A104076 and A104077

COURT OF APPEAL OF THE STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT-DIVISION THREE

INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA,

Plaintiff,

v.

GOLDEN EAGLE INSURANCE COMPANY, a California corporation,

Defendant and Respondent.

OSC PROCEEDINGS REGARDING THE CLAIMS OF PAULI SYSTEMS, INC.

Claimant/Appellant

Appeal from An Order Denying Application for Order to Show Cause
San Francisco County Superior Court No. 984502; OSC Nos. 638 and 647
The Honorable Alex Saldamando

APPLICATION OF UNITED POLICYHOLDERS TO FILE BRIEF AS AMICUS CURIAE IN SUPPORT OF CLAIMANT/APPELLANT PAULI SYSTEMS, INC.

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Comes now the applicant UNITED POLICYHOLDERS and respectfully requests that this court grant it permission to file a brief as amicus curiae in the above captioned action on behalf of claimant and appellant PAULI SYSTEMS, INC. United Policyholders is incorporated as a not-for-profit educational organization and was granted tax-exempt status under §501(c)(3) of the Internal Revenue Code. United Policyholders' mission is to educate the public on insurance issues and consumer rights. United Policyholders provides educational materials, provides speakers at community and government forums, organizes meetings in disaster areas, and acts as a clearinghouse for information on insurance issues.

United Policyholders also provides assistance in large catastrophes. For example, after a disastrous firestorm in 1991 that destroyed over three thousand structures in Oakland and Berkeley Hills, California, United Policyholders sponsored meetings, workshops, and seminars for the victims, and worked with local officials, insurance companies and relief agencies to facilitate claim settlements. United Policyholders has repeated this process in Florida for victims of Hurricane Andrew, in Texas, for victims of the Northridge Earthquake, and for Northern California victims of a wildfire.

United Policyholders also files amicus curiae briefs in insurance coverage cases of public importance. United Policyholders' amicus curiae briefs have been accepted by courts throughout the country. See, e.g., Humana, Inc. v. Forsyth, 525 U.S. 299, 313-14 (1999) (citing to pages 19-23 of Brief for United Policyholders as Amicus Curiae); Vandenberg v. Superior Court, 21 Cal. 4th 815, 88 Cal. Rptr. 2d 366 (Cal. 1999).

United Policyholders' activities are limited only to the extent that United Policyholders exists exclusively on donated labor and contributions of services and funds. This brief has been prepared *pro bono* by United Policyholders' counsel with no contributions from any source.

United Policyholders has a vital interest in seeing that insurance companies do not attempt to shift risk assumed in insurance policies back to their policyholders through allocation schemes unsupported by insurance policies or public policy. United Policyholders has an interest in ensuring that insurance companies live up to their promises to their policyholders.

The issues addressed in the accompanying proposed brief will affect policyholders throughout the State of California and nationwide. United Policyholders seeks to appear as amicus curiae to address certain questions of law presented by this appeal that are of significance well beyond the application of law to the specific facts of this case. Specifically, the brief of United Policyholders addresses the issue of the reasonable expectations of the parties to the insurance contracts.

The proposed brief accompanies this application.

Dated: November 4, 2004

Respectfully submitted,

STANZLER FUNDERBURK & CASTELLON LLP

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INTRODUCTION

The complaints in the underlying cases allege that the defendants are liable for having supplied sand, silica-containing abrasives, and other silica-containing products. (CT:25-26; 201-202). The defendants are also sued for marketing, manufacturing and distributing these products. (CT:24, ¶9, 199, ¶ 9). The complaints also allege, for example, that defendants sold defective masks and respirators which were not approved for blasting operations with silica-containing products (CT 27, ¶27; 202, ¶27). The complaints also allege that defendants failed to develop "silica-free products" (CT 33, ¶66; 208, ¶66) and failed to test their products adequately (CT 33, ¶65; 208, ¶65). The complaints thus allege that the defendants sold defective products. The liability policies at issue provide coverage for injuries resulting from the sale and distribution of products. Thus, there is a duty to defend these allegations. The insurance companies argument that sand is a "pollutant" defies logic and common sense but also must be rejected for another reason: if sand is a pollutant, excluded by the pollution exclusion, then the insurance policy is illusory. It provides no products liability coverage. The insurance company collected a premium but provided no coverage for what every manufacturer expects the policy will cover - claims arising out of the sale of products.

