December 16, 2006

The Honorable Chief Justice Ronald M. George
And the Honorable Associate Justices
Of the California Supreme Court
350 McAllister Street
San Francisco, CA 94102

Re: United Policyholder's and California Mortgage Association's Request for Depublication of *Medill v. Westport Insurance Company (October 4, 2006) 143 Cal. App. 4th 819, 2006 Cal.App. LEXIS 1537*
Second District Case No.s: B17007 & B182442

Dear Hon. Chief Justice Ronald M. George and the Associate Justices of the California Supreme Court:

Our firm represents United Policyholders (UP) and California Mortgage Association (CMA), who request this Court to depublish the case of *Medill v. Westport Insurance Company* (October 4, 2006) 143 Cal. App. 4th 819, 2006 Cal.App. LEXIS 1537, pursuant to Rule 979 of the California Rules of Court. In the *Medill* opinion, the Second District Court of Appeals abandons long standing precedent that an insurer has the burden of proof to establish that an exclusion in its policy defeats coverage. Instead, the Court of Appeal shifted the burden of proof to the policyholder to negate the application of an exclusion to a potentially covered claim, simply because the exclusion was contained in the definitions section of the policy. A copy of the *Medill* case is attached.

The decision would also discourage anyone from volunteering to be on a Board of Directors for a nonprofit organization, such as the one involved in the *Medill* case, which operated and renovated health care facilities for the elderly and Alzheimer's patients. The Court of Appeal broadly construed a breach of contract exclusion to hold that volunteer directors would not be afforded a defense for claims of breach of fiduciary duty, for the business decisions of the volunteer Board.

UP was founded in 1991 as a non-profit organization dedicated to educating the public on insurance issues and consumer rights. The organization is tax-exempt under Internal Revenue Code '501(c)(3). UP is funded by donations and grants from individuals, businesses, and foundations. UP serves as a resource for insurance claimants and actively monitors legal and marketplace developments affecting the interests of all policyholders. UP receives frequent invitations to testify at legislative and other public hearings, and to participate in regulatory proceedings on rate and policy issues.

A diverse range of policyholders throughout the United States communicate on a regular basis with UP, which allows it to provide important and topical information to courts throughout the country via the submission of amicus curiae briefs in cases involving insurance principles that are likely to impact large segments of the public and business community. UP's amicus brief was cited in the U.S. Supreme Court's opinion in *Humana v. Forsyth* (1999) 525 U.S. 299, 314, 119 S.Ct. 710, and its arguments were adopted by the California Supreme Court in *Vandenberg v. Superior Court* (1999) 21 Cal.4th 815. UP has filed amicus briefs on behalf of policyholders in over one hundred cases throughout the United States.

The California Mortgage Association ("CMA") is an association of primarily licensed real estate brokers (acting as mortgage brokers in making or arranging real property secured loans) and consumer finance lenders who make loans. CMA members originate, arrange and service loans in California and are policyholders under various policies of insurance including commercial general liability, errors and omissions and director's and officers policies.

UP and CMA strongly urge depublication of the recent opinion in *Medill v. Westport Insurance Corporation* (October 4, 2006) 143 Cal. App. 4th 819, 2006 Cal.App. LEXIS 1537, which would discourage anyone from volunteering to be a member of the Board of Directors of a nonprofit corporation and abandons long set precedent in this State that an insurer bears the burden of proof to establish that an exclusion and the facts upon which it is relying upon to deny a defense to its insureds, conclusively precludes the potential for coverage.

In the *Medill* case, the Second District Court of Appeal held that uncompensated volunteer directors of a nonprofit organization, which operated and renovated healthcare facilities for the elderly and Alzheimer's patients, were not entitled to a defense under their director's and officer's coverage in an action brought by bondholders. (*Medill v. Westport Insurance Corporation* (October 4, 2006) 2006 Cal.App. LEXIS 1537.) Bondholders sued the organization's directors for "breach of their fiduciary duties" and "negligence", arising from the alleged "wrongful disbursements" and "commingling" of bond funds resulting in the facilities securing the bonds to go into receivership. (*Medill*, supra at *4.) In reaching its conclusion that the directors' D & O carrier owed no duty to defend, the Court of Appeal held contrary to the long standing precedent in California, that the insureds had the burden of proof to negate

application of a breach of contract exclusion in the policy.

