v. MV Transportation* (2005) 36 Cal.4th 643, 654–655, 31 Cal.Rptr.3d 147, 115 P.3d 460.) If any facts stated in or fairly inferable from the complaint, or otherwise known or discovered by the insurer, suggest a claim potentially covered by the policy, the insurer's duty to defend arises. (*Ibid.*)

Lexington filed a motion for summary judgment in which it contended that it did not owe McMillin a duty to defend the underlying action because there was no potential for coverage for McMillin under the Lexington policies. Lexington noted that the policies contained additional insured endorsements that provided coverage ****224** to McMillin for " 'liability *arising out of* [the named insured subcontractors'] ongoing operations.' " (Italics altered.) Lexington argued that there was no potential for coverage for the construction defect claims asserted against McMillin in the underlying action because McMillin had "no liability to the homeowners until after the close of escrow of each homeowner's property" and thus, McMillin "did not have any ***192** liability to plaintiffs [in the underlying action] for property damage that took place *while* [the subcontractors] were working on the Project...." (Italics added.) The trial court granted Lexington's summary judgment motion on this ground, reasoning, that there was no possibility for coverage for McMillin as an additional insured under the policies "[b]ecause there were no homeowners in existence until after the subcontractors' work was complete[ ]...."

On appeal, McMillin contends that the fact that the homeowners did not own homes in the Project at the time the subcontractors completed their work does not establish that its liability did not *arise out of* the subcontractors' ongoing operations. In support of this contention, McMillin argues that the endorsements "make no reference to *when* liability must arise," and that nothing in the text of the endorsements "requires that the homeowners exist or make their claims during ongoing operations." In contrast, Lexington argues that "since the [h]omeowners' cause of action accrued after operations were completed, McMillin could have no liability to the homeowners *during* the [subcontractors'] 'ongoing operations.' " (Italics altered.) McMillin's argument is supported by the text of the endorsements, while Lexington's argument is not. The endorsements do not provide coverage solely for "liability ... *during* the [subcontractors'] 'ongoing operations' " (italics altered), but rather, broadly provide for coverage for liability " '*arising out of*' " (italics added) such operations. Thus, the fact that there were no homeowners in existence at the time the subcontractors completed their ongoing operations does not establish that McMillin could not have potential liability to the homeowners *arising out of* the subcontractors' ongoing operations. Accordingly, the trial court erred in granting Lexington's motion for summary judgment on this ground.

Financial Pacific also filed a motion for summary judgment on the ground that it did not owe McMillin a duty to defend the underlying action. Financial Pacific contended that McMillin was seeking coverage based on policies issued to subcontractors that installed drywall on the Project, and that neither the complaint in the underlying action nor any extrinsic evidence established that the homeowners in the underlying action had sought potentially covered damages arising out of the subcontractors' drywall installation. The trial court granted Financial Pacific's motion on this basis and entered a judgment in its favor.

On appeal, McMillin contends that the trial court erred in granting Financial Pacific's motion because there is a triable issue of fact with respect to whether there was a potential for coverage under the policies. In the unpublished portion of this

opinion, we conclude that the trial court properly determined that there was "no potential for coverage" under the relevant polices and that Financial Pacific was entitled to judgment as a matter of law.

***193** Accordingly, we reverse the summary judgment in favor of Lexington and affirm the summary judgment in favor of Financial Pacific.

II.

FACTUAL AND PROCEDURAL BACKGROUND

McMillin acted as the developer and general contractor of the Project. McMillin ****225** hired numerous subcontractors to perform construction work on the project, including Martinez Construction Concrete Contractor, Inc. (Martinez), Rozema Corporation (Rozema), A.M. Fernandez Drywall (A.M. Fernandez), and J.Q. Drywall.

Lexington issued CGL policies to Martinez and Rozema and Financial Pacific issued CGL policies to A.M. Fernandez and J.Q. Drywall. The Lexington and Financial Pacific policies name McMillin as an additional insured.

McMillin completed construction of the homes in the Project in June 2005.

In June 2010, several homeowners within the Project filed the underlying action against McMillin. The homeowners alleged that they had discovered defective conditions arising out of the construction of their homes.

McMillin tendered its defense of the underlying action to Lexington and Financial Pacific, among other insurers. Both Lexington and Financial Pacific refused to defend McMillin.

In October 2012, McMillin asserted claims against Lexington and Financial Pacific for declaratory relief, breach of contract, and breach of the implied covenant of good faith and fair dealing. With respect to each claim, McMillin contended that Lexington and Financial Pacific had breached their respective contractual obligations to defend McMillin in the underlying action.[2]

Lexington and Financial Pacific each filed a motion for summary judgment in which they contended that they did not owe McMillin a duty to defend the underlying action and that McMillin would therefore be unable to establish any of its claims as a matter of law.

The trial court granted both motions. The court subsequently entered a summary judgment in favor of Lexington and a separate summary judgment in favor of Financial Pacific.

***194** McMillin filed a notice of appeal from the summary judgment in favor of Lexington, and filed a second notice of appeal from the summary judgment in favor of Financial Pacific.

III.

DISCUSSION

The trial court erred in granting Lexington's motion for summary judgment, but properly granted Financial Pacific's motion for summary judgment

McMillin claims that the trial court erred in granting Lexington's and Financial Pacific's motions for summary judgment. McMillin maintains that the trial court erred in concluding that neither Lexington nor Financial Pacific had a duty to defend McMillin in the underlying action, and thus, that McMillin could not establish any of its claims for declaratory relief, breach of contract, and breach of the implied covenant of good faith and fair dealing.

A. *General principles of law relevant to both appeals*

1. *The law governing summary judgment*

A moving party is entitled to summary judgment when the party establishes that it is entitled to the entry of judgment as a matter of law. (Code Civ. Proc., § 437c, subd. (c).) A defendant may make this showing by demonstrating that the plaintiff ****226** cannot establish one or more elements of all of his causes of action, or that the defendant has a complete defense to each cause of action. (*Towns v. Davidson* (2007) 147 Cal.App.4th 461, 466, 54 Cal.Rptr.3d 568.)

In reviewing a trial court's ruling on a motion for summary judgment, the reviewing court makes " 'an independent assessment of the correctness of the trial court's ruling, applying the same legal standard as the trial court in determining whether there are any genuine issues of material fact or whether the moving party is entitled to judgment as a matter of law.' " (*Trop v. Sony Pictures Entertainment, Inc.* (2005) 129 Cal.App.4th 1133, 1143, 29 Cal.Rptr.3d 144.)

2. *The duty to defend*

In *Hartford Casualty Ins. Co. v. Swift Distribution, Inc.* (2014) 59 Cal.4th 277, 172 Cal.Rptr.3d 653, 326 P.3d 253 (*Hartford*), the Supreme ***195** Court explained that "[t]he duty to defend is guided by several well-established principles. An insurer owes a broad duty to defend against claims that create a potential for indemnity under the insurance policy. [Citation.] An insurer must defend against a suit even ' "where the evidence suggests, but does not conclusively establish, that the loss is not covered." ' " (*Id.* at p. 287, 172 Cal.Rptr.3d 653, 326 P.3d 253.)

The *Hartford* court also explained the manner by which a court is to determine whether an insurer owed its insured a duty to defend:

> " 'Determination of the duty to defend depends, in the first instance, on a comparison between the allegations of the complaint and the terms of the policy. [Citation.] But the duty also exists where extrinsic facts known to the insurer suggest that the claim may be covered.' [Citation.] This includes all facts, both disputed and undisputed, that the insurer knows or ' "becomes aware of" ' from any source.... 'Moreover, that the precise causes of action pled by the third party complaint may fall outside policy coverage does not excuse the duty to defend where, under the facts alleged, reasonably inferable, or otherwise known, the complaint could fairly be amended to state a covered liability.' [Citation.] Thus, '[i]f any facts stated or fairly inferable in the complaint, or otherwise known or discovered by the insurer, suggest a claim potentially covered by the policy, the insurer's duty to defend arises and is not extinguished until the insurer negates all facts suggesting potential coverage.' [Citation.] In general, doubt as to whether an insurer owes a duty to defend 'must be resolved in favor of the insured.' " (*Hartford, supra*, 59 Cal.4th at p. 287, 172 Cal.Rptr.3d 653, 326 P.3d 253.)

[3]However, "[w]hile the duty to defend is broad, it is 'not unlimited; it is measured by the nature and kinds of risks covered by the policy.' " (****227** *Hartford, supra*, 59 Cal.4th at p. 288, 172 Cal.Rptr.3d 653, 326 P.3d 253.)

The *Hartford* Court also explained the relative burdens of proof in a case in which the insured contends that an insurer breached the duty to defend:

> " '[T]he insured must prove the existence of a *potential for coverage*, while the insurer must establish *the absence of any such potential*. In other words, the insured need only show that the underlying claim *may* fall within policy coverage; the insurer must prove it *cannot*.' " [Citation.] Thus, an insurer may be excused from a duty to defend only when ' "the third party complaint can by no conceivable theory raise a single issue which could bring it within the policy coverage." ' " (*Hartford, supra*, 59 Cal.4th at p. 288, 172 Cal.Rptr.3d 653, 326 P.3d 253.)

***196** B. *The trial court erred in granting Lexington's motion for summary judgment*

1. *Additional factual and procedural background*

a. *The Project*

As noted in part II, *ante*, McMillin developed and acted as the general contractor for the Project. Martinez performed concrete flatwork on the Project between 2003 and November 2005. Rozema performed lath and stucco work on the Project between March 2003 and October 2005. McMillin completed construction of the homes in the Project by mid-June 2005.[3] McMillin completed all initial sales of the homes in the Project by early August 2005.

b. *Lexington's policies*

i. *The policy periods*

Martinez and Rozema each obtained CGL coverage through policies issued by Lexington. Lexington issued two CGL policies to Martinez for the policy periods February 27, 2004 through February 27, 2005 and February 27, 2005 through February 27, 2006, respectively. Lexington issued a CGL policy to Rozema for the policy period October 1, 2004 through October 1, 2005.

ii. *The insuring agreements*

All three policies contain identical insuring agreements that provide that Lexington would pay those sums that the insured became legally obligated to pay because of " 'property damage' " caused by an " 'occurrence' " during the policy period. The policies define "property damage" as:

> "a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
>
> ***197** "b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the 'occurrence' that caused it."

The policies define "occurrence" as:

> "[A]n accident, including continuous or repeated exposure to substantially the same general harmful conditions."

The policies further provide that Lexington has the duty to defend any suit seeking such damages.

iii. *The additional insured endorsements*

The Lexington policies contain substantively identical additional insured endorsements that amend the polices to provide coverage to McMillin " 'but only with respect to liability arising out of your [i.e., Martinez's or Rozema's] ongoing

operations performed for [McMillin].' " The endorsements also each contain an exclusion that states:

****228** "With respect to the insurance afforded to these additional insureds, the following exclusion is added:

"... Exclusions

"This insurance does not apply to 'bodily injury' or 'property damage' occurring after:

"(1) All work, including materials, parts or equipment furnished in connection with such work, on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the site of the covered operations has been completed; or

"(2) That portion of 'your work' out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or subcontractor engaged in performing operations for a principal as a part of the same project."

c. *McMillin's complaint in this action*

McMillin alleged in its complaint in this action that Martinez and Rozema had acted as subcontractors on the Project. McMillin also alleged that Lexington had issued CGL policies to both Martinez and Rozema, and that the policies listed McMillin as an additional insured. McMillin further alleged ***198** that the complaint in the underlying action "sought damages against [McMillin] arising out of alleged negligent and defective work of [McMillin] and its subcontractors and suppliers on the Project."

d. *Lexington's motion for summary judgment*

Lexington filed a motion for summary judgment on the ground that it did not owe McMillin a duty to defend the underlying action because there was no possibility for coverage under the policies, in light of the additional insured endorsements. Specifically, Lexington noted that the endorsements provided coverage only for " 'liability arising out of your [i.e., Martinez's or Rozema's] ongoing operations performed for [McMillin].' " (Italics omitted.) Lexington argued that there was no possible coverage under the endorsements because there were no homeowners who could have brought construction defect claims against McMillin during the time that Martinez's or Rozema's operations were ongoing. Specifically, Lexington argued in relevant part:

"McMillin would have no liability to the homeowners until after the close of escrow on each homeowner's property. [¶] Furthermore, pursuant to well-established California law, a construction defect action does not accrue until the plaintiff discovers the defect. [Citation.] Therefore McMillin did not have any liability to the homeowners until after close of escrow of their property, and only after the homeowners discovered the defects complained of in the [underlying action]. [¶] ... [P]laintiffs [in the underlying action] waited approximately five to seven years after taking possession of their properties to file [the underlying action]. As such, because McMillin did not have any liability to plaintiffs [in the underlying action] for property damage that took place *while Martinez and Rozema were working on the Project* ... the allegations in the [underlying action] are not covered under the ongoing operations additional insured endorsements to the [p]olicies." (Italics added.)

Lexington further argued "it is clear that the claims at issue in the [underlying action] constitute claims for *completed* operations" (italics added), and that the language ****229** of the endorsements made clear that McMillin was entitled to coverage only for *ongoing* operations claims.

Finally, Lexington contended that McMillin "understood the difference between an 'ongoing operations' additional insured endorsement and a 'completed operations' version." In support of this contention, Lexington cited a memorandum that

McMillin's risk manager, Jim Jordan, drafted in May of 2003, summarizing the standard additional insured endorsement form used in the Martinez and Rozema policies. Jordan's memorandum states in relevant part:

> "[The ongoing operations endorsement] restricts coverage for the Additional Insured to liability only arising out of the subcontractors' 'ongoing operations.' *In other words, the coverage for the Additional Insured ends* ***199** *when the subcontractor's work is no longer ongoing ... or, in other words, is finished or completed*...." (Emphasis and omissions are from Lexington's brief.)

e. *McMillin's opposition*

McMillin filed an opposition in which it argued that the fact that Martinez's and Rozema's work on the Project was completed before the homeowners owned their homes or made their claims in the underlying action did not establish the lack of a potential for coverage under the additional insured endorsements. McMillin noted that the endorsements in the relevant policies provided coverage to McMillin " 'with respect to liability **arising out of** ... **ongoing operations** performed' " for McMillin. McMillin argued, "This language does not incorporate any coverage limitations related to when the liability must arise. Instead, it told McMillin at the time operations were ongoing, that any liability 'arising out of' those operations would be insured."

McMillin also argued that whether it was covered under the endorsements was determined by "when the property damage occurred" (italics omitted) and that Lexington had presented "no evidence ... that any property damage could only have occurred after operations were completed."

McMillin maintained that Lexington was mistaken in contending that "no coverage is triggered because the homeowners' cause of action did not accrue until they discovered the defects." McMillin reasoned, "[T]hat is not the standard for the duty to defend[,] which depends upon when property damage *occurs*, not when it is discovered."

Finally, McMillin contended that, because the proper interpretation of the endorsements was a legal question, any statements made in Jordan's memorandum concerning coverage were "irrelevant and immaterial to whether a defense is owed." (Italics omitted.) McMillin also argued that, in any event, Jordan's memorandum merely reflected his understanding that coverage under the ongoing operations endorsement applies to property damage occurring before the completion of Martinez's and Rozema's work, which was consistent with McMillin's interpretation of the endorsement in its opposition to Lexington's motion.

f. *Lexington's reply*

In its reply, Lexington reiterated its argument that "[s]ince as a matter of law McMill[i]n could not have had liability to the ... plaintiffs ('Homeowners') until after the Homeowners took possession of their homes long after ***200** operations were complete, ... liability cannot have arisen from ongoing operations." For example, Lexington argued, "The critical question in this case ... is whether McMillin was liable to the Homeowners *during* Martinez ['s] and/or Rozema's ... ongoing operations." ****230** (Italics added.) Lexington then argued the answer to that question by stating, "McMillin had no liability to the Homeowners *during* Martinez'[s] and Rozema's ongoing operations because it is undisputed that the Homeowners took possession after all work had been completed." (Italics altered & boldface omitted.)

Lexington maintained that "[b]ecause the Homeowners in the [underlying action] could only sue for construction defect[s] after taking possession of their homes, and after all work had been completed, the word 'liability' in the [additional insured] endorsements must encompass a temporal element." Lexington made clear that, under its interpretation of the endorsements, McMillin had no possible coverage for construction defect claims, since such claims would accrue to homeowners only after the homeowners took possession of the homes and all of Martinez's and Rozema's work was complete. Lexington argued:

> "Here, it is undisputed that [the underlying action] involves construction defect claims[ ] [citation] and that the subject [additional insured] endorsements limit coverage for the [additional insured] to liability arising out of Martinez's and Rozema's ongoing operations performed [for] McMillin. [Citation.] Accordingly, there is no coverage for McMillin under the ongoing operations [additional insured] endorsements and Lexington owed no duty to defend McMillin."

g. *The trial court's ruling*

After hearing argument from counsel, the trial court issued a ruling granting Lexington's motion for summary judgment. The court reasoned in relevant part:

> "The additional insured endorsements ('AIE') provide[ ] coverage 'only with respect to liability arising out of [the subcontractors'] *ongoing operations*.' [Citation.] Because there were no homeowners in existence until after the subcontractors' work was completed, it follows that ... any potential liability to the homeowners arising out of the subcontractors' work must have arisen out of the subcontractor's *completed operations*." (Italics added.)

The trial court reasoned further that "[t]here is a distinction between ongoing operations and completed operations coverage." (Citing *Pardee Const. Co. v. Insurance Co. of the West* (2000) 77 Cal.App.4th 1340, 1340–1345, 92 Cal.Rptr.2d 443 (*Pardee*).)

After an extensive discussion of *Pardee*, the trial court stated:

> "Moreover, McMillin itself has acknowledged that [additional insured endorsement] ***201** coverage for ongoing operations ends when the subcontractor's work is completed. [Citation.] [4] [¶] [McMillin's] interpretation would also run afoul of the rule that insurance contracts must be construed to avoid rendering terms surplusage. [Citation.] McMillin contend [s] the endorsement provides coverage as long as liability arose out of the subcontractors' work. [McMillin] fail[s] to give any meaning to the phrase 'ongoing operations.' "

2. *Governing law*

a. *Applicable principles of law govern* ****231** *ing the interpretation of an insurance policy*

In *Hartford*, *supra*, the Supreme Court outlined the following relevant law governing the interpretation of an insurance policy:

> "In determining whether a claim creates the potential for coverage under an insurance policy, 'we are guided by the principle that interpretation of an insurance policy is a question of law.' [Citation.] 'Under statutory rules of contract interpretation, the mutual intention of the parties at the time the contract is formed governs interpretation. (Civ. Code, § 1636.)' [Citation.] In determining this intent, '[t]he rules governing policy interpretation require us to look first to the language of the contract in order to ascertain its plain meaning or the meaning a layperson would ordinarily attach to it.' [Citation]. We consider the ' "clear and explicit" meaning of these provisions, interpreted in their "ordinary and popular sense," unless "used by the parties in a technical sense or a special meaning is given to them by usage." ' [Citation.] We must also 'interpret the language in context, with regard to its intended function in the policy.' " (*Hartford*, *supra*, 59 Cal.4th at p. 288, 172 Cal.Rptr.3d 653, 326 P.3d 253.)

b. *The meaning of the key terms in the endorsement*

As discussed in part III.B.1.b.iii, *ante*, Lexington named McMillin as additional insured for " 'liability arising out of [Martinez's or Rozema's] ongoing operations performed for [McMillin].' "

i. *Liability*

We assume for purposes of this decision that Lexington is correct that the meaning of the term "liability" in the endorsements is "loss and legal obligation for [the loss]."

***202** ii. *Arising out of*

In *Acceptance Ins. Co. v. Syufy Enterprises* (1999) 69 Cal.App.4th 321, 81 Cal.Rptr.2d 557 (*Syufy*), the Court of Appeal discussed the meaning of the phrase "arising out of," while interpreting an additional insured endorsement in a CGL policy. The *Syufy* court stated:

> "California courts have consistently given a broad interpretation to the terms 'arising out of' or 'arising from' in various kinds of insurance provisions. It is settled that this language does not import any particular standard of causation or theory of liability into an insurance policy. Rather, it broadly links a factual situation with the event creating liability, and connotes only a minimal causal connection or incidental relationship." (*Id.* at p. 328, 81 Cal.Rptr.2d 557.)

iii. *Ongoing operations*

In *St. Paul Fire and Marine Ins. Co. v. American Dynasty Surplus Lines Ins. Co.* (2002) 101 Cal.App.4th 1038, 1056–1057, 124 Cal.Rptr.2d 818 (*St. Paul*), the court interpreted an additional insured endorsement that, as in this case, provided coverage limited " 'to liability [to [the additional insured]] arising out of [named insured's] ongoing operations performed for [the additional insured].' " (*Id.* at p. 1055, 124 Cal.Rptr.2d 818.) The *St. Paul* court stated that the term "ongoing operations" was "the work to be performed for [the additional insured] under the [s]ubcontract," by the named insured. (*Id.* at pp. 1056–1057, 124 Cal.Rptr.2d 818.)

3. *Application*

[4]In order to resolve this appeal, we are faced with a narrow question. Did the trial court properly determine that there was no potential for coverage under the endorsements naming McMillin as an additional insured for " 'liability arising out of [Martinez's or Rozema's] ongoing operations performed for [McMillin]' " because there were no homeowners in the Project ****232** at the time of Martinez's and Rozema's ongoing operations?

Lexington contends that the answer to that question is "yes," and that we may affirm the judgment on this basis. As it argued in the trial court, Lexington contends that the fact that there were no homeowners at the time Martinez and Rozema were working on the Project establishes that McMillin did not have any liability to the homeowners *during* Martinez's and Rozema's ongoing operations. Lexington repeats this contention throughout its brief:

> "The trial court correctly ruled that McMillin did not have any liability to the Homeowners *during* 'ongoing operations' because there were not Homeowners until after operations were completed." (Italics altered.)