Ritchie v. Anchor Casualty Co., 135 Cal. App. 2d 245 (1955) is directly on point. The policyholder was in the business of selling refined peanut oil and purchased a comprehensive liability policy with an endorsement for damages caused by its products. The insurance company later refused to defend a lawsuit brought by the purchaser of peanut oil , who claimed that the peanut oil had become rancid and had contaminated corn chips which were made from the peanut oil. The insurance company

argued that the complaint had not alleged an "accident" and had not alleged a liability imposed "by law" but a liability imposed by breach of contract. In rejecting these arguments, the court emphasized that the purchaser of insurance would normally expect coverage for the ordinary operations of this business:

> The courts will not sanction a construction of the insurer's language that will defeat the very purpose or object of the insurance [citations omitted]. When American Nut Company bought a property damage endorsement to protect against accidents growing out of the handling or use of its products or any condition in products manufactured, sold, handled or distributed by it, a reasonable expectation would be protection against the type of liability which would ordinarily grow out of its kind of business. ...The insurer is presumed to have known of the nature of the applicant's business and that it was one in which accidents might occur, not through explosion or violence of any kind but through an unwholesome condition in a food product such as peanut oil. ...Normally a businessman who takes "comprehensive" insurance with express coverage of "products property damage" would expect his ordinary transactions to be covered. If the insurer would create an exception to the general import of the principal coverage clauses, the burden rests upon it to phrase the exception in clear and unmistakable language [citation omitted]. *Id.* at 257-258.

These concepts have been applied by courts throughout the country. In *In re Hub Recycling, Inc.* 106 B. R. 372 (D. N. J. 1989) for example, the insurance company insured a policyholder in the recycling business, yet claimed that the cleanup of recycled materials was barred by the so-called "absolute pollution exclusion". Hub Recycling was in the business of recycling construction debris, brick, wood, glass, and aluminum. It was sued by the adjacent property owner who claimed that Hub Recycling was trespassing and dumping on its land. The insurance company refused to

defend, claiming that its policy did not provide coverage for the release of "pollutants", which were defined to include "contaminants and irritants". The court rejected the insurance company's argument that recycled materials could be considered "irritants and contaminants":

> To accept California Union's all encompassing definition is to assume that Hub paid for a comprehensive policy that provided almost no coverage. Such an interpretation is contrary to the expectations of the insured [citations omitted]. The insurer had clear notice that Hub was engaged in the business of recycling....Given the insured's knowledge of the nature of Hub's business and the clear purpose of Hub to purchase protection from liability, California Union had reason to know of Hub's more limited understanding of the policy's meaning...
> The evidence available to the court strongly suggests that at least some, if not most, of the materials were not inherently dangerous in the sense of an irritant or contaminant and thus not subject to the policy's exclusion". Id. at 375 -376 (footnote omitted).

The court cited with approval *Molton v. Allen & William v. St. Paul Fire & Marine Ins.*, 347 So. 2d 95 (Ala. 1977), in which the Supreme Court of Alabama ruled that sand and mud were not pollutants excluded by the pollution exclusion. Adjacent landowners filed a lawsuit against a real estate developer, claiming that the developer had negligently caused sand and dirt to pass from construction activities onto neighboring property. The policyholder argued that the pollution exclusion was intended to apply to industrial polluters and did not apply to sand or mud. The court held that "[w]e do not believe that the insured would reasonably expect that the alleged damage caused by its construction activity would be included in the descriptions set forth in the 'pollution exclusion' clause. *Id.* at 99.

