Calif. Justices Set To Tackle Key Liability Insurance Query

Law360

California's high court will hear arguments Tuesday in a builder's lawsuit over its insurer's refusal to cover allegations that it negligently failed to supervise a former employee who sexually assaulted a middle school student, a case that raises the broader question of whether liability coverage applies to the unexpected consequences of intentional conduct.

Here, Law360 reviews the history of the case in advance of the hearing.

What's at Stake

The case came before the California Supreme Court via a certified question from the Ninth Circuit in Ledesma & Meyer Construction Co. Inc.'s insurance dispute with Liberty Surplus Insurance Corp.

L&M has taken the position that its negligent failure to properly vet or monitor former employee Darold Hecht, who sexually assaulted a student at a middle school where the company was working, is an accident because it didn't anticipate that Hecht would commit the crime when it hired him. In denying coverage to L&M, though, Liberty has argued that the analysis must focus on Hecht's intentional criminal conduct, which is uninsurable under a California law known as Section 533.

While L&M's appeal involves a specific set of facts, the case raises broader questions about what types of events constitute an "occurrence," or accident, that qualifies for general liability insurance coverage in California.

"I think the fundamental question as to whether there is an occurrence — defined as an accident — is of paramount significance in insurance coverage law," said Caroline Ford, counsel in the Orange County, California, office of Haynes & Boone LLP, who is not involved in the case. "The Ninth Circuit recognized

the importance of that concept, and the need for it to be well-defined by the California Supreme Court."

The potential importance of the California high court's ruling has not gone unnoticed — the case has attracted a slew of amicus briefs in support of both L&M and Liberty.

In the construction company's corner are the National Center for Victims of Crime and policyholder advocacy group United Policyholders, as well as a number of public entities and faith-based organizations that are vulnerable to negligence-based liability claims stemming from employees' alleged sexual misconduct, including the Los Angeles Unified School District and several Christian associations.

UP warned that a ruling adopting Liberty's stance would extend beyond the type of scenario presented in L&M's case and eliminate insurance coverage for the accidental consequences "of a host of intentional acts." For instance, under Liberty's position, a person who intentionally swings a golf club but accidentally hits someone standing in the vicinity would not be covered for any claims resulting from the bystander's injuries, the nonprofit argued.

"That has never been the rule in California, and this court should reject Liberty's attempt to rewrite the [commercial general liability] policies that Liberty and scores of other insurers have sold to California businesses and individual consumers," UP contended in its brief.

Meanwhile, the American Insurance Association and Complex Insurance Claims Litigation Association have thrown their support behind Liberty, asserting that a ruling in L&M's favor would essentially reward companies that don't adequately screen and supervise workers.

"Employers should not be rewarded for keeping their heads in the sand, especially for such egregious conduct," the insurance groups argued in their brief. "Finding no applicable insurance coverage will encourage employers to be vigilant and to incur the costs of undertaking adequate supervision or running thorough background checks."

How We Got Here

In April 2002, L&M contracted with the San Bernardino County Unified School District to complete work on Cesar E. Chavez Middle School.

Allegations later arose that Hecht, one of L&M's project assistants and a registered sex offender, sexually abused a 13-year-old student at the school during the course of the project. Hecht was later convicted of molesting the girl and sentenced to 24 years in prison, and the victim filed numerous claims, including negligent hiring and supervision, against both the school district and construction firm in 2010, according to court records. She ultimately prevailed on the claims against L&M, court papers show.

Liberty had issued L&M a commercial general liability policy for the relevant time period and agreed to take up the construction company's defense, but denied a defense to the school district on the grounds it wasn't covered under the policy, forcing L&M to pay the school's defense costs on its own.

The insurer then followed up with a suit seeking a declaration that it wasn't obligated to defend or indemnify either L&M or the school district in the victim's underlying action, while the construction company hit back with its own breach of contract counterclaim.

In 2014, a California district court granted summary judgment in favor of Liberty, finding that "L&M's negligent hiring, retention and supervision of" Hecht was "too attenuated from the injury-causing conduct" to constitute an occurrence.

The construction company appealed, and in August 2016 a Ninth Circuit panel determined that the question of whether claims of negligence in hiring, retaining and supervising an employee who commits sexual abuse fall within the policy's coverage for an occurrence had never before been looked at by a California court, so the state's Supreme Court should weigh in.

L&M's Stance

In briefs filed with the California Supreme Court, L&M argued that a string of state high court precedent has established that, as long as the harm resulting from an employer's deliberate conduct was unexpected or unforeseen, that conduct qualifies as an accidental occurrence under a CGL policy.

The construction company further contended that an insured's actions need only be a "substantial factor" in causing an injury, not the direct cause, to implicate liability coverage. Indeed, to prevail on her negligent hiring and supervision claims, Hecht's victim merely had to show that L&M's negligence was a substantial factor in causing her harm, according to the company's brief.

Liberty could also have placed an exclusion in its policy for claims tied to negligent management of employees, but chose not to do so, L&M noted.

“Had [Liberty] done so, L&M would have been put on clear notice when it purchased the policy that it had no protection for liability resulting from its negligent hiring, retention or supervision of its employees,” L&M said. “It could have either knowingly foregone such coverage or gone into the market to buy additional protection.”

Liberty’s Stance

Liberty countered that L&M is mistaken about the proper focus of the occurrence analysis under California law. A court must look not to the source of the policyholder’s liability, such as a negligent hiring claim, but rather to the actual cause of the injury, the insurer contended.

“If the cause of the ‘bodily injury’ is not accidental, the ‘insuring agreement’ is not satisfied and coverage is not implicated,” Liberty argued. “This is true even if there are remote, antecedent events that are alleged to have invited the cause of the ‘bodily injury.'”

Applying that principle here, the middle school student’s injury was caused by Hecht’s intentional sexual abuse, not L&M’s alleged negligent hiring or supervision of its former employee, Liberty said.

“Without making the argument explicit, L&M suggests that an employer’s vicarious liability for an employee’s intentional tort should be considered the accident for the purposes of liability coverage,” the insurer argued. “However, where an intentional act is the immediate cause of the injury, the mere fact that the insured’s liability is vicarious does not mean the injury is caused by an ‘occurrence.'”

Counsel

L&M is represented by Michael J. Bidart, Ricardo Echeverria and Steven Schuetze of Shernoff Bidart Echeverria Bentley LLP and Jeffrey Isaac Ehrlich of Ehrlich Law Firm.

Liberty is represented by Patrick Fredette and Christopher Ryan of McCormick Barstow Sheppard Wayte & Carruth LLP.

The case is Liberty Surplus Insurance Corp., et al. v. Ledesma and Meyer Construction, et al., case number S236765, in the California Supreme Court.

–Editing by Rebecca Flanagan and Kelly Duncan.