***203** "In other words, the determinative issue is whether McMillin's potential liability to the Homeowners arose *during* a

named insured's 'ongoing operations.' " (Italics added.)

"On these facts, since the Homeowners' causes of action accrued after operations were completed, McMillin could have no liability to the Homeowners *during* the named insureds' 'ongoing operations.' " (Italics altered.)

"[T]he central question here is whether McMillin faced any liability to the Homeowners *during* the named insureds' 'ongoing operations,'...." (Italics added.)

"Under the terms of the Lexington [additional insured] [e]ndorsements, McMillin could have coverage for liability for bodily injury or property damage when that liability arises *during* ongoing operations." (Italics added.)

"The key issue is whether McMillin's liability arose *during* the named insureds' 'ongoing operations.' " (Italics added.)

"Specifically, the 'liability,' i.e., the loss and legal obligation for same, must take place *during* the named insured's ongoing operations." (Italics altered.)

[5]Even assuming that Lexington is correct that McMillin did not face any liability to homeowners *during* Martinez's or Rozema's ongoing operations,[5] the endorsements do not state that Lexington would provide coverage solely for liability occurring *during* Martinez's or Rozema's ongoing operations performed for McMillin. Rather, the endorsements state that Lexington would provide coverage to McMillin for liability "*arising out of*" such ongoing operations. The term "arising out of" is, of course, not synonymous with "during." (*Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey* (8th Cir. 1984) 726 F.2d 1286, 1290 [rejecting interpretation of agreement that "would require reading the words 'arising out of' as synonymous with 'during' "].)

Indeed, as discussed above, the phrase "arising out of," has specifically been given a "broad interpretation," in the context of additional insured endorsements. (See *Syufy, supra*, 69 Cal.App.4th at p. 328, 81 Cal.Rptr.2d 557.) The term "arising out of" in the endorsements granting McMillin coverage for " 'liability arising out of [Martinez's or Rozema's] ongoing operations,' " ***204** provides only that McMillin's liability must be "linked," through a "minimal causal connection or incidental relationship" (*ibid.*), with Martinez's or Rozema's ongoing operations. Thus, the fact that there were no homeowners at the time of Martinez's and Rozema's ongoing operations ****233** does not establish that McMillin could suffer no liability *arising out of* such ongoing operations.

For example, consider the work of Lexington subcontractors such as those in this case, who performed concrete flatwork and stucco work. The improper pouring of concrete on a foundation or the improper installation of stucco could permit water damage to other portions of the home.[6] Thus, consequential damage could begin long before the subcontractors' work ended. If homeowners did not discover and file suit to recover for such damages until after the subcontractors ceased ongoing operations, that would not establish that McMillin suffered no liability *arising out of* such ongoing operations.[7]

[6]Both Lexington and the trial court have focused on the terms "ongoing operations" and "completed operations" in tandem, suggesting that any claim by a homeowner is necessarily covered, if at all, only by "completed operations" coverage. Lexington appears to suggest that an "ongoing operations" additional insured endorsement does not afford the additional insured with coverage provided under a named insured subcontractor's "products-completed" coverage.

The policies in this case state that " 'property damage' " covered under the " 'products-completed operations hazard' " does *not* include the named insured subcontractors ' "[w]ork that has not yet been completed or abandoned." Thus, the policy language makes clear that property damage occurring *before* completion of the named insured subcontractors' work would not be covered by "products-completed operations hazard."[8]

***205** As our example above demonstrates, the lack of homeowners does not establish that any property damage caused by the named insured subcontractors' work occurred *after* the completion of their work. Thus, even assuming that Lexington is correct that an "ongoing operations" additional insured endorsement does not provide the additional insured with the same coverage afforded under a named insured subcontractor's "products-completed" coverage, a homeowner's construction defect claim is not, as Lexington suggests in its brief, necessarily one that is brought to recover under the "products-completed" coverage of a named insured subcontractor's policy. On the contrary, if property damage occurs before the named insured finishes ****234** work at the jobsite, under the plain language of the policy, an additional insured may be

entitled to coverage pursuant to an "ongoing operations" endorsement.[9]

This court's decision in *Pardee*, *supra*, 77 Cal.App.4th 1340, 92 Cal.Rptr.2d 443, on which both the trial court and Lexington heavily rely, does not support a contrary result. In *Pardee*, we concluded that several insurers that had issued CGL policies to subcontractors, including "*completed* operations coverage as to *projects completed before [the policies'] inception*," owed a duty to defend an additionally insured general contractor in third party litigation alleging vicarious liability for the subcontractors' acts in constructing the completed projects. (*Id.* at pp. 1344–1345, 92 Cal.Rptr.2d 443, italics added.) In the course of reaching this conclusion, the *Pardee* court noted that if the insurers had wished to exclude coverage for "projects *completed before inception of policies*" (*id.* at p. 1358, 92 Cal.Rptr.2d 443), the insurers had several options:

> "The insurers could have limited coverage by express policy language that coverage was limited to claims arising from work performed during the policy period. However, they did not. Indeed, they acknowledge they intended to provide the named insureds completed operations coverage for projects completed before inception of policies. Similarly, the insurers could have used the form 2009 additional endorsement, which has been widely employed since the mid-1980's to add a contractor as an additional insured under a subcontractor's policy and which clearly excludes 'completed operations.' Again, they did not." (*Id.* at p. 1358, 92 Cal.Rptr.2d 443, fn. omitted.)

[7]The *Pardee* court stated that, alternatively, the insurers could have used additional insured endorsements that restricted coverage to the ongoing operations of the named insured. (*Pardee*, *supra*, 77 Cal.App.4th at p. 1359, 92 Cal.Rptr.2d 443.) The *Pardee* court detailed the history of the availability of such endorsements ***206** as follows:

> "[I]n 1993, the Insurance Services Office (ISO) [10] revised the language of the form 2010 endorsement utilized by the insurance industry to expressly restrict coverage for an additional insured to the 'ongoing operations' of the named insured.[ ] This revised language effectively precludes application of the endorsement's coverage to completed operations losses. [Citation.] One insurance commentator stated regarding the 1993 revisions of the standard additional insured endorsement forms: 'The restriction of coverage in the two endorsements to only ongoing operations makes it clear that additional insureds will have no coverage under the named insured's policy for liability arising out of the products- ****235** completed operations [11] exposure.... The effect of this change—restricting the coverage to ongoing operations—is, however, much more profound on [form 2010]. Previous editions of [that form] contained no completed operations exclusion and, thus, could be called on to cover an additional insured for liability arising out of the products-completed operations hazard.' [Citation.] Similarly, construction industry and underwriting spokespersons have echoed this assessment: 'Completed Operations Coverage. Prior to the 1993 ... revisions, the standard ISO additional insured endorsements provided the additional insured with coverage for liability arising out of "your operations performed for" the additional insured, which included completed operations. More recent editions of these endorsements provide coverage only with respect to "your ongoing operations," which effectively eliminates coverage for completed operations.' [Citation.] Although these 1993 revisions postdated the insurers' policies here with the exception of [one insurer], they evince as to [the other insurers] alternative express limiting language that could have been employed. [¶] Consequently, the insurers' failure to use available language expressly excluding completed operations coverage implies a manifested intent not to do so." (*Id.* at pp. 1358–1359, 92 Cal.Rptr.2d 443.)

Since the *Pardee* court was discussing how the insurers in that case could have restricted coverage "for projects completed before inception of [the] policies" (*Pardee*, *supra*, 77 Cal.App.4th at p. 1358, 92 Cal.Rptr.2d 443), *Pardee* supports the proposition that an ongoing operations endorsement may be used by an insurer to make clear that there is no coverage for damages arising out of work completed *prior to the inception of the policy*. (See also *id.* at p. 1358, 92 Cal.Rptr.2d 443 ***207** ["insurers could have limited coverage by express policy language that coverage was limited to claims arising from work performed *during the policy period*" (italics added)].) It is undisputed in this case that Lexington did not establish that the damages in this case arose from work completed *before the inception of the policies*.

[8]Moreover, even assuming that an ongoing operations additional insured endorsement may have a broader effect (e.g., by restricting coverage to damages that occur before the completion of the subcontractors' ongoing operations), *the trial court did not conclude that Lexington had established as a matter of law that all of the property damage in the underlying action occurred only after the completion of the Martinez's and Rozema's ongoing operations*.[12] Lexington does not argue to ****236** the contrary on appeal. Instead, it contends, "The relevant issue is when liability arose, not when property damage first commenced."[13]

The parties have not cited, and our own research has not uncovered, any relevant California authority specifically addressing whether an ongoing operations additional insured endorsement such as the one in the Lexington policies provides coverage to the additional insured only for damages that occur before the completion of the named insured's ongoing operations. Cases from other jurisdictions are in conflict on this issue. (Compare e.g., *Noble v. Wellington Assocs.* (Miss.App. 2013) 145 So.3d 714, 720 ["endorsement did not cover property damage manifesting [14] itself after [subcontractor named insured] stopped working on the site"] with *Tri-Star Theme Builders, Inc. v OneBeacon Ins. Co.* (9th Cir. 2011) 426 Fed.Appx. 506, 508 (*Tri-Star*) [rejecting insurer's contention that additional ***208** insured general contractor was "covered [only] for damages suffered while [named insured subcontractor] was performing work on the [p]roject"].)

However, we need not decide this issue in this appeal, because Lexington has not established as a matter of law that all of the damages in the underlying action occurred after the completion of Martinez's and Rozema's ongoing operations. Rather, as discussed above, we need decide only whether Lexington and the trial court are correct that the nonexistence of homeowners at the time Martinez and Rozema ceased ongoing operations establishes as a matter of law the lack of potential for coverage for McMillin under the policies. On this issue, neither the *Pardee* court, nor any other case that Lexington has cited or of which we are aware, has held that the fact that there were no homeowners at the time the named insured subcontractor ceased ongoing operations demonstrates that an additional insured did not suffer liability arising out of the named insured's ongoing operations. The one out-of-state case that Lexington cites, without discussion, that comes closest to stating as much, *Hartford Ins. Co. v. Ohio Cas. Ins. Co.* (2008) 145 Wash.App. 765, 780, 189 P.3d 195 (*Ohio*), relied on *Pardee* only in reaching the conclusion that an insurer was "correct in its argument that the additional insured endorsement 'limited [the additional insured's] coverage to *property damage arising out of the subcontractors' work in progress* only.' " (*Ohio*, *supra*, at p. 778, 189 P.3d 195, italics added.)[15] As discussed above, we need not resolve the conflict in the non-California case law[16] concerning this issue because ****237** Lexington did *not* establish that all of the damage in the underlying action occurred after Martinez and Rozema completed operations.

We acknowledge that the *Ohio* court did conclude that an insurer had no duty to defend the additional insured in that case, in part, because "the condo owners did not own the units until after the completion of subcontractor operations." (*Ohio*, *supra*, 145 Wash.App. at p. 780, 189 P.3d 195.) However, the *Ohio* court did not cite *Pardee* as support for this portion of its analysis (*Ohio*, *supra*, at p. 780, 189 P.3d 195) nor did the court explain why it viewed this fact as establishing that there was no possibility for coverage under a policy that provided that "the additional insured was an insured only with respect to '[the named insured's] ongoing operations for that insured, whether the work is performed by [the named insured] or for [the named insured].' " (*Id.* at p. 777, 189 P.3d 195.) For the reasons stated above, the fact that there were no homeowners in the Project at the time Martinez and Rozema ceased ongoing operations does not logically ***209** establish that the complaint in the underlying action did not subject McMillin to potential " 'liability *arising out of* [Martinez's or Rozema's] ongoing operations performed for [McMillin].' " (Italics added.) In short, neither *Pardee*, nor the text of the endorsements, provide any support for the trial court's order or Lexington's contention on appeal.

Lexington's argument that we may affirm the judgment on the ground that McMillin's interpretation of the endorsement would render the term "ongoing" surplusage also fails. Lexington contends that we may affirm the judgment on this ground because McMillin purportedly argues that it is entitled to coverage for claims arising out of the subcontractors' completed operations, "since even 'completed operations' (under McMillin's argument) arise out of operations which were, at some point, ongoing."[17] Even assuming that McMillin is making this argument, we reverse the judgment solely on the narrow ground that the fact that there were no homeowners at the time Martinez and Rozema ceased ongoing operations does not establish as a matter of law the lack of a potential for coverage for McMillin under the policies. As explained above, we do not decide whether an ongoing operations endorsement such as that used in this case provides coverage to the additional insured only for damages that occur prior to the completion of the named insured's subcontractors' ongoing operations.[18]

[9]We also reject Lexington's argument that we may affirm the judgment on the ground that the May 2003 Jordan memorandum demonstrates that McMillin understood that the endorsements would provide no coverage for the claims in the underlying action. Even assuming that the Jordan memorandum is properly considered as extrinsic evidence of the parties' understanding of the endorsements, the Jordan memorandum merely states, "[c]overage for the Additional Insured ends when the subcontractor's work is no longer ongoing ... or, in other words, is finished or completed...." (Italics omitted.) ****238** Since homeowners are not mentioned in the cited portion of the Jordan memorandum, the memorandum does not constitute evidence that McMillin believed that the fact that there were no homeowners during the subcontractor's ongoing operations demonstrated that McMillin would have no potential coverage for construction defect claims under the endorsements.[19]

***210** Accordingly, we conclude that the trial court erred in granting Lexington's motion for summary judgment.[20]

C. *The trial court properly granted Financial Pacific's motion for summary judgment*[**]

IV.

DISPOSITION

The summary judgment in favor of Lexington is reversed. The summary judgment in favor of Financial Pacific is affirmed.

McMillin is entitled to recover its costs in its appeal from the summary judgment entered in favor of Lexington. Financial Pacific is entitled to recover its costs in McMillin's appeal from the summary judgment entered in favor of Financial Pacific.

WE CONCUR:

BENKE, Acting P. J.

DATO, J.

All Citations

17 Cal.App.5th 187, 225 Cal.Rptr.3d 221, 17 Cal. Daily Op. Serv. 10,849, 2017 Daily Journal D.A.R. 10,763

Footnotes

* Pursuant to California Rules of Court, rule 8.1110, this opinion is certified for publication with the exception of part III.C.

1 None of the parties make any argument concerning the significance of the distinctions between these parties. Accordingly, we refer to them collectively as McMillin.

2 McMillin states in its brief on appeal that "the duty to indemnify is not at issue in this action."

3 As indicated in the text, the parties' statements of undisputed facts state that McMillin completed construction of the homes in the Project by *mid-June 2005*, but that Martinez performed work on the Project until *November 2005* and Rozema performed work on the Project until *October 2005*. The trial court repeated these dates in its summary judgment order. The parties do not explain this apparent incongruity in their briefing. However, McMillin states in its opening brief, "McMillin concedes the homeowners did not exist until after the Project was completed." Accordingly, we assume for purposes of this decision that all of Martinez's and Rozema's work was completed prior to the date on which homeowners purchased the homes in the Project.

4 In support of this point, the trial court cited to two undisputed material facts referencing the May 2003 Jordan memorandum discussed in part II.B.1.d, *ante*, that stated in relevant part, "In other words, the coverage for the Additional Insured ends when the subcontractor's work is no longer ongoing ... or, in other words, is finished or completed...." (Italics omitted.)

5 We emphasize that we do not conclude that Lexington would have been entitled to summary judgment if the endorsements restricted coverage to liability occurring *during* ongoing operations.

6 We emphasize that we mention such potential damages by way of example for illustrative purposes and not to in any way suggest

that this is the basis of the potential coverage in this case.

7 In *Pulte Home Corp. v. American Safety Indemnity Co.* (2017) 14 Cal.App.5th 1086, 223 Cal.Rptr.3d 47, this court made a similar point in affirming a judgment against an insurer (American Safety) for breaching its duty to defend a general contractor named as an additional insured on several CGL policies issued to its subcontractors:

> "American Safety incorrectly focuses on when the current property owners became financially damaged through purchases. This begs the question of when the subject property damage occurred from the work of the subcontractors. The coverage potential depends on when the property became physically damaged." (*Id.* at p. 1113, 223 Cal.Rptr.3d 47.)

8 One prominent commentator explains that "[t]he 'products-completed operations hazard' covers liability for accidental bodily injury or property damage *following completion* of the insured's work or operations. This type of coverage is generally conditioned on damage occurring during the policy period, *as long as the work was completed before the damage occurred*...." (Croskey et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 2017) ¶ 7:1429, p. 7E-27 (second italics added).) Thus, "products-completed" coverage only covers damage that occurs *after* the named insured completes operations.

9 As discussed in the text, *post*, we need not, and do not, decide whether an additional insured is entitled to coverage under an "ongoing operations" endorsement where the property damage occurs *after* the named insured finishes work at the jobsite but before the termination of the policy.

10 In a footnote at this portion of the quotation, the *Pardee* court described the ISO as follows:

> " 'ISO is a nonprofit trade association that provides rating, statistical, and actuarial policy forms and related drafting services to approximately 3,000 nationwide property or casualty insurers. Policy forms developed by ISO are approved by its constituent insurance carriers and then submitted to state agencies for review. Most carriers use the basic ISO forms, at least as the starting point for their general liability policies.' " (*Pardee*, *supra*, 77 Cal.App.4th at p. 1359, 92 Cal.Rptr.2d 443.)

11 "[P]roducts-completed operations coverage applies to defects in merchandise or improper workmanship after the product has been completed and distributed." (*Travelers Casualty & Surety Co. v. Employers Ins. of Wausau* (2005) 130 Cal.App.4th 99, 113, 29 Cal.Rptr.3d 609.)

12 Coverage for property damage under an occurrence based CGL policy, such as the policies in this case, is deemed "to occur over the entire process of the continuing injury," and not simply when the damage is discovered or becomes manifest. (*Pepperell v. Scottsdale Ins. Co.* (1998) 62 Cal.App.4th 1045, 1053, 73 Cal.Rptr.2d 164 (*Pepperell*).) Given that damages from construction defects often consist of "a continuing and progressively deteriorating process" (*id.* at p. 1055, 73 Cal.Rptr.2d 164), damages may occur during a subcontractors' ongoing operations, only to be discovered at a far later time. (See, e.g., *id.* at pp. 1048–1049, 1054–1055, 73 Cal.Rptr.2d 164 [construction defect complaint that alleged defective roof design and construction that was completed by November 1988 alleged potentially covered damages, despite fact that policy terminated in 1989 and defects were not discovered until severe leakage occurred in 1991].)

13 In addition, Lexington does not contend that it presented evidence that established as a matter of law that the *exclusions* contained in the additional insured endorsements related to the timing of the occurrence of property damage applied. (See pt. III.B.1.b.iii, *ante* ["This insurance does not apply to ... 'property damage' occurring after: (1) All work ... at the site of the covered operations has been completed; or (2) That portion of 'your work' out of which the injury or damage arises has been put to its intended use...."].)

14 *Noble* is also distinguishable because, as discussed in footnote 12, *ante*, California law does *not* require that property damage become "manifest" in order to trigger coverage under a CGL policy. (*Pepperell*, *supra*, 62 Cal.App.4th at p. 1052, 73 Cal.Rptr.2d 164.)

15 The *Ohio* court suggested that the additional insured *would have* had coverage "[i]f there were allegations in the complaint [in the underlying construction defect action] or other evidence that would have shown that [the insurer] was being asked to cover [the additional insured] for liability arising from work in progress...." (*Ohio*, *supra*, 145 Wash.App. at p. 780, 189 P.3d 195, italics added.)

16 The Ninth Circuit has distinguished *Ohio* (*Tri-Star*, *supra*, 426 Fed.Appx. at p. 512) and criticized a portion of its reasoning (*Id.* at p. 514).

17 We quote from Lexington's respondent's brief.

18 One can imagine that damage from a subcontractor's ongoing operations might occur either *prior to* the completion of ongoing operations (e.g., a poorly installed pipe that causes a leak that begins to cause water damage to drywall while the subcontractor

continues to work on the project, but that is not discovered until the home is purchased) or *after* the completion of ongoing operations (e.g., a poorly installed pipe that causes a leak that begins to cause water damage to drywall after the subcontractor ceases operations).

19 We are not persuaded by Lexington's contention that we may affirm the judgment on the basis that McMillin failed to address the surplusage interpretation issue and the Jordan memorandum issue in its opening brief. While Lexington asserts that these issues are "*independent* grounds," upon which the trial court granted summary judgment, in fact, they are not. (Italics added.) The trial court's reasoning with respect to both issues was *related* to the sole ground on which the court granted summary judgment, namely, that Lexington established that it had no duty to defend McMillin in the underlying action because there was no possibility for coverage under the policies given the " 'ongoing operations' " limitation in the additional insured endorsements. McMillin adequately addressed this issue in its opening brief, and Lexington is not entitled to affirmance merely because McMillin did not address in its opening brief every aspect of the court's reasoning in granting summary judgment.

20 In its respondent's brief, Lexington raises two claims under separate headings that we need not consider in this appeal. Specifically, Lexington contends that it is entitled to "summary adjudication of McMillin's claim for bad faith." Lexington also maintains that McMillin is "not entitled to punitive damages." (Capitalization & boldface omitted.) Neither claim constitutes a basis for affirming the trial court's order granting *summary judgment* in favor of Lexington. We therefore express no opinion with respect to either issue.