Courts in other jurisdictions have ruled that coverage is "illusory" where the so-called "absolute pollution exclusion" is used to deny coverage

for products that are alleged to cause pollution, since that interpretation would deny virtually all coverage to the insured. In *American States Ins. Co. v. Kiger*, 662 N.E. 2d 945 (Ind. 1996), for example, the insurance company insured a gas ststaion, but argued that there was no coverage for its product - gasoline - that leaked from the station.

> We begin by noting the oddity in American States' position. That an insurance company would sell a "garage policy" to a gas station when the policy specifically excluded the major source of potential liability is, to say the least, strange. *Id.* at 948.

The court went on to explain its interpretation of the pollution exclusion.

> Clearly, this clause cannot be read literally as it would negate virtually all coverage. For example, if a visitor slips on a grease spill then, since grease is a "chemical', there would be no insurance coverage. ...We are particularly troubled by the interpretation offered by American States, as it makes it appear that Kiger was sold a policy that provided no coverage for a large segment of the gas station's business operations. *Id.* at 948-949

The court held that because the term "pollutant" did not obviously include gasoline, the provision was ambiguous.

In *Great Lakes Chem Corp. v. International Surplus Lines Ins. Co.*, 638 N.E. 2d 847 (Ind. App. 1994) the court recognized the conflict between providing product liability insurance and the attempt to exclude such coverage under the pollution exclusion. Great Lakes manufactured pesticide products containing ethylene dibromide (EDB), which allegedly contaminated the groundwater. The insurance company denied coverage, arguing that EDB was a pollutant and that coverage was precluded by the pollution exclusion. The court disagreed:

> Great Lakes, like most manufacturers, purchased liability

> insurance to protect itself from damage caused by its products. Here, because of the nature of the product and its intended use, the damage caused by EDB was environmental pollution. However, simply because the damage alleged in the underlying lawsuits is environmental damage does not mean that the pollution exclusion clauses should automatically apply to exclude coverage...To hold that the pollution exclusion clauses bar coverage to Great Lakes for the EDB claims would render the insurance coverage purchased by Great Lakes illusory. We hold that under the facts of this case, the EDB claims against Great Lakes are not excluded by the policies' pollution exclusion. *Id.* at 851.

These principles were applied in *Monticello Ins. Co. v. Mike's Speedway Lounge, Inc.*, 949 F. Supp. 694 (S.D. Ind. 1996) where the insurance company sold a general liability policy with an "absolute liquor exclusion" to a tavern. The court found that coverage was illusory:

> The policy on its face purports to provide commercial liability coverage for a tavern, yet also purports to exclude from coverage any personal injury and property damage claims "connected with" the selling, distributing, manufacturing or furnishing of alcoholic beverages.

Id. at 704.

The Court went on to rule that:

> Indiana courts have also held that insurance policies providing illusory coverage violate public policy. An insurance policy provides illusory coverage when "a premium was paid for coverage which would not pay benefits under any reasonably expected set of circumstances." [citation omitted]. *Id.*, at 99.

The court also noted that

> an insurer cannot avoid an illusory coverage problem by simply conceiving of a single hypothetical situation to which coverage would apply. ...illusory coverage is a matter of degree, not absolutes.

Id. at 70.

The Court concluded:

> Monticello issued a commercial liability policy to a tavern and incorporated an exclusion from coverage that would apply to virtually any claim the insured might reasonably be expected to file. Under these circumstances, the prospects for coverage are "sufficiently remote" that the liability coverage must be deemed illusory.

Id. at 702.

CONCLUSION

These principles apply here. The insurance companies cannot, on one hand, sell liability insurance to the companies that sell sand; or companies that make respirators that protect against sand; and then, on the other hand, say that there is no coverage for any claims involving sand! That is providing "illusory coverage." That is cheating the policyholder.

Dated: November 3, 2004

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to California Rules of Court, Rule 14(c)(1), I certify that this amicus brief is proportionately spaced and is prepared in "Times New Roman" 13 point font. The brief contains _____ words.

Dated: November 3, 2004

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