** See footnote *, *ante*.

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EXHIBIT F

15 Cal.App.5th 127
Court of Appeal,
Fourth District, Division 2, California.

GLOBAL MODULAR, INC., Cross-defendant and Appellant,
v.
KADENA PACIFIC, INC. Cross-complainant and Appellant.
North American Capacity Insurance Company, Plaintiff and Appellant;
v.
Kadena Pacific, Inc., Defendant and Appellant.

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Filed 9/8/2017

Synopsis

Background: Subcontractor responsible for building modular units for construction project brought action against general contractor for failure to pay, and general contractor countersued for breach of contract. Partial settlement was reached covering all claims except those of general contractor which were covered by subcontractor's commercial general liability (CGL) insurance. Insurer brought separate action for declaratory judgment regarding coverage. The Superior Court, Riverside County, Nos. RIC1103551 and RIC1304240, Daniel A. Ottolia, J., granted general contractor's motion for summary judgment as to insurance coverage, and entered judgment on jury verdict for general contractor after offset for settlement payment. All parties appealed.

Holdings: The Court of Appeal, Slough, J., held that:

[1] as a matter of first impression, CGL policy exclusion for damage to property on which subcontractor or its subsubcontractors "are performing operations" applied only to damage caused during physical construction activities;

[2] as a matter of first impression, CGL policy exclusion applicable to "[t]hat particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it" referred to the specific part of subcontractor's work on which it performed faulty workmanship;

[3] CGL insurance policy was not limited to risk of damage to third party property;

[4] delay damages for 131 days which general contractor spent remediating water damage constituted "property damage" within meaning of insuring clause of CGL policy;

[5] general contractor did not release its right to obtain attorney fees through settlement agreement; and

[6] settlement payment did not compensate general contractor for the same harm as the jury's damage award, and thus subcontractor was not entitled to offset.

Reversed in part; otherwise affirmed.

****822** APPEAL from the Superior Court of Riverside County. Daniel A. Ottolia, Judge. Affirmed in part; reversed in part with directions. (Super.Ct.Nos. RIC1103551 RIC1304240)

Attorneys and Law Firms

Larson & Gaston, John B. Larson, and Gloria G. Medel, Pasadena, for Cross-defendant and Appellant.

K&L Gates, Timothy L. Pierce, and Kate G. Hummel, Los Angeles, for Defendant, Cross-complainant, and Appellant.

Grimm, Vranjes & Greer, Mark Vranjes, and Charles A. Phillips, San Diego, for Plaintiff and Appellant.

Opinion

OPINION

SLOUGH, J.

***131** This case arises from an insurance dispute between a general contractor, its subcontractor, and the subcontractor's general liability carrier over water damage to a construction site caused by heavy rains. The United States Department of Veterans Affairs (VA) hired Kadena Pacific, Inc. (Kadena) as the general contractor to oversee construction of its Center for Blind Rehabilitation in Menlo Park. Kadena hired Global Modular, Inc. (Global) to build, deliver, and install the 53 modular units that would comprise the rehabilitation center. Because Kadena had hired a different subcontractor to install the roofing, Global agreed to deliver the units covered only by a roof deck substrate—a three-fourths of an inch base sheet of plywood.

Kadena had originally scheduled delivery of the units for the summer months, but delivery was delayed until October and November. This meant the roofless units were exposed to the elements during the rainy season, equipped with only a plywood substrate. Despite Global's efforts to protect the units by covering them with plastic tarps, the interiors suffered water damage from October through January. In February, Kadena and Global mutually agreed to terminate their contract and Kadena oversaw the remediation of the water-damaged interiors and completion of the project.

Global sued Kadena for failure to pay and Kadena countersued, alleging Global had breached the contract in various ways, including by failing to repair the water-damaged interiors. Before trial, the parties entered a partial settlement. Global paid ****823** Kadena $321,975 to release all of Kadena's claims arising from the VA project except for claims covered by Global's insurance policy with North American Capacity Insurance Company (NAC), and Global received $153,025 to dismiss its failure-to-pay claims. At trial, Kadena presented evidence on the scope and cost of its water remediation and argued Global was contractually responsible for the damage. The jury agreed and awarded Kadena slightly over $1 million.

In a separate suit brought by NAC, Kadena and NAC filed competing motions for summary judgment on the issue of whether NAC's policy required it to indemnify Global for the jury's damage award. The trial court ruled in favor of Kadena, finding the damage award covered under NAC's policy as a matter of law. The court also ruled that the award must be offset by the $321,975 Global paid in settlement and that Global was liable to Kadena for $360,000 in attorney fees.

On appeal, NAC contends the trial court erred in finding the water damages are covered under its policy; Kadena argues the court erred in ***132** offsetting those damages with Global's settlement payment; and Global and NAC argue the court erred in awarding attorney fees. We conclude the trial court properly determined NAC's policy covers the water damages and Kadena is entitled to attorney fees. However, we reverse the offset order because Global's settlement payment did not compensate Kadena for the costs of its water remediation; the parties agreed to reserve that issue for litigation.

I

FACTUAL BACKGROUND

A. *Trial on the Water Remediation Damages*

Global and Kadena presented the following evidence at trial. The VA's project specifications called for a modular design consisting of 53 units totaling over 37,000 square feet. In October 2009, Kadena hired Global to build, deliver, install, and partially finish the modular units for the project, at a contract price of about $3.5 million. Global's scope of work included the units' frame, ceiling, drywall, interior finishes, the HVAC and plumbing systems, and some aspects of the roof design, such as the plywood substrate, parapets, and hatches. The scope of work excluded flooring and roofing. Article XIII of the Kadena-Global contract stated Global assumed responsibility "for any loss or damage to the [units] ... however caused, until final acceptance thereof by [Kadena]." The contract conditioned "final acceptance" upon the VA's approval of the units.

Under the overarching construction schedule, Kadena was to pour the concrete foundations, then Global would deliver the units partially constructed, set them in place on the foundation, perform the additional construction required under the contract, then align and fasten the units together to form one main segment and two side wings. After Global's work was complete, Kadena and other subcontractors would finalize the project, which included installing the roofs and flooring, stuccoing the exterior of the units, and finishing the driveways and sidewalks. The VA had selected an EPDM roof, a rubberized sheet that adheres to the plywood substrate. According to Kadena, the roofing for all 53 units had to be installed at the same time (as opposed to piecemeal, as the units were delivered) in order to ensure the roof manufacturer's extended warranty.

Initially, the project schedule called for Global to deliver and finish the units during the summer months of 2010. But for various reasons, the schedule shifted significantly ****824** and Global did not deliver the units to the site until October and November. The parties spent a significant amount of trial ***133** time on the reasons for the delay in the delivery schedule. According to Kadena's witnesses, unexpected seismic and geological issues set the project back about 118 days and Global caused the rest of the delay by failing to timely build the units, submit designs, and install weld plates in the foundation.

Shortly after Global delivered the first shipment of units in early October, it rained and the interiors suffered water damage. Kadena's project manager emailed Global's operations manager and informed him that despite Global's use of plastic tarps, "the units experienced rain leakage and damage to the drywall and insulation." Over the next four months, the rains continued on and off and the units suffered additional water damage. Kadena's project manager sent several emails to Global's operations manager over this period, directing him to remediate the water damage and reminding him Global is responsible for the damage under their contract. Global's operations manager would respond to these emails by agreeing to address the issue. At trial, Global's operations manager testified that although his crew had tried to protect the units by covering them with heavy-duty plastic tarps, the fact the units were equipped with only a roof substrate made them impossible to fully waterproof and weatherproof. He said it was unusual for a client to exclude roofing from the scope of work and that Global was used to installing the roofs in their factory, prior to delivery, "to make sure that the building is protected."

In early January 2012, Global hired ServiceMaster, a company specializing in disaster response, to assist with the water intrusion remediation. Around that same time, the roofing contractor began installing the EPDM roof. By mid-February, Global was still in the process of trying to remediate the interior water damage and had not yet completed its work on the units. At that point, the relationship between Kadena and Global had deteriorated and the parties decided to terminate their contract. Kadena then took on the task of remediating the water damage and completing the units. Kadena used its own crew in addition to the services of four other companies to remove and replace water-damaged drywall, insulation, wood framing, and ducting.

At trial, Kadena presented evidence on the scope and cost of this water remediation (the repair/replacement costs) and the number of days it delayed the project (the delay damages). Kadena argued Global bore the risk of loss for those damages under Article XIII of their contract because the units were not complete (that is, accepted by the VA) when they were damaged. Global argued Kadena was responsible for the water damage because, as the general contractor coordinating the project, it should have developed a plan to protect the units when it became evident rain was going to be an issue—for example, by renting a place to store the units or having the roof installed piecemeal instead of all at once.

***134** The jury agreed with Kadena and found Global contractually liable for a total of $1,068,541.91 in water intrusion damages, broken down as follows: $617,332.86 for drywall and insulation repairs; $113,020.05 for carpentry repairs; $46,125 for mechanical duct repairs; and $292,064 for delay.[1]

****825** B. *Summary Adjudication of Insurance Coverage*

NAC sought a declaration it was not obligated to indemnify Global for the water intrusion damages because they were not covered under its commercial general liability (CGL) policy. That policy covers "property damage" caused by an "occurrence," which is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." From this broad, occurrence-based coverage the policy carves out a variety of exclusions. Relevant to this appeal are exclusions j(5) and j(6) and exclusion m.

Kadena and NAC filed competing motions for summary judgment on the issue of coverage. NAC argued exclusions j(5) and j(6) apply to the costs of repairing and replacing the wet drywall, insulation, framing, and ducting. As to the delay damages, NAC argued they do not fall under the policy's insuring clause because they are not "property damage" and, even if they were, exclusion m applies to preclude coverage. Kadena argued exclusions j(5) and j(6) do not apply or are at the very least ambiguous, and thus should be interpreted in favor of coverage. It argued the delay damages fall under the insuring clause and exclusion m is inapplicable.

The trial court ruled both types of damages are covered under the policy and granted Kadena's motion for summary judgment. As to the repair/replacement costs, the court held exclusions j(5) and j(6) are ambiguous and can reasonably be interpreted to exclude damage to only the particular component of Global's work that was defective. Applying this interpretation to the undisputed facts from trial, the court found none of the drywall, insulation, framing, or ducting Kadena repaired or replaced was defective, and thus concluded exclusions j(5) and j(6) did not apply. As to delay damages, the court determined they were covered by the insuring clause and exclusion m did not preclude coverage because, like exclusions j(5) and j(6), it applied only to defective work.

C. *Offset and Attorney Fees*

Following the jury's verdict, Global filed a motion to offset the damage award by the amount of its settlement payment to Global and Kadena filed a ***135** motion for attorney fees. The court granted both motions. It ruled offset was appropriate because it saw no distinction between the claims Kadena had settled and the jury's damage award. It found Kadena was entitled to attorney fees under the Kadena-Global contract and rejected Global's assertion Kadena had released its right to obtain attorney fees under the settlement agreement.

II

DISCUSSION

A. *The Summary Judgment Motions*

1. *Standards of review*

"The purpose of the law of summary judgment is to provide courts with a mechanism to cut through the parties' pleadings in order to determine whether, despite their allegations, trial is in fact necessary to resolve their dispute." (*Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 843, 107 Cal.Rptr.2d 841, 24 P.3d 493 (*Aguilar*).) Summary judgment is proper when there are no triable issues of material fact and the moving party is entitled to judgment as a matter of law. (Code Civ. Proc., § 437c, subd. (c).) A plaintiff is entitled to summary judgment if it establishes there is no defense to the claim, and a defendant is entitled to summary judgment if it establishes a complete defense to the plaintiff's claim, or shows that one or ****826** more elements of the claim cannot be established. (§ 437c, subd. (o); *Aguilar*, at p. 849, 107 Cal.Rptr.2d 841, 24 P.3d 493.) The moving party bears the burden of showing it is entitled to judgment as a matter of law. (*Aguilar*, at p. 850, 107 Cal.Rptr.2d

841, 24 P.3d 493.)

We review a grant of summary judgment de novo, and decide independently whether the facts not subject to triable dispute warrant judgment for the moving party as a matter of law. (*Intel Corp. v. Hamidi* (2003) 30 Cal.4th 1342, 1348, 1 Cal.Rptr.3d 32, 71 P.3d 296.) We are not bound by the trial court's stated reasons for granting summary judgment. (*Kids' Universe v. In2Labs* (2002) 95 Cal.App.4th 870, 878, 116 Cal.Rptr.2d 158.)

The interpretation of an insurance policy is a question of law we review de novo, applying the general principles of contract interpretation. (*Clarendon America Ins. Co. v. General Security Indemnity Co. of Arizona* (2011) 193 Cal.App.4th 1311, 1317, 124 Cal.Rptr.3d 1 (*Clarendon*).) The goal of contract interpretation is to determine the mutual intent of the parties, "if possible, solely from the written provisions of the contract." (*Ibid.*) When the words of an insurance contract are unambiguous, we give them their plain and ordinary meaning. (*Ibid.* [" 'If contractual ***136** language is clear and explicit, it governs' "].) "Courts will not strain to create an ambiguity where none exists." (*Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 18-19, 44 Cal.Rptr.2d 370, 900 P.2d 619.) However, if the language is ambiguous, it "will generally be construed against the party who caused the uncertainty to exist." (*Clarendon*, at p. 1317, 124 Cal.Rptr.3d 1.)

[1] [2] [3]When it comes to interpreting a policy's exclusionary provisions, the burden is on the insurer "to phrase exceptions and exclusions in clear and unmistakable language." (*Harris v. Glens Falls Ins. Co.* (1972) 6 Cal.3d 699, 701, 100 Cal.Rptr. 133, 493 P.2d 861.) It is a "fundamental principle that an insurer cannot escape its basic duty to insure by means of an exclusionary clause that is unclear." (*State Farm Mut. Auto. Ins. Co. v. Jacober* (1973) 10 Cal.3d 193, 201, 110 Cal.Rptr. 1, 514 P.2d 953.) As a result, we resolve all "doubts, uncertainties and ambiguities" in exclusionary language in favor of the insured. (*Producers Dairy Delivery Co. v. Sentry Ins. Co.* (1986) 41 Cal.3d 903, 912, 226 Cal.Rptr. 558, 718 P.2d 920.) This rule of interpretation applies even when another construction, one that would exclude coverage for the risk in question, is equally reasonable. (*Smith Kandal Real Estate v. Continental Casualty Co.* (1998) 67 Cal.App.4th 406, 415-416, 79 Cal.Rptr.2d 52.)

With these principles in mind, we turn to the language of NAC's policy.

2. *The repair/replacement costs*

NAC does not dispute the repair/replacement costs fall under the policy's insuring clause because the wet interior components constitute property damage caused by an occurrence—rain. Instead, the dispute centers on whether the repair/replacement costs fall under exclusions j(5) and j(6).

Before turning to the provisions, we note this case presents an issue of first impression. Two California decisions, *Clarendon* and *Baroco West, Inc. v. Scottsdale Ins. Co.* (2003) 110 Cal.App.4th 96, 1 Cal.Rptr.3d 464 (*Baroco*), which we discuss *post*, involve exclusions j(5) and j(6), however they do not interpret the language of the provisions relevant here. There are, however, some federal and out-of-state cases that do. Although these decisions are not binding on us, we consider them insofar as we find their reasoning persuasive. (See ****827** *Episcopal Church Cases* (2009) 45 Cal.4th 467, 490, 87 Cal.Rptr.3d 275, 198 P.3d 66 [finding out-of-state decisions persuasive].)

a. *Exclusion j(5)*

[4]Exclusion j(5) excludes coverage for "[t]hat particular part of real property on which you or any contractors or subcontractors working directly or ***137** indirectly on your behalf are performing operations, if the 'property damage' arises out of those operations." By its terms, the exclusion applies only if the damage arises out of Global's operations and applies only to damage to the particular part of real property on which Global was performing operations at the time of damage.

The parties' dispute concerns the meaning of the phrase "are performing operations." NAC argues the phrase refers to *works*

in progress and therefore exclusion j(5) applies when the property damage occurs before construction is complete. Kadena argues the phrase is more narrow, referring only to the *particular component* Global was *physically working on* at the time of the property damage. Under that interpretation, the exclusion does not apply to the water intrusion damages because the intrusion occurred during heavy rains when Global was not working on the units.

We conclude the use of the active, present tense construction "are performing operations" indicates the exclusion applies only to damage caused during physical construction activities. Had the policy drafters intended the exclusion to apply more broadly to damage to any of the insured's work in progress, we would expect the provision to say something along the lines of, "property damage to that particular part of real property on which your operations are not yet complete" or even "property damage to your work arising out of your operations." The drafters use this kind of broad language elsewhere in the policy, such as in exclusion l, which excludes " '[p]roperty damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard.' " This provision precludes coverage for damage to any of the insured's work once it has been completed or abandoned. We find it telling exclusion j(5) employs a much more narrow construction, restricting the excluded damage to only that *particular* part *on which* the insureds *are performing* operations.

Other courts that have interpreted this exclusion agree. In *Mid-Continent Cas. Co. v. JHP Dev., Inc.* (5th Cir. 2009) 557 F.3d 207 (*Mid-Continent*), the Fifth Circuit held exclusion j(5) did not apply to damage that occurred during a suspension of construction activities before the contract work was complete. The court explained, "the use of the present tense 'are performing operations' in exclusion j(5) makes clear that the exclusion" applies "only to property damage caused during *active physical construction activities*." (*Id.* at pp. 213, 218, italics added.)

In *Columbia Mut. Ins. Co. v. Schauf* (Mo. 1998) 967 S.W.2d 74 (*Schauf*), the Supreme Court of Missouri interpreted an identical exclusion to require physical construction operations at the time of damage. In that case, a contractor hired to paint cabinets accidentally started a fire in his client's ***138** kitchen while cleaning his paint sprayer at the end of the day. At issue was whether he was "performing operations" when he started the fire. He argued he was not because his contract defined his scope of work as "painting" the cabinets and he was not *in the middle of painting* when he started the fire. (*Id.* at p. 79.) The court disagreed, stating "[i]t would not be reasonable to conclude, for example, that an insured is performing operations on real property when touching a paint brush ****828** to the wall, but is not performing operations on real property when dipping that brush into the can of paint. Although [the contractor] was not directly producing an effect on real property when he started the fire, he was, nevertheless, performing operations on the [client's] house." (*Ibid*.)

In rejecting such a narrow definition of "performing operations" that would distinguish among types of operations, the Missouri Supreme Court nevertheless adopted a definition that required "doing or performing ... practical work." (*Schauf*, *supra*, 967 S.W.2d at p. 78.) The court explained: "In order for the instant exclusion to apply, [the contractor] must have been *performing operations on real property* within the meaning of this provision. *Perform* means 'to carry out or bring about: ACCOMPLISH, EXECUTE.' Webster's Third New International Dictionary 1678 (1966). *Operation* is defined as 'a doing or performing of a practical work....' *Id.* at 1581. In this context, *on* is 'used as a function word to indicate the object of action or motion.' *Id.* at 1575." (*Ibid.*) The court concluded, the exclusion bars coverage for damage to the property on which the insured " '*is performing operations*,' not on which the insured *did perform operations, will perform operations*, or *has contracted to perform operations*." (*Id.* at p. 81.)

Like the Missouri Supreme Court, we view the most reasonable interpretation the one that applies a word's ordinary definition and gives meaning to every word in the provision. NAC's interpretation would broadly apply to any period before an insured's work on a project is complete—whether or not the damage occurred while the insured was physically present and working on the project at the time of damage. In our view, that interpretation overlooks the present tense of the phrase "are performing operations" and the active aspect of "perform" and "operate." But, even if we were inclined to find NAC's interpretation reasonable, we would be required to resolve the ambiguity in favor of coverage. (E.g., *Western Employers Ins. Co. v. Arciero & Sons, Inc.* (1983) 146 Cal.App.3d 1027, 1030, 194 Cal.Rptr. 688 ["It is well-known that any ambiguities in an insurance policy will be construed against the insurer"]; *Producers Dairy Delivery Co. v. Sentry Ins. Co.*, *supra*, 41 Cal.3d at p. 912, 226 Cal.Rptr. 558, 718 P.2d 920 [any doubts as to the application of insurance exclusions are resolved in favor of coverage].)

NAC argues Kadena's interpretation is irrelevant because Kadena is not a party to the policy and, as a result, it is improper to construe policy ***139** ambiguities in Kadena's favor. NAC asserts the proper inquiry is what Global, the insured, understood

the policy to mean and points out that Global argues on appeal the jury's damage award is not covered under the policy. Contrary to NAC's contention, our interpretation is not based on Kadena's understanding of the contract. Instead, we base our interpretation on the objectively reasonable meaning of the policy's plain language—in other words, what Global should have understood the policy to mean *at the time of contracting*. (See, e.g., *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1265, 10 Cal.Rptr.2d 538, 833 P.2d 545 [applying a policy's "objectively reasonable" meaning protects the insured's reasonable expectations over the "subjective beliefs of the insurer"].) Global's position on appeal is irrelevant to that inquiry. We therefore affirm the court's determination that exclusion j(5) does not apply to the repair/replacement costs.

b. *Exclusion j(6)*

[5]Exclusion j(6) applies to "[t]hat particular part of any property that must ****829** be restored, repaired or replaced because 'your work' was incorrectly performed on it." The parties disagree over the meaning of "that particular part" and "work ... incorrectly performed."

NAC argues the exclusion applies to the repair/replacement costs as they are a result of Global's inadequate efforts to waterproof the units. In other words, Global's *waterproofing* is the incorrectly performed work and *the units* are the particular part that must be repaired because of that work. Kadena contends this interpretation is too broad. To begin with, Kadena disagrees Global's waterproofing efforts were incorrectly performed and instead argues the severe weather simply overcame the plastic tarps and plywood substrate. Even assuming Global's waterproofing efforts were subpar, Kadena argues they do not constitute *incorrect work* as the phrase is used in exclusion j(6). Kadena contends the phrase refers to a *product*, such as warped or uneven floors, not a *process* like covering the units with plastic tarps. Finally, assuming Global's waterproofing efforts are incorrect work, the "particular part" Global performed the incorrect work "on" was the plywood substrate, not the interior parts of the units for which Kadena sought repair/replacement costs. Those parts—the drywall, insulation, framing, and ducting—were not defective and were not the subject of Global's incorrect work, and as a result, their repair and replacement costs do not fall under exclusion j(6). We agree with Kadena that the exclusion applies narrowly.

Merriam-Webster defines "particular" as "of, relating to, or being a single person or thing," "distinctive among other examples or cases of the same general category," and "one unit or element among others." (Webster's 9th New Collegiate Dict. (1991) p. 858.) The same source defines "part" as ***140** "one of the often indefinite or unequal subdivisions into which something is or is regarded as divided and which together constitute the whole." (*Id.* at p. 857.) These definitions indicate the phrase is intended to be a narrowing element, one that limits the provision's application to a distinct part of a construction project. That the incorrect work must have been performed "on" that particular part is an additional narrowing element. Had the policy drafters not intended the exclusion to apply narrowly, they easily could have left out the prepositional phrase and written the exclusion to apply to "that particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed." Were this how the exclusion read, NAC's interpretation would be objectively reasonable. As written, however, the exclusion's narrowing language demonstrates it refers to the *specific part of the insured's work* on which the insured performed faulty workmanship and not, more broadly, to the *general area of the construction site* affected by the insured's work.

Courts of other states have also adopted this interpretation. In *Schauf*, the Missouri Supreme Court explained, "[h]ouses and buildings can be divided into so many parts that attempting to determine which part or parts are the subject of the insured's operations can produce several reasonable conclusions." (*Schauf, supra*, 967 S.W.2d at p. 80.) Finding the exclusion ambiguous and therefore interpreting it narrowly, the court concluded, "[t]he exclusion applies to the 'property *on* which [the insured] is performing operations,' not to the area *in* which the insured is performing operations." (*Id.* at p. 81.)

In *Mid-Continent*, the Fifth Circuit applied the narrower interpretation of exclusion j(6), explaining: "The narrowing 'that particular part' language is used to distinguish the damaged property that was itself ****830** the subject of the defective work from other damaged property that was *either the subject of nondefective work by the insured* or that was not worked on by the insured at all." (*Mid-Continent, supra*, 557 F.3d at p. 215, italics added.) The Sixth Circuit has also applied the narrower interpretation, stating: "The opening words of the exclusion—namely, '[t]hat particular part'—are *trebly restrictive*, straining to the point of awkwardness to make clear that the exclusion applies only to building parts on which defective work was performed, and not to the building generally." (*Fortney & Weygandt, Inc. v. Am. Mfrs. Mut. Ins. Co.* (6th Cir. 2010) 595 F.3d

308, 311, italics added.)

While no *California* case has interpreted the phrase "that particular part" as it appears in exclusion j(6), the cases interpreting the phrase in other CGL policy provisions reject the idea that it extends to the insured's project as a whole or to the entire area affected by the insured's defective work. In ***141** *Eichler Homes, Inc. v. Underwriters at Lloyd 's, London* (1965) 238 Cal.App.2d 532, 47 Cal.Rptr. 843 (*Eichler*) and *Blackfield v. Underwriters at Lloyd 's, London* (1966) 245 Cal.App.2d 271, 53 Cal.Rptr. 838 (*Blackfield*) the policies excluded "damage to that particular part of any property upon which the [insured] is or has been working caused by the faulty manner in which the work has been performed." (*Eichler*, at p. 534, 47 Cal.Rptr. 843; *Blackfield*, at p. 273, 53 Cal.Rptr. 838.) In both cases, the insured had built an entire house and an identifiable portion of the house turned out to be defective, causing damage to other portions of the house. (*Eichler*, at p. 535, 47 Cal.Rptr. 843 [defective heating system]; *Blackfield*, at p. 272, 53 Cal.Rptr. 838 [defective foundation].) In both cases, the insurance company argued the exclusionary provision applied to the entire house as the entire house was the subject of the insured's work under the construction contract. (*Eichler*, at p. 538, 47 Cal.Rptr. 843; *Blackfield*, at pp. 275-276, 53 Cal.Rptr. 838.) The *Eichler* and *Blackfield* courts rejected this argument and held the exclusion applied only to the particular component of the house that had been defective. (*Eichler*, at p. 538, 47 Cal.Rptr. 843; *Blackfield*, at pp. 275-276, 53 Cal.Rptr. 838.)

Based on the above, we conclude exclusion j(6) applies only to the particular *component* of the insured's work that was incorrectly performed and not to the insured's entire project. Here, based on the undisputed facts from trial, the only arguably defective components or parts of Global's work are the plastic tarps, as they failed to keep the water out. However, because the jury was not asked to decide whether Global's waterproofing efforts were incorrect or simply overcome by heavy rains, it is by no means an undisputed fact the tarps were faulty or Global's placement of them incorrect.[2] But more importantly, there was no allegation *the items for which Kadena sought repair and replacement costs*—the drywall, insulation, framing, and ducting—*were defective*. Those items were acceptable until it rained and they suffered water damage. We therefore conclude the trial court was correct in determining exclusion j(6) does not preclude coverage for the repair/replacement costs as a matter of law.

c. *NAC's contentions*

[6]NAC argues exclusions j(5) and j(6) unambiguously apply to the repair/replacement ****831** costs because the exclusions cover "faulty workmanship" and Global provided faulty work by failing to protect the units from the rain. NAC asserts CGL policies are intended to cover only the risk of damage to *third-party property* and are not meant to insure contractors against the "business risks" occasioned by their own faulty workmanship. According to ***142** NAC, a determination that exclusions j(5) and j(6) do not apply to the repair/replacement costs will "turn the insurance industry on its head." We disagree.

[7]NAC is correct that CGL policies "are not designed to provide contractors and developers with coverage against claims their work is inferior or defective." (*Maryland Casualty Co. v. Reeder* (1990) 221 Cal.App.3d 961, 967, 270 Cal.Rptr. 719.) "The risk of replacing and repairing defective materials or poor workmanship has generally been considered a commercial risk which is not passed on to the liability insurer ... As one commentator explained: 'This distinction is significant. Replacement and repair costs are to some degree within the control of the insured. They can be minimized by careful purchasing, inspection of material, quality control and hiring policies. If replacement and repair costs were covered, the incentive to exercise care or to make repairs at the least possible cost would be lessened since the insurance company would be footing the bill for all scrap.' " (*Ibid.*) However, this is not a garden variety case of an insured seeking coverage for the costs of repairing its defective materials or poor workmanship. Here, Kadena contracted for units equipped with substrate only. Such a product is not designed to withstand heavy rains. Global's finished product was in actuality an unfinished product awaiting a roof, the very thing that would have prevented the property damage. This is simply not a case where an insurance company is being asked to foot the bill for the insured's decision to use cheap or defective materials.

The problem with NAC's argument is that it is based on its view of the underlying policy of commercial general liability insurance and not on an application of the policy language to the facts of the case. The actual text of the CGL policy does not support NAC's argument. For starters, the insuring clause makes no distinction between insured and third-party property. It provides NAC "will pay those sums that the insured becomes legally obligated to pay as damages because of ... 'property damage,' " and property damage is defined as "[p]hysical injury to tangible property" with no reference to ownership.

Similarly, nothing in the text of exclusions j(5) and j(6) indicates they are meant to apply broadly to any damage to the insured's work before completion. As discussed above, had the policy drafters intended exclusions j(5) and j(6) to exclude damage to all of the insured's work before completion, they either would have drafted those provisions as broadly as exclusion 1 or would not have limited exclusion 1 to completed operations.

Other jurisdictions have rejected similar invitations to ignore policy language in favor of a general principle against insuring against "business risks." In *Lamar Homes, Inc. v. Mid-Continent Cas. Co.* (Tex. 2007) 242 S.W.3d 1, the insurance company argued the policy did not ***143** cover "damage to the insured's own work" because the underlying purpose of a CGL policy is to bear the risk of damage to third-party property. (*Id.* at p. 12.) The Supreme Court of Texas held the CGL policy at issue made no such distinction: "The CGL's insuring agreement simply asks whether 'property damage' has been caused by an 'occurrence.' Therefore, any preconceived notion that a CGL policy is ****832** only for tort liability [for damage to third-party property] must yield to the policy's actual language." (*Id.* at p. 13.) The court stated that coverage for so-called "business risks" of an insured's faulty workmanship "depends, as it always has, on the policy's language," which, the court noted, contained an insuring clause that was "quite broad." (*Id.* at p. 14.)

The Supreme Court of Minnesota echoed this conclusion in *Thommes v. Milwaukee Ins. Co.* (Minn. 2002) 641 N.W.2d 877, where it held exclusions j(5) and j(6) were ambiguous and thus did not preclude coverage. (*Id.* at p. 884.) The court warned against affording the "business risk" doctrine more weight than the text of policy exclusions. The "first step" in determining coverage "is to examine the policy language." (*Id.* at p. 882.) The business risk principle can be useful "as a means of illuminating the underlying purpose of CGL insurance," but it should never "serve as the foundation for a separate 'business risk doctrine' that operates to override the express language of policy exclusions." (*Id.* at p. 880.)

NAC contends case law supports its argument that exclusions j(5) and j(6) preclude coverage for damage to an insured's work while construction is ongoing. NAC principally relies on *Clarendon*, *Baroco*, and *Bituminous Cas. v. Northern Ins. Co.* (2001) 249 Ga.App. 532, 548 S.E.2d 495 (*Bituminous*). In *Clarendon*, a couple sued the contractor they had hired to build their home, alleging various construction defects on the contractor's part had caused damage to the building's interior and exterior. (*Clarendon*, *supra*, 193 Cal.App.4th at p. 1315, 124 Cal.Rptr.3d 1.) The focus of the opinion was whether the "products-completed operations hazard" clause applied, but, as an alternate ground for finding no coverage, the court concluded exclusion j(6) applied to the couple's claims of " 'defects and deficiencies' " in the contractor's work. (*Id.* at pp. 1316, 1326, 124 Cal.Rptr.3d 1.)

In *Baroco*, this court held the insurer had no duty to defend the insured against allegations its work was defective because exclusions j(5) and j(6) applied to preclude coverage. (*Baroco*, *supra*, 110 Cal.App.4th at p. 105, 1 Cal.Rptr.3d 464.) The complaint apparently contained various allegations of defective work, but the only allegation referenced in the opinion is that the driveway was "cracked and slipping." (*Id.* at pp. 99, 104, 1 Cal.Rptr.3d 464.)

In *Bituminous*, the contractor installed a defective deck and agreed to replace it. (*Bituminous*, *supra*, 249 Ga.App. at p. 532, 548 S.E.2d 495.) Over a weekend during ***144** the replacement construction, a predicted storm blew off the plastic sheets covering the contractor's unfinished work, and interior portions of the house were inundated with water. (*Ibid.*) The court held exclusions j(5) and j(6) applied to preclude coverage for the water damage because it was "caused by the defective workmanship of the insured." (*Id.* at p. 534, 548 S.E.2d 495.)

These cases are factually distinguishable because they involve the cost of replacing an insured's defective—as opposed to non-defective—work. *Bituminous* seems the most analogous as it involves rain and plastic tarps, but the comparison is superficial. The contractor in *Bituminous* had acknowledged its product, the deck, was defective and the water intrusion occurred as it was replacing that product. Thus, the property damage in *Bituminous* can truly be said to have occurred *because* the contractor's work was *incorrectly performed*. Here, on the other hand, we do not know whether Global's rain protection was defective or simply overcome by heavy rain.

More importantly, none of these decisions interpret the exclusionary language ****833** at issue here—"are performing operations," "that particular part," and "work ... incorrectly performed." And, given the case law supporting our interpretation of those phrases, even if NAC's decisions did support its interpretation (and we do not think they do), the exclusions would be, at best, ambiguous.

We affirm the trial court's determination that NAC's policy covers the repair/replacement costs as a matter of law.

3. *Delay damages*

NAC argues the trial court erred in concluding the policy covers the delay damages the jury awarded for the 131 days Kadena spent remediating the water damage to the unit interiors. NAC contends damages for delay are not covered by the CGL's insuring clause because they do not constitute "property damage." Even if delay were covered, NAC argues, exclusion m applies to Kadena's delay damages because the underlying repair/replacement costs are excluded under j(5) and j(6).[3] We disagree on both points.

[8] [9]First, we reject NAC's argument that exclusion m applies to the delay damages because, as just discussed in the previous section, exclusions j(5) and j(6) *do not* apply to the underlying repair/replacement costs. Second, ***145** contrary to NAC's contention, delay damages arising from "property damage" fall under the insuring clause, which obligates NAC to "pay those sums that the insured becomes legally obligated to pay as *damages because of* ... 'property damage' to which this insurance applies." (Italics added.) The policy does not define damages, but courts generally interpret the term to mean payments made to compensate a party for direct and consequential injuries caused by the acts of another. (*AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 826, 274 Cal.Rptr. 820, 799 P.2d 1253 (*AIU*); *Powerine Oil Co., Inc. v. Superior Court* (2005) 37 Cal.4th 377, 385, 396-397, 33 Cal.Rptr.3d 562, 118 P.3d 589 ["damages" in an insuring clause covers court-awarded "direct and consequential damages"].)

Here, the 131 days of remediation was time Kadena could have spent completing the project had the units' interiors not been damaged. That delay constitutes a consequential loss (a loss occasioned by the water intrusion) and as such, is part of the damages NAC must pay "because of" property damage. (Cf. *AIU*, *supra*, 51 Cal.3d at pp. 829-830, 274 Cal.Rptr. 820, 799 P.2d 1253 [interpreting "damages" in CGL insuring clause broadly to include all of the government's "expenses" attributable to "actual cleanup, mitigation of damage, or investigation and monitoring"].) We therefore affirm the trial court's determination that Kadena's delay damages are covered under the policy.

B. *Motion for Attorney Fees*

[10]Global and NAC argue we must reverse the fee award because Kadena released its right to obtain attorney fees under its settlement agreement with Global.[4] We conclude Kadena did not release ****834** attorney fees related to its water damage claim and the court's ruling was correct.

California Code of Civil Procedure sections 1033 and 1033.5 allow a party to "claim[ ]" attorney fees as costs if allowed under law or statute. Article XXXV of the Kadena-Global contract states that Global "expressly agrees" to pay the reasonable attorney fees Kadena incurs in "enforcing any provision or obligation arising under" the contract. California Civil Code section 1717 provides: "In any action on a contract, where the contract specifically provides that attorney's fees and costs, which are incurred to enforce that contract, ... the party who is determined to be the party prevailing on the contract ... shall be entitled to reasonable attorney's fees in addition to other costs."

***146** When Kadena and Global negotiated their settlement, multiple claims involving the VA project were pending. Global had sued Kadena for failure to pay for its work on the modular units and Kadena had sued Global, alleging three breaches of contract: failure to provide materials on time, failure to provide materials in a workmanlike manner, and failure to repair the water damage to the units. The settlement agreement was intended to resolve all of the parties' disputes except for claims Global's insurance would cover. To accomplish this, the agreement contained two main provisions, one releasing "all claims" arising from the VA project and another carving out a limited subset of claims arising from the VA project that the parties were reserving for litigation. The carve-out provision states in full:

"4.1.1 Notwithstanding the language of Civil Code section 1542 and the waiver provided in Section 4.2 of this AGREEMENT, it is the PARTIES' express intent and they so agree that this AGREEMENT *does not release claims from the Project related to* property damage, personal injury, [loss] of use and other claims that are covered under the [NAC]

insurance policies described in Section 4.9.1 of this AGREEMENT, true and accurate copies of which are attached to this AGREEMENT as Exhibits 'A' and 'B.' " (Italics added.)

Based on the above, we conclude the settlement agreement allows Kadena to pursue its water damage claim and, in turn, the Kadena-Global contract, Civil Code section 1717, and Code of Civil Procedure sections 1033 and 1033.5 allow Kadena, as the prevailing party, to seek attorney fees as part of that claim. In asserting Kadena released its right to claim attorney fees under the settlement agreement, Global and NAC rely on an incomplete excerpt of the settlement's carve-out provision. They argue the provision carved out *only* "property damage [claims] ... that are covered by [NAC insurance] policies" and that a claim for attorney fees is not technically a claim for "property damage."

First, as the full text of the carve-out provision demonstrates, it applies not just to covered property damage claims but to claims "related to" covered property damage claims. Global and NAC simply ignore the relevant language in the provision. Second, even if it did not contain the phrase "related to," we would conclude the carve-out provision encompasses a claim for attorney fees because such a claim attaches to a successful claim as a matter of right under Kadena and Global's contract and California statutory law. Either way one interprets the carve-out provision—that attorney fees are *part of* the property damage claim or that a claim for attorney fees is *related to* the property damage claim—Kadena did not release its right to obtain attorney fees under the settlement agreement.

****835** Global and NAC argue the carve-out provision applies only to claims that are covered by NAC's policy and, while the policy obligates NAC to pay all ***147** attorney fees taxed against the insured in any suit NAC defends on the insured's behalf, that obligation is part of NAC's *defense* obligation, not its *indemnification* obligation. Put another way, they contend attorney fees are not "claims," but instead "costs taxed against the insured" in a lawsuit over a covered claim. How attorney fees are defined under NAC's policy may become relevant if Global seeks indemnification for the fees *from NAC*, but it is irrelevant to Kadena's ability to obtain such fees *from Global*. For that determination, we look to the provisions of the Kadena-Global contract, California statutory law, and the settlement agreement. Under those authorities, Kadena's claim against Global for attorney fees is a claim covered by the carve-out provision.

C. *Motion for Offset*

Kadena contends the court erred when it granted Global's motion to offset the jury's damage award by $321,975—the amount Global paid Kadena under the settlement agreement. Global defends the trial court's ruling by arguing Kadena pursued at trial every conceivable claim it had "from the beginning of the project to the end of Global's involvement and beyond." Kadena argues the record clearly establishes it litigated only its water damage claims because it had released its other claims under the settlement agreement in exchange for a payment of $321,975. We agree with Kadena that Global is not entitled to an offset.

1. *Additional background*

After the parties terminated their contract, Global filed a suit in state court alleging Kadena breached the contract by failing to pay Global for its work, as well as a collection action under the Miller Act in federal court. Kadena filed a cross-complaint in the breach of contract action alleging Global failed to: (1) "provide the services and materials required under the [contract] in a timely manner"; (2) "provide modular buildings which were constructed in a good and workmanlike manner according to industry standards and applicable government and building codes"; and (3) "deliver the required modular buildings in a manner in which they were protected from the elements." Kadena alleged it suffered at least $5 million in damages as a result of these breaches.

In August 2012, while these suits were pending, Global and Kadena executed their settlement agreement. As explained, they agreed to release all claims arising out of the VA project *except* claims from the project "related to" claims covered by NAC's policy (the "insured claims"). Before the parties began working together on the project, Global had placed $500,000 in an escrow account to be released to Global on completion of the project or to ***148** be released to Kadena if Global breached the contract. In exchange for Kadena's promise to release all claims against Global that are not covered by NAC's

policy (the "uninsured claims"), Global agreed to pay Kadena $321,975 from the escrow account. As consideration for Global's promise to release the failure-to-pay suits, Global kept $153,025 of the escrow funds. Global agreed to dismiss its state and federal suits, but the parties agreed Kadena "need not dismiss its cross-complaint," instead, it would "continue to pursue only those claims not released [in the settlement]."

The parties proceeded to trial on Kadena's now-limited cross-complaint and the court gave the jury the following instruction at the outset:

****836** "The project started in early 2010. Global built the units at its factory in Chowchilla and then transported them to the project site in Menlo Park. The units were delivered partially constructed. Upon delivery, they were to be set onto poured concrete foundations. Thereafter, Global was to finish the installation by completing interior work, installing doors and windows, and utilities. Kadena was to install the final roof membrane.

"Global delivered the first modular units in October of 2010. Shortly after the first units were delivered, the project experienced rain, which continued throughout the winter. Although Global took measures to protect the modular units from the rain, they experienced water damage. Kadena contends that Global is responsible *for the water damage*. Global denies responsibility and contends that Kadena could have taken action to prevent the water damage.

"Kadena also claims that it was delayed in its ability to complete the project. Kadena claims that its damages *from water damage and from delays* exceed $1 million." (Italics added.)

During trial, Kadena limited its evidence of damages to how much it cost to have its own crew and four other companies remediate the water-damaged drywall, insulation, framing, and ducting, and to how much it suffered in delay damages during that remediation. Kadena's owner, Scott Bailey, testified the company experienced 131 "days of delay that was specific to the rain [remediation]." To calculate the costs of this delay, Bailey multiplied Kadena's average overhead costs for one day of project supervision by the 131 days Kadena spent on remediation. He studied Kadena's financial records and determined its average daily overhead cost for the VA project was $2,239, which, multiplied by 131, equaled about $293,000.

Before closing argument, Kadena's counsel asked the court to provide a limiting instruction directing the jury to focus on only the issue of water damages because the parties had already resolved any other issues under their ***149** contract. Kadena's counsel was concerned the jury would consider the evidence it had heard about Kadena not being able to pay Global because the VA had withheld those amounts. Global's counsel opposed the instruction; he wanted to argue during closing that Kadena had suffered no damages because it had completed the modular units for less than the Global-Kadena contract price. The following exchange occurred:

Kadena's Counsel: "[W]e have a settlement agreement that resolved everything about payment under the contract, and the only thing left in the case is what's—our pursuit of the property damage claim ... So I think we need to give them an instruction that says the only thing we are asking you to focus on is the valuation of the property damage. There may be other issues about the contract that you haven't heard about, and that's because they've already been resolved, and you need not worry about them."

"The Court: All right. I would read a limiting instruction to that effect."

Global's Counsel: "I intended, past tense, to introduce the fact that the complete job was completed by Kadena for less money than what they would have had to pay my client; hence, no damages."

Kadena's Counsel: "That's not true. We don't have all the—we only have the water damage costs. We don't have the cost of finishing their work."

Global's Counsel: "That's the whole kit and caboodle. That's what your client testified to."

Kadena's Counsel: "No, he did not."

****837** "The Court: I don't think there was any evidence of the total cost. I did not hear any evidence of the total cost."

Global's Counsel: "If that's the Court's ruling."

"The Court: That is the Court's ruling."

At the close of evidence, the court instructed the jury that Kadena's claim for breach of contract was based on Global's alleged obligation, and failure, to "repair the water damage" to the unit interiors. It also provided the limiting instruction Kadena's counsel had requested:

"As you may have determined, this case *focuses on the water damage* for which Global is responsible, if at all, and the value of any such damages to Kadena to address the water damage. There are *other issues* related to the contract that have *already been* ***150** *resolved*, and you need not worry about those issues or any issues outside the issue of property damage, if any, for which Global is responsible." (Italics added.)

The special verdict form listed eight categories of damages: (1) Concrete Repair; (2) In-house Drywall Repair; (3) Rough Carpentry; (4) WF Hayward Drywall Repair; (5) KR Environmental Services; (6) ServiceMaster Restoration; (7) Golden Valley Mechanical Duct Repair; and (8) Damages Due to Delay. The jury found Global was responsible for repairing the water damage under the contract and assigned amounts to each of the damage items.

After trial, Global brought a motion for offset, asking the court to subtract $321,975—the amount it paid Kadena under the settlement—from the jury's damage award. Kadena opposed the motion, arguing the settlement payment compensated it for different harms than the damage award. Kadena acknowledged its cross-complaint had alleged Global breached the contract in multiple ways, causing over $5 million in damages, but pointed out the parties subsequently settled all of those allegations except the allegation that Global was responsible for repairing the water damage. The trial court granted the motion for offset, finding trial had not been limited to insured claims and concluding the insured and noninsured claims are too intertwined to separate.

2. *Analysis*

[11] [12] [13]The equitable concept of offset recognizes it is unfair to require a defendant to compensate a plaintiff twice for the same injury. "To prevent a double recovery, equity demands credit be given for payments received on the judgment." (*Jhaveri v. Teitelbaum* (2009) 176 Cal.App.4th 740, 753, 98 Cal.Rptr.3d 268 (*Jhaveri*).) "The plaintiff is entitled only to a single recovery of full compensatory damages for a single injury." (*Howard v. American Nat. Fire Ins. Co.* (2010) 187 Cal.App.4th 498, 516, 115 Cal.Rptr.3d 42.)

[14] [15]"The right of offset rests upon the inherent power of the court to do justice to parties appearing before it" and we review a trial court's ruling on a motion for offset for abuse of discretion. (*Jhaveri*, *supra*, 176 Cal.App.4th at p. 753, 98 Cal.Rptr.3d 268.) A trial court abuses its discretion if it misinterprets the law or makes a factual finding not supported by substantial evidence. (*Ibid.* [upholding court's offset ruling because "substantial evidence supports the ... finding that appellants are entitled to a $61,000 credit against the judgment"]; *Board of Administration v. Wilson* (1997) 57 Cal.App.4th 967, 973, 67 Cal.Rptr.2d 477 ["The question is whether the trial court's actions are consistent with the substantive law and, if so, whether the application of law to the facts of the case is within the range of discretion conferred upon the trial court"].)

[16] ***151 **838** Thus, to warrant offset, Global's settlement payment to Kadena must have compensated Kadena *for the same harm* as the jury's damage award. The record demonstrates this was not the case. Kadena had originally sued Global alleging various contractual breaches and seeking over $5 million in damages. Before trial, however, the parties settled several claims—Global its failure-to-pay claim and Kadena all of its uninsured claims. At trial, Kadena upheld its end of the settlement agreement by pursuing only its allegation that Global breached the contract by failing to repair the units' water-damaged drywall, insulation, framing, and ducting. That the trial was so limited is evidenced by the court's opening instructions describing the nature of the suit, the limited scope of Kadena's evidence on its damages, the court's closing instructions (most notably the limiting instruction), and the jury's special verdict, which shows the jury awarded *specific categories* of damages relating only to the water remediation and not, say, to defective workmanship or pre-rain delays.

Indeed, the trial court recognized the limited nature of the jury's damage award in its written ruling on the cross-motions for summary judgment when it stated the delay damage component "compensates for delays that *relate only to the covered property damages* [i.e., water damage] and is not an item of general delay damages." (Italics added.)

Based on this record, the trial court's conclusion that trial was not limited to insured claims is not supported by substantial evidence. The court's ruling overlooks the fact Kadena settled its faulty workmanship and pre-rain delay claims after filing its cross-complaint and limited the evidence of its damages to the costs of remediating the water damage to the unit interiors. The record demonstrates Global's settlement payment compensated Kadena for releasing those faulty workmanship and pre-rain delay (i.e., uninsured) claims, and did not compensate for the water damage remediation costs. As a result, the settlement payment does not constitute a payment "received on" the judgment. (*Jhaveri, supra*, 176 Cal.App.4th at p. 753, 98 Cal.Rptr.3d 268.)

[17] [18]In arguing otherwise, Global claims nothing in the settlement agreement delineates between insured and uninsured claims. It also contends Kadena presented evidence of uninsured claims at trial. These arguments strike us as disingenuous considering Global's representations to the trial court about the import of the settlement agreement. Before trial, Global served Kadena with notice of its motion in limine to exclude "any evidence of damages claimed by [Kadena], which are not covered under [Global's] policies of insurance." Global made the following argument in its motion: "[P]ivotal in this case is the underlying settlement entered ... in which KADENA agreed to release **any and all claims** as against GLOBAL **except** 'property damage, personal injury, loss of use and other claims' covered by GLOBAL's Commercial General Liability Policies issued by [NAC].... In short, if KADENA's damage claims do not constitute 'covered damages' under the NAC CGL POLICIES, KADENA's claims are barred ... Accordingly, evidence of ***152** damages not covered under the NAC CGL POLICIES is wholly irrelevant to the subject action [and] has no probative value." Global's motion demonstrates it knows full well how the settlement agreement operates, and we will not countenance its attempts to avoid that result on appeal.[5]

[19] ****839** Finally, Global argues even if we find the offset ruling erroneous, we cannot reverse unless we find the error prejudicial. We have no trouble concluding Kadena was prejudiced by an unwarranted $321,975 reduction in its damage award. Accordingly, we reverse the offset ruling and direct the trial court to reinstate the full jury award.[6]

III

DISPOSITION

We reverse the order granting Global's motion for offset and affirm the judgment in all other respects. Kadena shall recover its costs on appeal.

We concur:

MILLER, Acting P.J.

FIELDS, J.

All Citations

15 Cal.App.5th 127, 222 Cal.Rptr.3d 819, 17 Cal. Daily Op. Serv. 8981, 2017 Daily Journal D.A.R. 8880

Footnotes

[1] In fact, the jury award totaled $1,168,931.08, but Kadena elected not to pursue two categories of damages—mold and concrete—because NAC's insurance policy has a $1 million limit.

[2] The issue for the jury was limited to whether Global contractually bore the risk of loss to the units at the time they were damaged. At trial, Kadena introduced multiple emails in which its project manager accuses Global of not doing enough to protect the units from the rain, but the purpose of these emails was not to prove Global's waterproofing efforts were "incorrect" but rather to show Global had accepted responsibility for the damage.

[3] Exclusion m applies to property damage to "impaired property" or "property that has not been physically injured," arising out of "[a] defect, deficiency, inadequacy or dangerous condition" in the insured's "product" or "work," or arising out of the insured's "delay or failure ... to perform a contract or agreement in accordance with its terms."

[4] Kadena sought attorney fees directly from Global and the trial court entered the award against Global, not NAC. NAC has standing to challenge the judgment, however, because its policy obligates it to pay attorney fees taxed against Global in any suit NAC defends, and NAC has represented it provided Global defense at trial.

[5] Kadena brought Global's motion in limine to our attention in a motion to augment the appellate record, which we grant. Global argues we cannot augment the record with its motion in limine because Global never filed it with the court. The rule allowing record augmentation "is to be construed liberally" and allows a party to supplement the appellate record with any materials that were before the trial court. (*People v. Brooks* (1980) 26 Cal.3d 471, 484, 162 Cal.Rptr. 177, 605 P.2d 1306 citing an earlier version of Cal. Rules of Court, rule 8.155 [formerly rule 12]; *Vons Companies, Inc. v. Seabest Foods, Inc.* (1996) 14 Cal.4th 434, 444, fn.3, 58 Cal.Rptr.2d 899, 926 P.2d 1085.) On the morning of the first day of trial, the court stated for the record that it had discussed Global's motion in limine with the parties, and Global agreed to withdraw it. We see no issue in considering something the trial court clearly considered.

[6] Reinstating the full award has no effect on Kadena's election not to pursue its mold and concrete damages under NAC's policy.

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EXHIBIT G

The Narrowing of Additional Insured Coverage and Its Impact on P3 Projects

Wednesday, July 26, 2017
P3

Additional Insured coverage is a common method of risk transfer used in construction projects. In 1985, the standard form of the additional insured endorsement used in insurance policies conferred much broader protection than the forms subsequently published in 2004 and 2013.

The net effect has been a narrowing of the risk transfer that can be achieved through standard form additional insured endorsements. In addition, some recent court decisions have limited the reach of additional insured coverage available under the current standard forms. This narrowing of additional insured protection can have a significant impact on P3 projects (Public-private partnership) where the projects are expensive, the risks are significant and the parties have great need for risk transfer.

Even where a project involves a project specific insurance program like an OCIP, CCIP or other wrap-up, some form of additional insured coverage is likely to still be needed because some participants and some risks will be excluded from the project's insurance program. Risk managers and others in the construction industry should pay close attention to the risk transfer process to avoid disappointment in the event of a loss.

Until 2004, it was not unusual to see additional insured coverage extended to claims that arose in some way, nearly any way, out of the project work, irrespective of who was at fault. After 2004, changes in the policy forms began to narrow the scope of additional insured coverage available. Coverage for a claim would often be denied unless the primary insured was at least partially at fault, even if the claim arose out of the project. After 2013, that coverage narrowed further, confining it to be no broader than that required by the underlying contract and limited by the anti-indemnity statutes seen in most states.

Meanwhile, some recent court decisions have supported the denial of coverage in a variety of instances. For example, in *Gilbane Bldg. Co./TDX Constr. Corp. v. St. Paul*

Fire & Mar. Ins. Co., 38 N.Y.S.3d 1 (N. Y. App. Div. 2016), an insurance company challenged the additional insured coverage that was sought by a participant on a project. The endorsement in the *Gilbane* case specifically extended additional insured coverage where required by written contract. The construction manager's agreement with the project's financier required the prime contractor to name the construction manager as an additional insured to its insurance. In its construction contract, the prime contractor agreed to provide such coverage and it supplied a certificate of insurance evidencing that such insurance was in place. Yet the insurance company later denied coverage, pointing to language in its own policy form that limited additional insured coverage to those "*with whom* you have agreed to add as an additional insured." The insurance company successfully argued that this was different from a requirement to extend such status to someone "*for whom*" you agreed to extend additional insured coverage. The use of the preposition "with," versus "for," completely changed the outcome of the case, even though every party involved other than the insurance company agreed that coverage should be extended.

In *Burlington Insurance Co. v. New York City Transit Authority,* 2017 NY Slip Op 04384 (N.Y. June 6, 2017), the Transit Authority employed a contractor to perform tunnel excavation. The contract between the Transit Authority and the contractor required additional insured coverage. The contractor's insurance policy required fault on the part of the contractor, at least partially, for coverage to be extended. A Transit Authority employee was injured when he tried to avoid an explosion after the contractor's equipment touched a live electrical cable buried in concrete at the excavation site. New York's highest court found that no coverage was available because the Transit Authority had buried the live cable and had failed to advise the contractor of it. The court recognized that the contractor's actions were causally linked to the accident because "but for" the contractor's striking the live cable, the accident would not have occurred. However, the court held that the language of the additional insured endorsement required that the actions of the insured be the 'proximate' cause of the accident and therefore ruled that there was no coverage for the Transit Authority under the additional insured endorsement. This ruling will confound those in the marketplace. The lower court had interpreted the policy language to require only a causal connection, making no distinction between the legalistic concepts of 'but for' cause and 'proximate' cause, as no such distinction was made in the policy. The distinctions are concepts that lawyers and insurance companies can argue about, but they do not have a lot of relevance to construction workers on a job site. In dissent, one of the judges aptly noted that if the insurance company had wanted to limit coverage by requiring proximate causation, it could easily have put those words into the policy.

The narrowing of additional insured coverage will force companies to depend more on contractual indemnity provisions, although these are of limited value if the other party has limited assets. Companies should examine their additional insured endorsements and, when possible, require that broader language be used, like that seen in older standard form endorsements ("arising out of" is broader than "caused in whole or in part"). Instead of benefiting from coverage as an additional insured when there is property damage or bodily injury, a would-be additional insured may have to sue the

primary insured to gain access to that party's insurance policy.

The use of a project specific insurance program like an OCIP or a CCIP, where most participants are covered by the same policy, can avoid many of the complications associated with the tangled web of additional insured coverage. This is particularly relevant for P3 projects such as large infrastructure jobs. But OCIPs and CCIPs are not without their own pitfalls and problems. In the context of additional insurance coverage, those pitfalls include the problem that some design professionals and some trades may not be eligible to participate in the program. Some may not qualify due to nature of their work. Some may not qualify due to their work comp history or other factors. Some may fabricate materials away from the job site and need separate coverage for that location and in transit. Whenever these problems arise, they will need to be addressed on both sides of the equation: the project specific insurance program must accommodate the involvement of these "outsiders" and their separate insurance coverage; the "outsider's" separate insurance coverage must extend additional insured status to those inside the OCIP/CCIP and not be excluded because the project is otherwise covered by a wrap up (a common exclusion).

Risk managers embarking on P3 projects and on other complex projects should carefully analyze their risk transfer program and should engage knowledgeable brokers, lawyers and others to ensure that their expectations are met and that they are not disappointed in the event of a loss.

The Policyholder Report

Advising Insureds. Litigating Coverage Disputes Against Insurers.

ball janik LLP

Oregon's broad duty to defend extends to "additional insureds"

By **Kevin Mapes** on August 19, 2015

POSTED IN ADDITIONAL INSURED, CGL INSURANCE, CONSTRUCTION DEFECT, DUTY TO DEFEND, OREGON COURT OF APPEALS

On August 19, 2015, the Oregon Court of Appeals issued its opinion in ***West Hills Development Co. v. Chartis Claims, Inc.***, reaffirming the broad nature of an insurer's duty to defend, even when that duty is owed to an "additional insured."

Contracting parties rely on indemnity agreements and additional insured status to protect against liability arising from the other party's negligence. Insurers, however, frequently ignore or summarily deny tenders from parties who qualify as additional insureds under the policies they issued. That is exactly what happened in *West Hills*. A general contractor was sued for alleged construction defects in a townhome project. The general contractor then tendered the defense of that lawsuit to a subcontractor's insurer as an additional insured under the subcontractor's insurance policy. The subcontractor's insurer denied coverage, and the general contractor, West Hills, sued the insurer, Oregon Automobile Insurance Company ("Oregon Auto"), for breach of the duty to defend. The trial court agreed with West Hills, granting summary judgment in the contractor's favor.

On appeal, Oregon Auto relied primarily on two arguments to justify its refusal to defend. First, the insurer argued that it could have no obligation to West Hills as an additional insured because the original construction defect did not identify its named insured, the subcontractor, by name. Noting the broad nature of the duty to defend under Oregon law, the Court of

Appeals rejected that argument. “To trigger the duty to defend, a complaint needs only to make allegations with which a claim covered by the policy may be proven. The insurer is charged with the responsibility to recognize the insured’s exposure that the complaint presents.” The Court noted that the original complaint alleged damages arising from negligent supervision of subcontractors, and that Oregon Auto’s insured was a subcontractor, holding that “[i]t did not need to be identified in the complaint for the insurer to recognize its responsibility.”

Second, Oregon Auto looked to the language of its policy to support its failure to defend. Again, the Court of Appeals disagreed. The insuring language provided West Hills with additional insured status, “but only with respect to liability arising out of [the named insured’s] ongoing operations[.]” Oregon Auto argued that West Hills could not be an additional insured unless there were allegations of property damage while its insured subcontractor was still on the job. West Hills, in contrast, argued that there was coverage as long as liability arises from the subcontractor’s operations, even if the damage occurs later. The Court of Appeals declined to reach the reasonableness of the competing interpretations, finding it unnecessary.

> **“This case involves only the duty to defend, and enough is alleged to have triggered the duty to defend – without resolution of the construction of this additional insured endorsement. The original complaint pleaded the possibility of damage occurring even within the narrower coverage Oregon Auto understands. The original complaint would permit proof of damages before [the named insured] finished its work.**

For all policyholders, *West Hills* presents yet another appellate opinion affirming the broad nature of an insurer’s duty to defend. As long as a complaint includes allegations that could possibly result in a covered claim, the defense obligation is triggered. For owners, contractors, and others entitled to additional insured status, *West Hills* is of even greater value, as insurers cannot hide behind vague “ongoing operations” language to deny coverage. In the face of an insurer’s denial of an additional insured’s tender, the additional insured should be prepared to respond aggressively. The Court of Appeals’ opinion in *West Hills* is a valuable weapon in that fight.

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Oregon Policyholders and Judgment Creditors Get Big Win on Insurance Coverage Issues

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Section 19.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

Grand Ballroom

Friday, May 18th 2018
11:00 AM – 12:00 PM

Course Title:
Mediating the Luxury Single Family Home Construction Defect Case

Ross Feinberg, Esq., Scott Albrecht, Esq., Brian Kahn, Esq.,
Rosemary Nunn, Esq., Jeffrey Carvalho, Esq. and Kory Kruckenberg

LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
FRIDAY, FEBRUARY 9, 2018

Mediating a luxury home construction defect case

By Ross W. Feinberg

Residential construction defect actions typically take four forms: (1) statutory condominium actions, filed by an elected Board of Directors; (2) grouping of tract single family residences; (3) a planned unit development suing for common area defects; and (4) the luxury custom estate, filed by often times a discerning homeowner concerning their "one of a kind" property. It is the last of these that require the broadest range of skills by the mediator.

Luxury home cases often require different insights and approaches then that of their construction defect counterparts. The homes typically involve complex construction schematics combined with amenities that bespoke desires of grandeur, such as infinity pools to nowhere; priceless art; floating decks; recording studios; elevators; walls of glass and the like which lead to a web of expectations by the homeowner and resultant ramifications. Put simply; the homes are stunning in design and aspirations.

Take these issues and couple them with a homeowner, who is more often than not, a high profile individual and extremely invested in the building of their "one of a kind home" and you have a recipe for conflict. The homeowner often expects certainty and perfection not just in their home, but also in the results of litigation.

As a result, when mediating this type of case, the parties should select a mediator who can execute a variety of skills. The mediator must be friendly but also firm, and develop a keen understanding of the goals of the homeowner and aspects of the case that have triggered the need for litigation.

The initial step in this process is to gauge the personality and temperament of the homeowners and bond with them as early as possible during the mediation process. This is no easy task and can often be hampered by the homeowner's dreams for their very own dream home. Such a combination can result in a perfect storm at mediation.

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While a mediator is always neutral, bonding with the homeowner serves all parties in luxury home cases. When a mediator truly recognizes the owners' passion, traits and expectations, he or she can begin to diffuse the intense emotions associated with every one of these cases.

The mediator can quickly earn the homeowner's respect by scheduling a meeting on-site at the homeowner's property. This meeting should be set early and is for dual purposes of establishing the homeowner's trust while at the same time garnering a deep understanding of their personality traits.

The mediator in these cases, as with any construction defect case with multiple parties, must be a strong case manager. It is imperative for the mediator to establish an aggressive, yet sustainable set of deadlines for investigating and resolving the dispute.

To resolve the case efficiently, a mediator must quickly grasp the source and breadth of the alleged defects, sort out the parties and insurance coverage, clearly communicate an analysis of the legal issues, and anticipate likely obstacles to settlement. In fact, the mediator of the luxury home construction defect case, must do all of the above and more.

In addition to functional and aesthetic problems, these defect cases can trigger personal injury or health-related claims. I recently mediated a luxury home case in which the owner's child had been repeatedly hospitalized for respiratory issues that, it turned out, were caused by problems with the home's forced-air unit that terminated into the child's bedroom.

Beyond these intangible, emotional aspects of a luxury home construction defect case, these matters often come with significant other challenges. Examples include a lack of written contracts, lack of insurance and builders who, themselves, are as emotionally tied to the very home that is the subject of the litigation.

In my experience, the average luxury home case can involve upwards of 40 parties, including builders, design professionals, subcontractors and insurance carriers, all of whom are usually looking to shift the risk to others. To diffuse the inevitable tension that arises among them during mediation, I've done everything from bringing ice cream into a conference room filled with 45 parties to writing "Tuesday" on the conference room's white board and asking the group, "Can we start here? Can we all agree that it's Tuesday?"

Equally important, appropriate and oft times necessary, is for the mediator to draw on experts within the construction community to assist in determining the wisest and most cost efficient repair.

An experienced mediator can actually match an appropriate contractor with the luxury homeowner dependent on their respective personalities, goals and needs.

Once comfortable that the homeowner's trust has been procured, the experienced mediator can look to trusted contacts who will actually perform the repair work. Specifically, the mediator can help define the scope of repair, review repair proposals and personally introduce the owner and the contractor so they can bond.

To be effective, the mediator must possess and utilize a myriad of cognitive listening skills in addition to resolving a complex web of issues. Similarly, the mediator must not only step into the shoes of all the parties, but also into the shoes of all the lawyers and experts.

In traditional litigation, it can take as many as five years to land a trial date. And even if a construction defect case is fully litigated, there will likely be continued post-trial fighting among insurance companies regarding coverage, damages, indemnity, and the duty to defend.

When it comes to someone's multi-million dollar custom home, five years can feel like a lifetime. In contrast, with the right mediator, at least 98 percent of luxury home cases can settle. An experienced mediator can help the parties transparently collaborate on all aspects of the resolution so that the owners can return to their dream home as quickly, efficiently and affordably as possible.

Ross Feinberg *is a JAMS neutral, based in Orange County. He has successfully mediated more than 2,000 cases both as counsel and mediator. He can be can be reached at rfeinberg@jamsadr.com.*

FEINBERG

Section 20.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

North Ballroom

Friday, May 18th 2018
11:00 AM – 12:00 PM

Course Title:
Creative Solutions to the Florida Problem:
Making No Contribution and No State Law Work for You

Rebecca Appelbaum, Esq., Scott Rembold, Esq., Christine Gudaitis, Esq.,
Lee Kantor, Esq. and Mary Rowe

Creative Solutions to the Florida Problem: Making No Contribution and No State Law Work for You

North Ballroom
Friday, May 18th 2018
11:00 AM – 12:00 PM

Rebecca Appelbaum, Adams and Reese, LLP
Christine Gudaitis, Ver Ploeg and Lumpkin,
Lee Kantor, Hightower, Stratton, Novigrod, Kantor, P.A.
Scott Rembold, Rembold Hirschman
Mary Rowe, Markel

I. The Anti-Contribution Rule

A. The Problem

Under Florida law, because each primary insurer's duty to defend is a personal contractual obligation that does not inure to the benefit of another insurer, there is no right of contribution or equitable subrogation between primary insurers to recover the costs of defending a mutual insured. *Continental Cas. Co. v. United Pacific Ins. Co.,* 637 So. 2d 270 (Fla. 5th DCA 1994).

"The rationale for [the anti-contribution rule] is rooted n public policy: if insurers could sue each other for reimbursement, they 'would have no incentive to settle and protect the interest of the insured, since another lawsuit would be forthcoming to resolve the coverage dispute between the insurance companies.'" *Zurich American Ins. Co. v. Amerisure Ins. Co.,* 2017 WL 366232, *5 (M.D. Fla. January 19, 2017)(citing *Argonaut Ins. Co. v. Maryland Cas. Co.,* 372 So. 2d 960, 964 (Fla. 3rd DCA 1979)). The anti-contribution rule was designed to de-incentive insurers from shirking their obligations to their insureds. *Id.,* at *5, n.9 (*citing Pennsylvania Lumbermens Mut. Ins. Co. v. Indiana Lumbermens Mut. Ins. Co.,* 43 So.3d 182 (Fla. 4th DCA 2010)).

In *Pennsylvania Lumbermens,* one co-primary insurer defended its insured and reserved its rights to reimbursement of defense costs. Once a court determined that the insurer's policy did not provide coverage, the insurer, through an assignment from the insured, sought to collect its defense costs from the co-primary insurer. The court refused to allow the first insurer to collect because it still had an independent contractual duty to defend their mutual insured. That purpose of the anti-contribution rule "would be frustrated if carriers could reopen the door to litigation through the legal fiction of obtaining their insureds' rights." *Zurich American* at *5, n.9.

B. Solutions?

1. Ignore the Insurer-Insured Relationship

In *Continental Casualty Co. v. City of South Daytona*, 807 So. 2d 91, 93 (Fla. 5th DCA 2002), the court held that in a case where the City was only vicariously liable to the plaintiff, the underlying indemnity agreement between the Little League and the City "shifted exposure from the City's own liability carrier to the Little League's liability carrier, and that the primary obligation to defend the City for an action arising out of the Little League's use of the City's facilities was with Continental," the Little League's insurer.

The *Zurich American* court explained:

> Florida courts have crafted a narrow work-around to the anti-contribution doctrine. A "responsive" insurer who complied with its insured's tender for defense can extract reimbursement from the "nonresponsive" insurer when the insured had separately contracted with another entity, itself an insured of the nonresponsive carrier, to indemnify the first insured. … The logic of the exception is that the insured parties' express decision to "shift[] exposure" from one to the other is imputed to the insurer relationship and overcomes the general anti-contribution principle.

Zurich Am. Ins. Co. v. Amerisure Ins. Co., No. 9:16-CV-81393, 2017 U.S. Dist. LEXIS 8366, at *19 (S.D. Fla. Jan. 19, 2017)(internal citations omitted).

2. Make Your Policy Excess

In *Travelers Property Casualty Company of America v. Amerisure Ins. Co.,* 161 F. Supp. 3d 1133 (N.D. Fla. 2015), *aff'd,* 674 Fed. Appx. 957 (11th Cir. 2017), Travelers, as a primary carrier for the general contractor, was entitled to recover the fees and costs incurred in defending the general contractor as well as the fees and costs incurred by Travelers in pursuing third-party claims against the subcontractors. The court found that the general contractor was an additional insured under the Amerisure policy issued to the stucco subcontractor. When Amerisure refused to defend the general contractor against a lawsuit alleging, among other things, defects in the stucco work, Travelers defended its named insured, "reserving its subrogation rights against Amerisure." *Travelers* at 1135. The court found that Amerisure wrongfully refused to defend the general contractor and was therefore liable to Travelers for all of the fees and costs incurred in the defense. Despite each insurer having briefed the issue, the court did not address the other insurance language in the Travelers policy.

II. Mediation Attendance

Florida Rule of Civil Procedure 1.720 states that a party is deemed to appear at mediation if the following persons are physically present: a party of party representative having full authority to settle without further consultation and the party's counsel of record and a representative of the insurance carrier for any insured party who is not such carrier's outside counsel and who has full authority to settle in an amount up to the amount of the plaintiff's last demand or policy limits, whichever is less, without further consultation.

In *Carbino v. Ward,* 801 So. 2d 1028 (Fla. 5th DCA 2001), the court held as a matter of first impression that sanctions are required under Fla. R. Civ. P. 1.720 for failure to appear at mediation without good cause. In an unopposed motion for sanctions in *HDE, Inc. v. Bee-Line Supply Co.,* 181 So. 3d 1285 (Fla. 5th DCA 2015), the court found that not only did a representative of the party not attend mediation pursuant to the court order and rule, the insurer's representative only had limited authority which was also a violation of the rule.

Supreme Court of Florida

No. SC10-2329

IN RE: AMENDMENTS TO FLORIDA RULE OF CIVIL PROCEDURE 1.720.

[November 3, 2011]

PER CURIAM.

This matter is before the Court for consideration of proposed amendments to Florida Rule of Civil Procedure 1.720 (Mediation Procedures). We have jurisdiction. See art. V, § 2(a), Fla. Const.

The Committee on Alternative Dispute Resolution Rules and Policy (Committee) has filed a petition to amend rule 1.720. The amendments proposed by the Committee revise the requirements in rule 1.720 pertaining to the appearance of a party or a party's representative at a mediation conference. The proposals are in response to the Committee's charge to monitor court rules governing alternative dispute resolution procedures and to make recommendations as necessary to improve the use of mediation. See In re Committee on Alternative

Dispute Resolution Rules and Policy, Fla. Admin. Order No. AOSC03-32 (July 8, 2003).

The Committee's proposals were approved by The Florida Bar's Civil Procedure Rules Committee. The Court published the proposed amendments for comment. Two comments were filed and the Committee filed a response.

Having considered the Committee's petition, the comments filed, and the Committee's response, we adopt the amendments to rule 1.720 as proposed by the Committee, with a minor modification to new subdivision (e) (Certification of Authority). We modify new subdivision (e) to provide that the written notice be served on all parties participating in a mediation conference.

Accordingly, Florida Rule of Civil Procedure 1.720 is hereby amended as set forth in the appendix to this opinion. New language is indicated by underscoring, and deletions are indicated by struck-through type. The Committee notes are offered for explanation only and are not adopted as an official part of the rule. The amendments shall become effective January 1, 2012, at 12:01 a.m.

It is so ordered.

CANADY, C.J., and PARIENTE, LEWIS, QUINCE, POLSTON, LABARGA, and PERRY, JJ., concur.

THE FILING OF A MOTION FOR REHEARING SHALL NOT ALTER THE EFFECTIVE DATE OF THESE AMENDMENTS.

Original Proceeding – The Supreme Court Committee on Alternative Dispute Resolution Rules and Policy

Judge William D. Palmer, Chair, Committee on Alternative Dispute Resolution Rules and Policy, Fifth District Court of Appeal, Daytona Beach, Florida,

for Petitioner

Donald E. Christopher, Chair, Civil Procedure Rules Committee, Orlando, Florida, and John F. Harkness, Jr., The Florida Bar, Tallahassee, Florida; and Patrick S. Scott of Gray Robinson, P.A., Fort Lauderdale, Florida,

Responding with comments

APPENDIX

RULE 1.720. MEDIATION PROCEDURES

(a) Interim or Emergency Relief. [NO CHANGE]

(b) ~~Sanctions for Failure to Appear.~~Appearance at Mediation. ~~If a party fails to appear at a duly noticed mediation conference without good cause, the court upon motion shall impose sanctions, including an award of mediator and attorneys' fees and other costs, against the party failing to appear. If a party to mediation is a public entity required to conduct its business pursuant to chapter 286, Florida Statutes, that party shall be deemed to appear at a mediation conference by the physical presence of a representative with full authority to negotiate on behalf of the entity and to recommend settlement to the appropriate decision-making body of the entity. Otherwise, unless~~Unless otherwise permitted by court order or stipulated by the parties ~~or changed by order of the court~~in writing, a party is deemed to appear at a mediation conference if the following persons are physically present:

(1) The party or ~~it's~~a party representative having full authority to settle without further consultation; and

(2) The party's counsel of record, if any; and

(3) A representative of the insurance carrier for any insured party who is not such carrier's outside counsel and who has full authority to settle in an amount up to the amount of the plaintiff's last demand or policy limits, whichever is less, without further consultation.

(c) Party Representative Having Full Authority to Settle. A "party representative having full authority to settle" shall mean the final decision maker with respect to all issues presented by the case who has the legal capacity to execute a binding settlement agreement on behalf of the party. Nothing herein shall be deemed to require any party or party representative who appears at a mediation conference in compliance with this rule to enter into a settlement agreement.

(d) Appearance by Public Entity. If a party to mediation is a public entity required to operate in compliance with chapter 286, Florida Statutes, that party shall be deemed to appear at a mediation conference by the physical presence

of a representative with full authority to negotiate on behalf of the entity and to recommend settlement to the appropriate decision-making body of the entity.

(e) Certification of Authority. Unless otherwise stipulated by the parties, each party, 10 days prior to appearing at a mediation conference, shall file with the court and serve all parties a written notice identifying the person or persons who will be attending the mediation conference as a party representative or as an insurance carrier representative, and confirming that those persons have the authority required by subdivision (b).

(f) Sanctions for Failure to Appear. If a party fails to appear at a duly noticed mediation conference without good cause, the court, upon motion, shall impose sanctions, including award of mediation fees, attorneys' fees, and costs, against the party failing to appear. The failure to file a confirmation of authority required under subdivision (e) above, or failure of the persons actually identified in the confirmation to appear at the mediation conference, shall create a rebuttable presumption of a failure to appear.

~~(c)~~(g) Adjournments. [NO CHANGE]

~~(d)~~(h) Counsel. [NO CHANGE]

~~(e)~~(i) Communication with Parties or Counsel. The mediator may meet and consult privately with any party or parties or their counsel.

~~(f)~~(j) Appointment of the Mediator. [NO CHANGE]

~~(g)~~(k) Compensation of the Mediator. [NO CHANGE]

Committee Notes

2011 Amendment. Mediated settlement conferences pursuant to this rule are meant to be conducted when the participants actually engaged in the settlement negotiations have full authority to settle the case without further consultation. New language in subdivision (c) now defines "a party representative with full authority to settle" in two parts. First, the party representative must be the final decision maker with respect to all issues presented by the case in question. Second, the party representative must have the legal capacity to

execute a binding agreement on behalf of the settling party. These are objective standards. Whether or not these standards have been met can be determined without reference to any confidential mediation communications. A decision by a party representative not to settle does not, in and of itself, signify the absence of full authority to settle. A party may delegate full authority to settle to more than one person, each of whom can serve as the final decision maker. A party may also designate multiple persons to serve together as the final decision maker, all of whom must appear at mediation.

New subdivision (e) provides a process for parties to identify party representative and representatives of insurance carriers who will be attending the mediation conference on behalf of parties and insurance carriers and to confirm their respective settlement authority by means of a direct representation to the court. If necessary, any verification of this representation would be upon motion by a party or inquiry by the court without involvement of the mediator and would not require disclosure of confidential mediation communications. Nothing in this rule shall be deemed to impose any duty or obligation on the mediator selected by the parties or appointed by the court to ensure compliance.

The concept of self determination in mediation also contemplates the parties' free choice in structuring and organizing their mediation sessions, including those who are to participate. Accordingly, elements of this rule are subject to revision or qualification with the mutual consent of the parties.

III. Construction Contracts and Risk Transfer

AIA® Document A101™ – 2017

Standard Form of Agreement Between Owner and Contractor where the basis of payment is a Stipulated Sum

AGREEMENT made as of the _____ day of _____ in the year _____
(In words, indicate day, month and year.)

BETWEEN the Owner:
(Name, legal status, address and other information)

and the Contractor:
(Name, legal status, address and other information)

for the following Project:
(Name, location and detailed description)

The Architect:
(Name, legal status, address and other information)

This document has important legal consequences. Consultation with an attorney is encouraged with respect to its completion or modification.

The parties should complete A101™–2017, Exhibit A, Insurance and Bonds, contemporaneously with this Agreement.

AIA Document A201™–2017, General Conditions of the Contract for Construction, is adopted in this document by reference. Do not use with other general conditions unless this document is modified.

The Owner and Contractor agree as follows.

TABLE OF ARTICLES

ARTICLE 1 THE CONTRACT DOCUMENTS

The Contract Documents consist of this Agreement, Conditions of the Contract (General, Supplementary, and other Conditions), Drawings, Specifications, Addenda issued prior to execution of this Agreement, other documents listed in this Agreement, and Modifications issued after execution of this Agreement, all of which form the Contract, and are as fully a part of the Contract as if attached to this Agreement or repeated herein. The Contract represents the entire and integrated agreement between the parties hereto and supersedes prior negotiations, representations, or agreements, either written or oral. An enumeration of the Contract Documents, other than a Modification, appears in Article 9.

ARTICLE 2 THE WORK OF THIS CONTRACT

The Contractor shall fully execute the Work described in the Contract Documents, except as specifically indicated in the Contract Documents to be the responsibility of others.

ARTICLE 3 DATE OF COMMENCEMENT AND SUBSTANTIAL COMPLETION

§ 3.1 The date of commencement of the Work shall be:
(Check one of the following boxes.)

☐ The date of this Agreement.

☐ A date set forth in a notice to proceed issued by the Owner.

☐ Established as follows:
(Insert a date or a means to determine the date of commencement of the Work.)

If a date of commencement of the Work is not selected, then the date of commencement shall be the date of this Agreement.

§ 3.2 The Contract Time shall be measured from the date of commencement of the Work.

§ 3.3 Substantial Completion

§ 3.3.1 Subject to adjustments of the Contract Time as provided in the Contract Documents, the Contractor shall achieve Substantial Completion of the entire Work:
(Check one of the following boxes and complete the necessary information.)

☐ Not later than ( ) calendar days from the date of commencement of the Work.

☐ By the following date:

§ 3.3.2 Subject to adjustments of the Contract Time as provided in the Contract Documents, if portions of the Work are to be completed prior to Substantial Completion of the entire Work, the Contractor shall achieve Substantial Completion of such portions by the following dates:

Portion of Work	Substantial Completion Date

§ 3.3.3 If the Contractor fails to achieve Substantial Completion as provided in this Section 3.3, liquidated damages, if any, shall be assessed as set forth in Section 4.5.

ARTICLE 4 CONTRACT SUM

§ 4.1 The Owner shall pay the Contractor the Contract Sum in current funds for the Contractor's performance of the Contract. The Contract Sum shall be ($), subject to additions and deductions as provided in the Contract Documents.

§ 4.2 Alternates

§ 4.2.1 Alternates, if any, included in the Contract Sum:

Item	Price

§ 4.2.2 Subject to the conditions noted below, the following alternates may be accepted by the Owner following execution of this Agreement. Upon acceptance, the Owner shall issue a Modification to this Agreement.
(Insert below each alternate and the conditions that must be met for the Owner to accept the alternate.)

Item	Price	Conditions for Acceptance

§ 4.3 Allowances, if any, included in the Contract Sum:
(Identify each allowance.)

Item	Price

§ 4.4 Unit prices, if any:
(Identify the item and state the unit price and quantity limitations, if any, to which the unit price will be applicable.)

Item	Units and Limitations	Price per Unit ($0.00)

§ 4.5 Liquidated damages, if any:
(Insert terms and conditions for liquidated damages, if any.)

§ 4.6 Other:
(Insert provisions for bonus or other incentives, if any, that might result in a change to the Contract Sum.)

ARTICLE 5 PAYMENTS

§ 5.1 Progress Payments

§ 5.1.1 Based upon Applications for Payment submitted to the Architect by the Contractor and Certificates for Payment issued by the Architect, the Owner shall make progress payments on account of the Contract Sum to the Contractor as provided below and elsewhere in the Contract Documents.

§ 5.1.2 The period covered by each Application for Payment shall be one calendar month ending on the last day of the month, or as follows:

§ 5.1.3 Provided that an Application for Payment is received by the Architect not later than the day of a month, the Owner shall make payment of the amount certified to the Contractor not later than the day of the month. If an Application for Payment is received by the Architect after the application date fixed above, payment of the amount certified shall be made by the Owner not later than ( ) days after the Architect receives the Application for Payment.
(Federal, state or local laws may require payment within a certain period of time.)

§ 5.1.4 Each Application for Payment shall be based on the most recent schedule of values submitted by the Contractor in accordance with the Contract Documents. The schedule of values shall allocate the entire Contract Sum among the various portions of the Work. The schedule of values shall be prepared in such form, and supported by such data to substantiate its accuracy, as the Architect may require. This schedule of values shall be used as a basis for reviewing the Contractor's Applications for Payment.

§ 5.1.5 Applications for Payment shall show the percentage of completion of each portion of the Work as of the end of the period covered by the Application for Payment.

§ 5.1.6 In accordance with AIA Document A201™–2017, General Conditions of the Contract for Construction, and subject to other provisions of the Contract Documents, the amount of each progress payment shall be computed as follows:

§ 5.1.6.1 The amount of each progress payment shall first include:

- **.1** That portion of the Contract Sum properly allocable to completed Work;
- **.2** That portion of the Contract Sum properly allocable to materials and equipment delivered and suitably stored at the site for subsequent incorporation in the completed construction, or, if approved in advance by the Owner, suitably stored off the site at a location agreed upon in writing; and
- **.3** That portion of Construction Change Directives that the Architect determines, in the Architect's professional judgment, to be reasonably justified.

§ 5.1.6.2 The amount of each progress payment shall then be reduced by:

- **.1** The aggregate of any amounts previously paid by the Owner;
- **.2** The amount, if any, for Work that remains uncorrected and for which the Architect has previously withheld a Certificate for Payment as provided in Article 9 of AIA Document A201–2017;
- **.3** Any amount for which the Contractor does not intend to pay a Subcontractor or material supplier, unless the Work has been performed by others the Contractor intends to pay;
- **.4** For Work performed or defects discovered since the last payment application, any amount for which the Architect may withhold payment, or nullify a Certificate of Payment in whole or in part, as provided in Article 9 of AIA Document A201–2017; and
- **.5** Retainage withheld pursuant to Section 5.1.7.

§ 5.1.7 Retainage

§ 5.1.7.1 For each progress payment made prior to Substantial Completion of the Work, the Owner may withhold the following amount, as retainage, from the payment otherwise due:
(Insert a percentage or amount to be withheld as retainage from each Application for Payment. The amount of retainage may be limited by governing law.)

§ 5.1.7.1.1 The following items are not subject to retainage:
(Insert any items not subject to the withholding of retainage, such as general conditions, insurance, etc.)

§ 5.1.7.2 Reduction or limitation of retainage, if any, shall be as follows:
(If the retainage established in Section 5.1.7.1 is to be modified prior to Substantial Completion of the entire Work, including modifications for Substantial Completion of portions of the Work as provided in Section 3.3.2, insert provisions for such modifications.)

§ 5.1.7.3 Except as set forth in this Section 5.1.7.3, upon Substantial Completion of the Work, the Contractor may submit an Application for Payment that includes the retainage withheld from prior Applications for Payment pursuant to this Section 5.1.7. The Application for Payment submitted at Substantial Completion shall not include retainage as follows:
(Insert any other conditions for release of retainage upon Substantial Completion.)

§ 5.1.8 If final completion of the Work is materially delayed through no fault of the Contractor, the Owner shall pay the Contractor any additional amounts in accordance with Article 9 of AIA Document A201–2017.

§ 5.1.9 Except with the Owner's prior approval, the Contractor shall not make advance payments to suppliers for materials or equipment which have not been delivered and stored at the site.

§ 5.2 Final Payment

§ 5.2.1 Final payment, constituting the entire unpaid balance of the Contract Sum, shall be made by the Owner to the Contractor when

.1 the Contractor has fully performed the Contract except for the Contractor's responsibility to correct Work as provided in Article 12 of AIA Document A201–2017, and to satisfy other requirements, if any, which extend beyond final payment; and

.2 a final Certificate for Payment has been issued by the Architect.

§ 5.2.2 The Owner's final payment to the Contractor shall be made no later than 30 days after the issuance of the Architect's final Certificate for Payment, or as follows:

§ 5.3 Interest

Payments due and unpaid under the Contract shall bear interest from the date payment is due at the rate stated below, or in the absence thereof, at the legal rate prevailing from time to time at the place where the Project is located.
(Insert rate of interest agreed upon, if any.)

_____ % _____

ARTICLE 6 DISPUTE RESOLUTION

§ 6.1 Initial Decision Maker

The Architect will serve as the Initial Decision Maker pursuant to Article 15 of AIA Document A201–2017, unless the parties appoint below another individual, not a party to this Agreement, to serve as the Initial Decision Maker.
(If the parties mutually agree, insert the name, address and other contact information of the Initial Decision Maker, if other than the Architect.)

§ 6.2 Binding Dispute Resolution
For any Claim subject to, but not resolved by, mediation pursuant to Article 15 of AIA Document A201–2017, the method of binding dispute resolution shall be as follows:
(Check the appropriate box.)

☐ Arbitration pursuant to Section 15.4 of AIA Document A201–2017

☐ Litigation in a court of competent jurisdiction

☐ Other *(Specify)*

If the Owner and Contractor do not select a method of binding dispute resolution, or do not subsequently agree in writing to a binding dispute resolution method other than litigation, Claims will be resolved by litigation in a court of competent jurisdiction.

ARTICLE 7 TERMINATION OR SUSPENSION
§ 7.1 The Contract may be terminated by the Owner or the Contractor as provided in Article 14 of AIA Document A201–2017.

§ 7.1.1 If the Contract is terminated for the Owner's convenience in accordance with Article 14 of AIA Document A201–2017, then the Owner shall pay the Contractor a termination fee as follows:
(Insert the amount of, or method for determining, the fee, if any, payable to the Contractor following a termination for the Owner's convenience.)

§ 7.2 The Work may be suspended by the Owner as provided in Article 14 of AIA Document A201–2017.

ARTICLE 8 MISCELLANEOUS PROVISIONS
§ 8.1 Where reference is made in this Agreement to a provision of AIA Document A201–2017 or another Contract Document, the reference refers to that provision as amended or supplemented by other provisions of the Contract Documents.

§ 8.2 The Owner's representative:
(Name, address, email address, and other information)

§ 8.3 The Contractor's representative:
(Name, address, email address, and other information)

§ 8.4 Neither the Owner's nor the Contractor's representative shall be changed without ten days' prior notice to the other party.

§ 8.5 Insurance and Bonds

§ 8.5.1 The Owner and the Contractor shall purchase and maintain insurance as set forth in AIA Document A101™–2017, Standard Form of Agreement Between Owner and Contractor where the basis of payment is a Stipulated Sum, Exhibit A, Insurance and Bonds, and elsewhere in the Contract Documents.

§ 8.5.2 The Contractor shall provide bonds as set forth in AIA Document A101™–2017 Exhibit A, and elsewhere in the Contract Documents.

§ 8.6 Notice in electronic format, pursuant to Article 1 of AIA Document A201–2017, may be given in accordance with AIA Document E203™–2013, Building Information Modeling and Digital Data Exhibit, if completed, or as otherwise set forth below:
(If other than in accordance with AIA Document E203–2013, insert requirements for delivering notice in electronic format such as name, title, and email address of the recipient and whether and how the system will be required to generate a read receipt for the transmission.)

§ 8.7 Other provisions:

ARTICLE 9 ENUMERATION OF CONTRACT DOCUMENTS

§ 9.1 This Agreement is comprised of the following documents:

.1 AIA Document A101™–2017, Standard Form of Agreement Between Owner and Contractor

.2 AIA Document A101™–2017, Exhibit A, Insurance and Bonds

.3 AIA Document A201™–2017, General Conditions of the Contract for Construction

.4 AIA Document E203™–2013, Building Information Modeling and Digital Data Exhibit, dated as indicated below:
(Insert the date of the E203-2013 incorporated into this Agreement.)

.5 Drawings

Number	Title	Date

.6 Specifications

Section	Title	Date	Pages

.7 Addenda, if any:

Number	Date	Pages

Portions of Addenda relating to bidding or proposal requirements are not part of the Contract Documents unless the bidding or proposal requirements are also enumerated in this Article 9.

.8 Other Exhibits:
(Check all boxes that apply and include appropriate information identifying the exhibit where required.)

☐ AIA Document E204™–2017, Sustainable Projects Exhibit, dated as indicated below:
(Insert the date of the E204-2017 incorporated into this Agreement.)

☐ The Sustainability Plan:

Title	Date	Pages

☐ Supplementary and other Conditions of the Contract:

Document	Title	Date	Pages

.9 Other documents, if any, listed below:
(List here any additional documents that are intended to form part of the Contract Documents. AIA Document A201™–2017 provides that the advertisement or invitation to bid, Instructions to Bidders, sample forms, the Contractor's bid or proposal, portions of Addenda relating to bidding or proposal requirements, and other information furnished by the Owner in anticipation of receiving bids or proposals, are not part of the Contract Documents unless enumerated in this Agreement. Any such documents should be listed here only if intended to be part of the Contract Documents.)

This Agreement entered into as of the day and year first written above.

OWNER *(Signature)*	**CONTRACTOR** *(Signature)*
(Printed name and title)	*(Printed name and title)*

AIA® Document A102™ – 2017 Exhibit A

Insurance and Bonds

This Insurance and Bonds Exhibit is part of the Agreement, between the Owner and the Contractor, dated the _____ day of _____ in the year _____
(In words, indicate day, month and year.)

for the following **PROJECT**:
(Name and location or address)

This document has important legal consequences. Consultation with an attorney is encouraged with respect to its completion or modification.

This document is intended to be used in conjunction with AIA Document A201™–2017, General Conditions of the Contract for Construction. Article 11 of A201™–2017 contains additional insurance provisions.

THE OWNER:
(Name, legal status and address)

THE CONTRACTOR:
(Name, legal status and address)

TABLE OF ARTICLES

ARTICLE A.1 GENERAL

The Owner and Contractor shall purchase and maintain insurance, and provide bonds, as set forth in this Exhibit. As used in this Exhibit, the term General Conditions refers to AIA Document A201™–2017, General Conditions of the Contract for Construction.

ARTICLE A.2 OWNER'S INSURANCE

§ A.2.1 General

Prior to commencement of the Work, the Owner shall secure the insurance, and provide evidence of the coverage, required under this Article A.2 and, upon the Contractor's request, provide a copy of the property insurance policy or policies required by Section A.2.3. The copy of the policy or policies provided shall contain all applicable conditions, definitions, exclusions, and endorsements.

§ A.2.2 Liability Insurance

The Owner shall be responsible for purchasing and maintaining the Owner's usual general liability insurance.

§ A.2.3 Required Property Insurance

§ A.2.3.1 Unless this obligation is placed on the Contractor pursuant to Section A.3.3.2.1, the Owner shall purchase and maintain, from an insurance company or insurance companies lawfully authorized to issue insurance in the jurisdiction where the Project is located, property insurance written on a builder's risk "all-risks" completed value or equivalent policy form and sufficient to cover the total value of the entire Project on a replacement cost basis. The Owner's

property insurance coverage shall be no less than the amount of the initial Contract Sum, plus the value of subsequent Modifications and labor performed and materials or equipment supplied by others. The property insurance shall be maintained until Substantial Completion and thereafter as provided in Section A.2.3.1.3, unless otherwise provided in the Contract Documents or otherwise agreed in writing by the parties to this Agreement. This insurance shall include the interests of the Owner, Contractor, Subcontractors, and Sub-subcontractors in the Project as insureds. This insurance shall include the interests of mortgagees as loss payees.

§ A.2.3.1.1 Causes of Loss. The insurance required by this Section A.2.3.1 shall provide coverage for direct physical loss or damage, and shall not exclude the risks of fire, explosion, theft, vandalism, malicious mischief, collapse, earthquake, flood, or windstorm. The insurance shall also provide coverage for ensuing loss or resulting damage from error, omission, or deficiency in construction methods, design, specifications, workmanship, or materials. Sub-limits, if any, are as follows:
(Indicate below the cause of loss and any applicable sub-limit.)

Cause of Loss	Sub-Limit

§ A.2.3.1.2 Specific Required Coverages. The insurance required by this Section A.2.3.1 shall provide coverage for loss or damage to falsework and other temporary structures, and to building systems from testing and startup. The insurance shall also cover debris removal, including demolition occasioned by enforcement of any applicable legal requirements, and reasonable compensation for the Architect's and Contractor's services and expenses required as a result of such insured loss, including claim preparation expenses. Sub-limits, if any, are as follows:
(Indicate below type of coverage and any applicable sub-limit for specific required coverages.)

Coverage	Sub-Limit

§ A.2.3.1.3 Unless the parties agree otherwise, upon Substantial Completion, the Owner shall continue the insurance required by Section A.2.3.1 or, if necessary, replace the insurance policy required under Section A.2.3.1 with property insurance written for the total value of the Project that shall remain in effect until expiration of the period for correction of the Work set forth in Section 12.2.2 of the General Conditions.

§ A.2.3.1.4 Deductibles and Self-Insured Retentions. If the insurance required by this Section A.2.3 is subject to deductibles or self-insured retentions, the Owner shall be responsible for all loss not covered because of such deductibles or retentions.

§ A.2.3.2 Occupancy or Use Prior to Substantial Completion. The Owner's occupancy or use of any completed or partially completed portion of the Work prior to Substantial Completion shall not commence until the insurance company or companies providing the insurance under Section A.2.3.1 have consented in writing to the continuance of coverage. The Owner and the Contractor shall take no action with respect to partial occupancy or use that would cause cancellation, lapse, or reduction of insurance, unless they agree otherwise in writing.

§ A.2.3.3 Insurance for Existing Structures
If the Work involves remodeling an existing structure or constructing an addition to an existing structure, the Owner shall purchase and maintain, until the expiration of the period for correction of Work as set forth in Section 12.2.2 of the General Conditions, "all-risks" property insurance, on a replacement cost basis, protecting the existing structure against direct physical loss or damage from the causes of loss identified in Section A.2.3.1, notwithstanding the undertaking of the Work. The Owner shall be responsible for all co-insurance penalties.

§ A.2.4 Optional Extended Property Insurance.
The Owner shall purchase and maintain the insurance selected and described below.
(Select the types of insurance the Owner is required to purchase and maintain by placing an X in the box(es) next to the description(s) of selected insurance. For each type of insurance selected, indicate applicable limits of coverage or other conditions in the fill point below the selected item.)

☐ **§ A.2.4.1 Loss of Use, Business Interruption, and Delay in Completion Insurance,** to reimburse the Owner for loss of use of the Owner's property, or the inability to conduct normal operations due to a covered cause of loss.

☐ **§ A.2.4.2 Ordinance or Law Insurance,** for the reasonable and necessary costs to satisfy the minimum requirements of the enforcement of any law or ordinance regulating the demolition, construction, repair, replacement or use of the Project.

☐ **§ A.2.4.3 Expediting Cost Insurance**, for the reasonable and necessary costs for the temporary repair of damage to insured property, and to expedite the permanent repair or replacement of the damaged property.

☐ **§ A.2.4.4 Extra Expense Insurance,** to provide reimbursement of the reasonable and necessary excess costs incurred during the period of restoration or repair of the damaged property that are over and above the total costs that would normally have been incurred during the same period of time had no loss or damage occurred.

☐ **§ A.2.4.5 Civil Authority Insurance,** for losses or costs arising from an order of a civil authority prohibiting access to the Project, provided such order is the direct result of physical damage covered under the required property insurance.

☐ **§ A.2.4.6 Ingress/Egress Insurance,** for loss due to the necessary interruption of the insured's business due to physical prevention of ingress to, or egress from, the Project as a direct result of physical damage.

☐ **§ A.2.4.7 Soft Costs Insurance,** to reimburse the Owner for costs due to the delay of completion of the Work, arising out of physical loss or damage covered by the required property insurance: including construction loan fees; leasing and marketing expenses; additional fees, including those of architects, engineers, consultants, attorneys and accountants, needed for the completion of the construction, repairs, or reconstruction; and carrying costs such as property taxes, building permits, additional interest on loans, realty taxes, and insurance premiums over and above normal expenses.

§ A.2.5 Other Optional Insurance.
The Owner shall purchase and maintain the insurance selected below.
(Select the types of insurance the Owner is required to purchase and maintain by placing an X in the box(es) next to the description(s) of selected insurance.)

☐ **§ A.2.5.1 Cyber Security Insurance** for loss to the Owner due to data security and privacy breach, including costs of investigating a potential or actual breach of confidential or private information.
(Indicate applicable limits of coverage or other conditions in the fill point below.)

☐ **§ A.2.5.2 Other Insurance**
(List below any other insurance coverage to be provided by the Owner and any applicable limits.)

Coverage	Limits

ARTICLE A.3 CONTRACTOR'S INSURANCE AND BONDS

§ A.3.1 General

§ A.3.1.1 Certificates of Insurance. The Contractor shall provide certificates of insurance acceptable to the Owner evidencing compliance with the requirements in this Article A.3 at the following times: (1) prior to commencement of the Work; (2) upon renewal or replacement of each required policy of insurance; and (3) upon the Owner's written request. An additional certificate evidencing continuation of commercial liability coverage, including coverage for completed operations, shall be submitted with the final Application for Payment and thereafter upon renewal or replacement of such coverage until the expiration of the periods required by Section A.3.2.1 and Section A.3.3.1. The certificates will show the Owner as an additional insured on the Contractor's Commercial General Liability and excess or umbrella liability policy or policies.

§ A.3.1.2 Deductibles and Self-Insured Retentions. The Contractor shall disclose to the Owner any deductible or self-insured retentions applicable to any insurance required to be provided by the Contractor.

§ A.3.1.3 Additional Insured Obligations. To the fullest extent permitted by law, the Contractor shall cause the commercial general liability coverage to include (1) the Owner, the Architect, and the Architect's consultants as additional insureds for claims caused in whole or in part by the Contractor's negligent acts or omissions during the Contractor's operations; and (2) the Owner as an additional insured for claims caused in whole or in part by the Contractor's negligent acts or omissions for which loss occurs during completed operations. The additional insured coverage shall be primary and non-contributory to any of the Owner's general liability insurance policies and shall apply to both ongoing and completed operations. To the extent commercially available, the additional insured coverage shall be no less than that provided by Insurance Services Office, Inc. (ISO) forms CG 20 10 07 04, CG 20 37 07 04, and, with respect to the Architect and the Architect's consultants, CG 20 32 07 04.

§ A.3.2 Contractor's Required Insurance Coverage

§ A.3.2.1 The Contractor shall purchase and maintain the following types and limits of insurance from an insurance company or insurance companies lawfully authorized to issue insurance in the jurisdiction where the Project is located. The Contractor shall maintain the required insurance until the expiration of the period for correction of Work as set forth in Section 12.2.2 of the General Conditions, unless a different duration is stated below:
(If the Contractor is required to maintain insurance for a duration other than the expiration of the period for correction of Work, state the duration.)

§ A.3.2.2 Commercial General Liability

§ A.3.2.2.1 Commercial General Liability insurance for the Project written on an occurrence form with policy limits of not less than _____ ($__) each occurrence, _____ ($__) general aggregate, and _____ ($__) aggregate for products-completed operations hazard, providing coverage for claims including

- **.1** damages because of bodily injury, sickness or disease, including occupational sickness or disease, and death of any person;
- **.2** personal injury and advertising injury;
- **.3** damages because of physical damage to, or destruction of, tangible property, including the loss of use of such property;
- **.4** bodily injury or property damage arising out of completed operations; and
- **.5** the Contractor's indemnity obligations under Section 3.18 of the General Conditions.

§ A.3.2.2.2 The Contractor's Commercial General Liability policy under this Section A.3.2.2 shall not contain an exclusion or restriction of coverage for the following:

- **.1** Claims by one insured against another insured, if the exclusion or restriction is based solely on the fact that the claimant is an insured, and there would otherwise be coverage for the claim.
- **.2** Claims for property damage to the Contractor's Work arising out of the products-completed operations hazard where the damaged Work or the Work out of which the damage arises was performed by a Subcontractor.
- **.3** Claims for bodily injury other than to employees of the insured.
- **.4** Claims for indemnity under Section 3.18 of the General Conditions arising out of injury to employees of the insured
- **.5** Claims or loss excluded under a prior work endorsement or other similar exclusionary language.
- **.6** Claims or loss due to physical damage under a prior injury endorsement or similar exclusionary language.
- **.7** Claims related to residential, multi-family, or other habitational projects, if the Work is to be performed on such a project.
- **.8** Claims related to roofing, if the Work involves roofing.
- **.9** Claims related to exterior insulation finish systems (EIFS), synthetic stucco or similar exterior coatings or surfaces, if the Work involves such coatings or surfaces.
- **.10** Claims related to earth subsidence or movement, where the Work involves such hazards.
- **.11** Claims related to explosion, collapse, and underground hazards, where the Work involves such hazards.

§ A.3.2.3 Automobile Liability covering vehicles owned, and non-owned vehicles used, by the Contractor, with policy limits of not less than _____ ($__) per accident, for bodily injury, death of any person, and property damage arising out of the ownership, maintenance and use of those motor vehicles along with any other statutorily required automobile coverage.

§ A.3.2.4 The Contractor may achieve the required limits and coverage for Commercial General Liability and Automobile Liability through a combination of primary and excess or umbrella liability insurance, provided such primary and excess or umbrella insurance policies result in the same or greater coverage as the coverages required under Section A.3.2.2 and A.3.2.3, and in no event shall any excess or umbrella liability insurance provide narrower coverage than the primary policy. The excess policy shall not require the exhaustion of the underlying limits only through the actual payment by the underlying insurers.

§ A.3.2.5 Workers' Compensation at statutory limits.

§ A.3.2.6 Employers' Liability with policy limits not less than _____ ($__) each accident, _____ ($__) each employee, and _____ ($__) policy limit.

§ A.3.2.7 Jones Act, and the Longshore & Harbor Workers' Compensation Act, as required, if the Work involves hazards arising from work on or near navigable waterways, including vessels and docks

§ A.3.2.8 If the Contractor is required to furnish professional services as part of the Work, the Contractor shall procure Professional Liability insurance covering performance of the professional services, with policy limits of not less than _____ ($__) per claim and _____ ($__) in the aggregate.

§ A.3.2.9 If the Work involves the transport, dissemination, use, or release of pollutants, the Contractor shall procure Pollution Liability insurance, with policy limits of not less than _____ ($__) per claim and _____ ($__) in the aggregate.

§ A.3.2.10 Coverage under Sections A.3.2.8 and A.3.2.9 may be procured through a Combined Professional Liability and Pollution Liability insurance policy, with combined policy limits of not less than _____ ($__) per claim and _____ ($__) in the aggregate.

§ A.3.2.11 Insurance for maritime liability risks associated with the operation of a vessel, if the Work requires such activities, with policy limits of not less than_____ ($__) per claim and_____ ($__) in the aggregate.

§ A.3.2.12 Insurance for the use or operation of manned or unmanned aircraft, if the Work requires such activities, with policy limits of not less than_____ ($__) per claim and_____ ($__) in the aggregate.

§ A.3.3 Contractor's Other Insurance Coverage

§ A.3.3.1 Insurance selected and described in this Section A.3.3 shall be purchased from an insurance company or insurance companies lawfully authorized to issue insurance in the jurisdiction where the Project is located. The Contractor shall maintain the required insurance until the expiration of the period for correction of Work as set forth in Section 12.2.2 of the General Conditions, unless a different duration is stated below:

(If the Contractor is required to maintain any of the types of insurance selected below for a duration other than the expiration of the period for correction of Work, state the duration.)

§ A.3.3.2 The Contractor shall purchase and maintain the following types and limits of insurance in accordance with Section A.3.3.1.

(Select the types of insurance the Contractor is required to purchase and maintain by placing an X in the box(es) next to the description(s) of selected insurance. Where policy limits are provided, include the policy limit in the appropriate fill point.)

☐ **§ A.3.3.2.1** Property insurance of the same type and scope satisfying the requirements identified in Section A.2.3, which, if selected in this section A.3.3.2.1, relieves the Owner of the responsibility to purchase and maintain such insurance except insurance required by Section A.2.3.1.3 and Section A.2.3.3. The Contractor shall comply with all obligations of the Owner under Section A.2.3 except to the extent provided below. The Contractor shall disclose to the Owner the amount of any deductible, and the Owner shall be responsible for losses within the deductible. Upon request, the Contractor shall provide the Owner with a copy of the property insurance policy or policies required. The Owner shall adjust and settle the loss with the insurer and be the trustee of the proceeds of the property insurance in accordance with Article 11 of the General Conditions unless otherwise set forth below.

(Where the Contractor's obligation to provide property insurance differs from the Owner's obligations as described under Section A.2.3, indicate such differences in the space below. Additionally, if a party other than the Owner will be responsible for adjusting and settling a loss with the insurer and acting as the trustee of the proceeds of property insurance in accordance with Article 11 of the General Conditions, indicate the responsible party below.)

☐ **§ A.3.3.2.2 Railroad Protective Liability Insurance,** with policy limits of not less than _____ ($__) per claim and _____ ($__) in the aggregate, for Work within fifty (50) feet of railroad property.

☐ **§ A.3.3.2.3 Asbestos Abatement Liability Insurance,** with policy limits of not less than _____ ($__) per claim and _____ ($__) in the aggregate, for liability arising from the encapsulation, removal, handling, storage, transportation, and disposal of asbestos-containing materials.

☐ **§ A.3.3.2.4** Insurance for physical damage to property while it is in storage and in transit to the construction site on an "all-risks" completed value form.

☐ **§ A.3.3.2.5** Property insurance on an "all-risks" completed value form, covering property owned by the Contractor and used on the Project, including scaffolding and other equipment.

☐ **§ A.3.3.2.6 Other Insurance**

(List below any other insurance coverage to be provided by the Contractor and any applicable limits.)

Coverage	**Limits**

§ A.3.4 Performance Bond and Payment Bond
The Contractor shall provide surety bonds, from a company or companies lawfully authorized to issue surety bonds in the jurisdiction where the Project is located, as follows:
(Specify type and penal sum of bonds.)

Type	Penal Sum ($0.00)
Payment Bond	
Performance Bond	

Payment and Performance Bonds shall be AIA Document A312™, Payment Bond and Performance Bond, or contain provisions identical to AIA Document A312™, current as of the date of this Agreement.

ARTICLE A.4 SPECIAL TERMS AND CONDITIONS
Special terms and conditions that modify this Insurance and Bonds Exhibit, if any, are as follows:

AIA® Document G715™ – 2017

Supplemental Attachment for ACORD Certificate of Insurance 25

PROJECT: *(name and address)*	**CONTRACT INFORMATION:** Contract For: Date:	**CERTIFICATE INFORMATION:** Producer: Insured: Date:
OWNER: *(name and address)*	**ARCHITECT:** *(name and address)*	**CONTRACTOR:** *(name and address)*

A. General Liability		**Yes**	**No**	**N/A**
1.	Does this policy include coverage for:			
a	Damages because of bodily injury, sickness, or disease, including occupational sickness or disease, and death of any person?	☐	☐	☐
b	Personal injury and advertising injury?	☐	☐	☐
c	Damages because of physical damage to or destruction of tangible property, including the loss of use of such property?	☐	☐	☐
d	Bodily injury or property damage arising out of completed operations?	☐	☐	☐
e	The Contractor's indemnity obligations included in the Contract Documents?	☐	☐	☐
2.	Does this policy contain an exclusion or restriction of coverage for:			
a	Claims by one insured against another insured, where the exclusion or restrictions is based solely on the fact that the claimant is an insured, and there would otherwise be coverage for the claim?	☐	☐	☐
b	Claims for property damage to the Contractor's Work arising out of the products-completed operations hazard where the damaged Work or the Work out of which the damage arises was performed by a Subcontractor?	☐	☐	☐
c	Claims for bodily injury other than to employees of the insured?	☐	☐	☐
d	Claims for the Contractor's indemnity obligations included in the Contract Documents arising out of injury to employees of the insured?	☐	☐	☐
e	Claims for loss excluded under a prior work endorsement or other similar exclusionary language?	☐	☐	☐
f	Claims or loss due to physical damage under a prior injury endorsement or similar exclusionary language?	☐	☐	☐
g	Claims related to residential, multi-family, or other habitational projects?	☐	☐	☐
h	Claims related to roofing?	☐	☐	☐
i	Claims related to exterior insulation finish systems, synthetic stucco, or similar exterior coatings or surfaces?	☐	☐	☐
j	Claims related to earth subsistence or movement?	☐	☐	☐
k	Claims related to explosion, collapse, and underground hazards?	☐	☐	☐

B. Other Insurance Coverage		**Yes**	**No**	**N/A**
1.	Indicate whether the Contractor has the following insurance coverages and, if so, indicate the coverage limits for each.			
a	Professional liability insurance Coverage limits:	☐	☐	☐
b	Pollution liability insurance Coverage limits:	☐	☐	☐
c	Insurance for maritime liability risks associated with the operation of a vessel	☐	☐	☐

Coverage limits:

d	Insurance for the use or operation of manned or unmanned aircraft Coverage limits:	☐	☐	☐
e	Property insurance Coverage limits:	☐	☐	☐
f	Railroad protective liability insurance Coverage limits:	☐	☐	☐
g	Asbestos abatement liability insurance Coverage limits:	☐	☐	☐
h	Insurance for physical damage to property while it is in storage and in transit to the construction site Coverage limits:	☐	☐	☐
i	Other:	☐	☐	☐

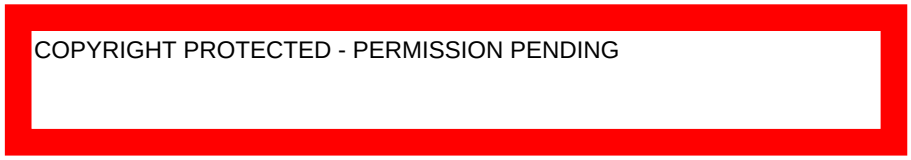
_____

(Authorized Representative)

_____

(Date of Issue)

IV. Experts and Extrapolation



Section 21.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

South Ballroom

Friday, May 18th 2018
12:00 PM – 1:00 PM

Course Title:
Everyone is a Small Player

Paloma Ramirez, Esq., Patrick Mendes Esq., Paul Nolan Esq.,
Anne Goyette Esq. and Carolyn Crawford

Everyone is a Small Player

Time and time again, attorneys in construction defect litigation seek to frame their clients as "peripheral parties." The client is "just the electrician" or "just the plumber." In an age where many of the "big targets" are out of business or their insurance policies are exhausted, we are left trying to resolve cases with nothing but "small players." This panel will discuss litigation and settlement strategies where "everyone is a small player" including the impact of additional insured obligations and *Crawford*.

I. Defining "Peripheral Party"

A. 10 or 15 years ago, peripheral parties were those with "minor" scopes of work

1. The parties in litigation could generally be placed into three tiers of exposure:

a) *High Exposure*: Stucco, Framing, Roofing, Sometimes Windows

b) *Medium Exposure*: Windows, Plumbing, Concrete (Foundations)

c) *Low Exposure*: Concrete (Flatwork), Electrical, Flooring, Finish Work, Landscaping

B. Changes in Construction Defect Litigation have resulted in changes to this dynamic.

1. Many of the larger subcontractors are no longer participating in litigation.

a) No longer in business

b) Developers cannot locate insurance information or policies are exhausted.

2. Plaintiffs and Developers have started looking to the next tier of subcontractors to fund settlements

a) As a result, the typical "peripheral party" has become more important to the resolution of cases and a bigger "target."

b) Insurance coverage is likewise a much larger issue

3. What is a peripheral party now??

a) "Peripheral Parties" are now defined by things such as:

(1) Lack of insurance coverage

(2) Subcontractor being defunct

(3) No Actual Liability

b) <u>Carriers</u>: Reconsider how you evaluate cases.

(1) Now, before determining your reserves and/or reasonable settlement value, consider the following:

(a) Does your insured have a written contract with indemnity provision requiring duty to defend and indemnify?

(b) Is your client still in business?

(c) How many subcontractors are participating? Any large trades participating in the litigation and to what extent?

(d) What are Developer's defense fees to date and who is paying them? Developer's primary carrier? AIs? Developer? Do you anticipate any subrogation actions?

c) Counsel: New considerations

(1) Do not just look at your client's exposure and stop your analysis

(a) Look at the parties participating in the litigation

(b) Identify the defense fee situation early / Does your client have an accepted AI?

(c) Find out early if your client has any coverage issues.

(2) Keep in mind your carrier needs an early evaluation of the participation status of other parties.

(3) Put together strategies early in litigation:

(a) Discuss the claims against your client with Plaintiffs early to identify and set expectations regarding settlement value.

(b) Inform the mediator regarding coverage issues for your client in addition to discussing liability issues.

(c) Request early mediator's proposals to further set Plaintiffs' expectations and, hopefully, obtain early resolution.

(d) Remember to work with your carriers to obtain reasonable early settlement authority to enable early substantive settlement discussions.

II. There are No More "Big Players" – Litigation Strategies

A. Oops! The Developer is Not in this One???

1. When the Developer is missing from the litigation for whatever reason, the case typically flounders. Everyone is waiting for the Developer, who is not even there, to take the lead.
2. The Defense Needs to Meet and Confer to Determine Who Will Take the Lead or Alternative Strategies

a) Counsel should make sure the carrier knows the biggest party is out. This sets the stage for discussing sharing of defense responsibilities and costs.

(1) Carriers – If there is no Cross-Complaint in the case or the Cross-Complaint filed was filed by a non-CD Developer firm – red flag.

b) Look at the "biggest" parties in the case or the parties with the "biggest" exposure to lead the defense.

3. Get a Discovery Referee / Mediator on board early, participating with the "Defense Leadership"
4. Look at Availability of Documents

5. Share Certain Costs if Necessary to Move the Case Along

    a) All the carriers on the subcontractor side want to keep the costs down. Retention of a discovery referee / mediator, however, are essential to positioning the case for resolution. Sharing costs minimizes the exposure of any one party to these expenses.

    b) Further, taking depositions is more likely to happen efficiently if there is a prior agreement regarding how the costs will be shared.

6. Don't forget, we have to all work together since most of us are peripheral parties.

B. Developer is in the Game, But Not Participating

1. The Defense Needs to Determine Who Will Take the Lead or Alternative Strategies
2. Much like the handling of a case where there is no Developer, except a CMO will be in place. One or more subcontractor, however, will need to ensure Plaintiffs' and Developer's compliance with the same.

    a) Consider requesting opportunity for parties to petition the Court to be identified formally as "peripheral parties," including identification of exceptions to CMO for the same.

3. Identify Relevant Discovery that Needs to be Completed, such as *Crawford*

C. Larger Subcontractors Are Out (Defunct And/Or No Insurance)

1. Identify this as an issue prior to mediations and large expenditure of Developer defense fees as it will ultimately control resolution.

    a) Adjusters and Counsel – communicate with each other regarding the number of other subcontractors in the case and who they are.

2. At mediation, defense counsel should obtain information regarding missing trades, coverage issues faced by large trades and/or the Developer, accepted AIs, and defense fees incurred / not paid.

    a) Mediators:

        (1) Consider early mediator's proposals.

        (2) Where settlements are achieved, consider sending congratulatory correspondence to those parties (cc'ing all counsel) as motivation to other parties to resolve.

3. Perform discovery as to *Crawford* allocations, defect and cost of repair allocations.
4. Identify relevant discovery to be completed and possible expert meetings to discuss actual claims and expectations
5. More motion practice?

    a) Dispositive motions re Statute of Limitations or other SB800 defenses for small parties?

    b) Early discussions in status conferences regarding pre-trial motions or motions which may ultimately impact settlement valuations.

D. *Crawford* / Defense Fee Arguments by Developers

1. Defense fee issues have elevated the exposure of ALL subcontractors. This is compounded when the subcontractors with the most obvious "indemnity" exposure are not participating.
    a) All parties need to consider this issue in evaluating the value of a case.
2. *Crawford* versus AI? Are they separate and distinct obligations?
    a) This discussion comes down to Damages - There is no cause of action for breach of the duty to defend if there are no damages.
3. Get *Crawford* discovery started early
    a) Counsel / carriers should have a clear understanding of how much Developer's defense fees are to date and who is paying those fees.
    b) Early in the litigation, the parties should investigate the manner of allocation of defense fees and evaluate the party's potential exposure based upon multiple considerations:
        (1) Number of Parties in the case;
        (2) Scope of work of party;
        (3) Potential allocation of damages to the party; and
        (4) Whether related trades are participating in the litigation.
4. Standing
    a) Where an AI has paid defense fees, who owns the right to recover *Crawford*?
        (1) The AI carrier owns the right for recovery of *Crawford* fees, unless the Developer is "out of pocket."
        (2) Developer only has the right to recover defense fees paid pursuant to an AI where it has the permission of the AI carrier.
    b) Absent a written assignment of rights, Developer only has the right to recover "out of pocket" defense fees. See *Bramalea*

III. Settlement Strategies for the Peripheral Party Dominated Case

A. Reasonableness Rules the Day!

1. ALL parties need to be realistic in their expectations in these types of cases.
2. Parties should evaluate exposure based upon both liability and *Crawford* in identifying settlement value, particularly in light of a lack of sources to fund global settlements.

B. To Minimize Exposure as Much as Possible, Consider the Following:

1. The Empty Chair Defense
    a) Who is responsible for settlement gaps posed by missing trades?
    b) Who is responsible for *Crawford* with respect to missing trades?

c) How is *Crawford* allocated?

(1) Joint and Several?

(2) Pro Rata?

(3) Relevant Allocations / Per Cost of Repair?

(4) Other Methods?

2. Resolution with Plaintiffs Prior to Discussing with Developer

a) Most indemnity provisions require subcontractors to defend and indemnify Developer.

(1) If a subcontractor settles with Plaintiffs and obtains a scope of work release for itself and Developer, subcontractor has indemnified Developer as to those claims.

(2) Does this cut off the duty to defend as well?

3. Do Not Be Afraid of the "T" Word ("Trial")

a) "Going to Trial" is one of the biggest pieces of leverage employed by Plaintiffs and Developer to drive up settlement value.

b) If you are ready for trial, this is no longer leverage.

Sample Peripheral Party CMO Language

10. PETITION FOR PERIPHERAL PARTY STATUS

Following the Publication of Plaintiffs' Preliminary Defect List and Cost of Repair Estimate, any party may petition the Mediator for peripheral party status. Such petition shall be served on all parties.

All parties shall have fifteen (15) days from service of any such petition to object. If no such objection is received, the mediator shall conduct a hearing to review the merits of the petition and any objection before publishing a finding as to whether such party should be designated a peripheral party.

11. DESIGNATION AS A PERIPHERAL PARTY

A peripheral party is a party who has an exposure at trial based on Plaintiffs' cost of repair of less than $10,000.00. A party once so designated can, at its sole discretion, determine which one or more mediation sessions referenced and other meetings referenced herein would be productive for it to attend and notify the Mediator. Peripheral parties shall not share in the cost of any mediation that they do not participate in and discovery shall be limited to depositing pertinent non-privileged documents.

Attendance at Mandatory Settlement Conference(s) ("MSC") referenced herein is not discretionary for peripheral parties if at the time of said MSC takes place the peripheral party has not yet offered a sum in settlement acceptable to either Plaintiffs or other Cross-Defendants. "Acceptable" does not mean that the claims against the peripheral party must be fully resolved prior to the MSC. The Mediator shall determine if a peripheral party's participation in an MSC is required.

Section 22.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

Grand Ballroom

Friday, May 18th 2018
12:00 PM – 1:00 PM

Course Title:
Real World Solutions to the Real Problems Presented By Wrap Up Programs

Robert Closson, Esq., Bruce Wick, Keith Koeller, Esq. and Brian Chien, Esq.

Section 23.

West Coast Casualty's
Construction Defect Seminar
May 16th, 17th and 18th, 2018

North Ballroom

Friday, May 18th 2018
12:00 PM – 1:00 PM

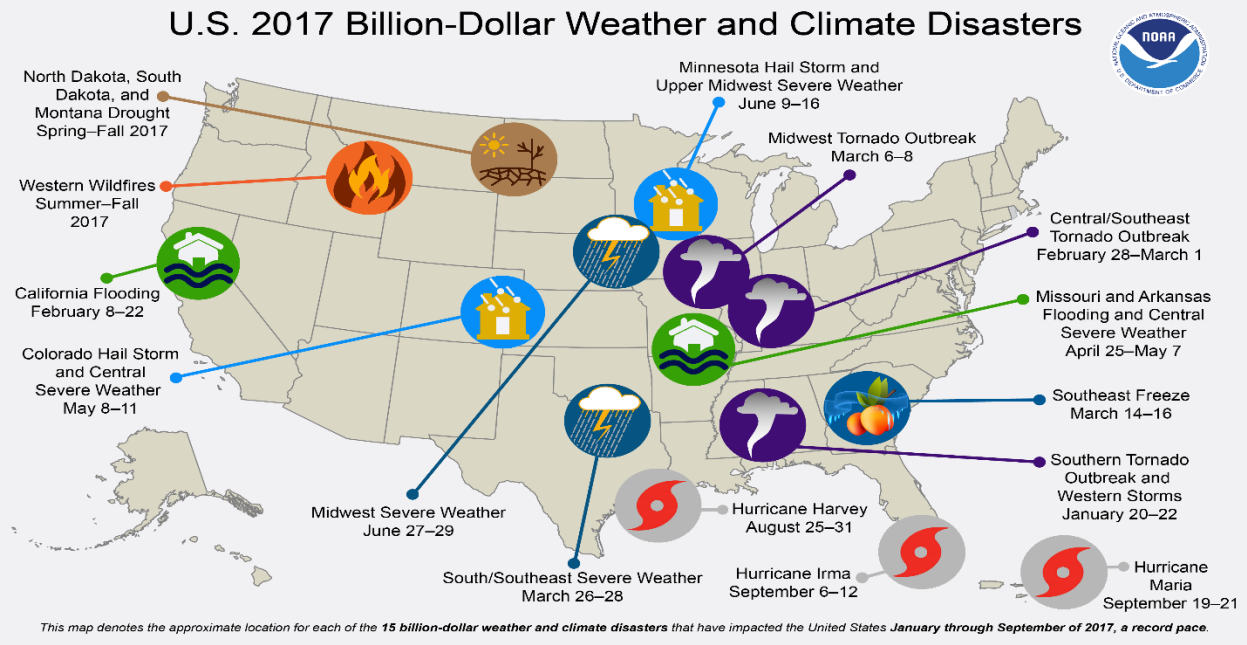
Course Title:
When Mother Nature Attacks, Are you Covered?

Robert Carlson, Esq., William Noonan, Diane Kelly and John Lupfer, Esq.

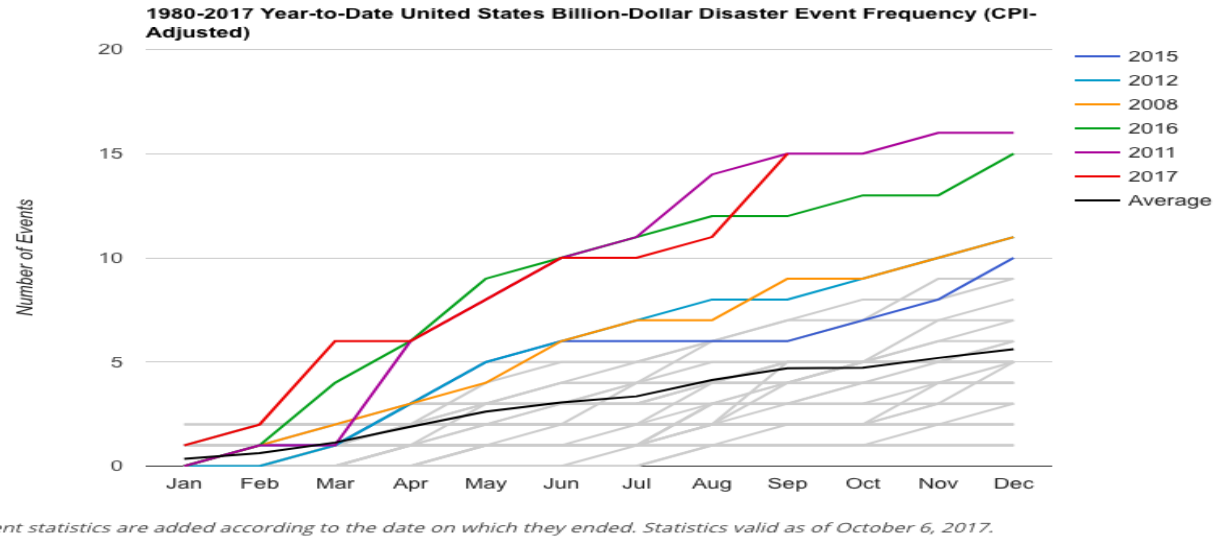
When Mother Nature Attacks, Are You Covered

The purpose of this panel is to discuss the issues impacting the construction and insurance industry relative to natural disasters. Our panel is comprised of industry leaders in the construction, insurance procurement, insurance adjustment and litigation areas who will be discussing their unique prospective on these risks and how they address them in their professional practices.

By way of context, in 2017, the United States suffered close to $400 Billion in damages.



Unfortunately, this has been an upward trend with no signs of a decrease on the horizon.



As to the specific impacts that these natural disasters have on the construction industry, they are experienced by way of: expensive preparation costs, large deductibles, damages to completed and uncompleted work, disruption of the construction schedules, increases in soft costs and labor shortages.

Aside from the impacts on ongoing construction, these natural disasters are also causing an increase in insurance claims in both the first party property context, builder's risk, and construction defect claims. Given the amounts of exposure at issue and the inherent nature of construction, the long-term impacts of the 2017 season will be felt for years to come. For instance, due to the large deductibles associated with builder's risk claims (or even the lack of such coverages) we are seeing property claims recast as construction defect claims. Further, the repairs associated with hurricane damage (or lack thereof) and the potential for subrogation actions will cause these claims to continue well into the future.

By way of risk mitigation, there are a number of products on the market that come into play and potentially overlap. These include flood and property insurance, builders risk policies, subcontractor default insurance, and general liability coverages. Each over discrete exposures which are typical in a natural disaster type of loss and each have their own benefits and drawbacks.