The law in California has always been that if an insurer is relying upon an exclusion to deny coverage, the burden of proof is on the insurer to establish that its exclusion applies to defeat coverage. (*Garvey v. State Farm* (1989) 48 Cal.3d 395, 406; *Ins. Co. of North America v. Sam Harris Const*. (1978) 22 Cal.3d 408, 412-413.) "Any ambiguity in an exclusionary clause will be strictly construed against the insurer, and any reasonable doubts as to uncertain language must be resolved in favor of the insured." (*Crane v. State Farm* (1971) 5 Cal.3d 112, 115.)

In the *Medill* case, the insurer's policy broadly covered any ""loss' the 'insured' was legally obligated to pay resulting from civil 'claims' that are made against the 'insured' because of 'wrongful act'…." (*Medill*, supra at *9.) However, an exclusion was contained within the definition sections of the policy for the term "loss". The exclusion precluded coverage for "damages arising out of breach of any contract". (Id at *9-*10.) Generally, exceptions for coverage for breach of contract damages in D & O policies are contained in the exclusion section, as opposed to the definition section of a D & O policy. (See e.g. *Church Mutual Insurance Company v. United States Liability Insurance Company*, 347 F. Supp.2d 880 (S.D. Cal., 2004). However, the Second District Court of Appeal held that because the breach of contract exclusion was contained in the definitions section of the policy, which was incorporated into the insuring clause, the insured directors had the burden of proof to negate application of the exclusion. (*Medill* supra at *17.) This is contrary to prior California precedent and conflicts with a number of earlier appellate decisions. (See *Garvey v. State Farm* (1989) 48 Cal.3d 395, 406; *Ins. Co. of North Amerisca v. Sam Harris Const*. (1978) 22 Cal.3d 408, 412-413.)

Simply because an insurer places an exclusion to coverage in the definitions section of the policy, should not shift the burden of proof to the policyholder. As previously held by this Court, "it is the function served by policy language, not the location of language in an insurance policy, that is determinative." *(Aydin Corp. v. First State Ins. Co*. (1999) 18 Cal.4th 1183, 1191.

Recently this Supreme Court in *Haynes v. Farmers Ins. Exchange* (2004) 32 Cal.4th 1198 described an exception for coverage for permissive users, contained in the definition of "insured" of an auto policy, as an "exclusion" subject to the customary rules of policy interpretation. This Court held that it was the insurer's "burden" of making the coverage exception or limitation "conspicuous, plain and clear" in its policy. (Id at 1205.) Likewise, the fact that the D & O insurer in the *Medill* case placed its breach of contract exclusion in the definitions section of the policy, should not change the rules of policy interpretation, and shift the burden of proof to the policyholder to prove the exclusion does not apply.

Moreover, the appellate court so broadly construed the "arising from" breach of contract exclusion as to eviscerate coverage for policyholders with policies containing similar exclusions. In holding that a similar exclusion in a D & O policy did not preclude the insurer's duty to defend, director's sued for fraud. One federal court noted that if the "arising out of" breach of contract exclusion "is read literally and broadly", as the Second District Court of Appeal did in the *Medill* case, coverage would be excluded for "any claim connected in any way with a breach of contract, no matter how attenuated the connection." (*Church Mutual Ins. Co. v. United States Liability Ins. Co.*, 347 F.Supp.2d 880, 885.)

In the *Medill* case, the directors were not sued for breach of contract. They had no liability for breach of contract damages. They were sued for breach of fiduciary duties and other causes of action arising from their decisions and participation on the Board of Directors and allegations of mismanagement of the organization's funds, and the commingling of funds, which resulted in the security for the bonds to go into receivership. (*Medill*, supra at *4.) Simply because the claim remotely related to the corporation's breach of its bond obligations should not preclude the directors from coverage. The Court of Appeal made no analysis or consideration as to what was the proximate cause giving rise to the suit. In analyzing whether or not an exclusion applies to preclude coverage under a liability policy, courts look to the proximate cause giving rise to the alleged liability. (See *State Farm Mut. Auto. Ins. Co. v. Partridge* (1973) 10 Cal. 3d 94, 101.) And if liability arises from two concurrent causes, of which only one is excluded, the insurer still owes a duty to defend. (Id.) Here, at least one cause giving rise to the suit was the Board's alleged mismanagement of organization's funds and the commingling of the organization's funds.

The appellate court also did not analyze the nature claim under the standards set forth by the Supreme Court in *Vandenberg v. Superior Court* (1999) 21 Cal. 4th 815, in which the Supreme Court held that an action alleging breach of contract may give rise to a covered claim because, "[W]hether a particular claim falls within the coverage afforded by a liability policy is not affected by the form of the legal proceeding. Accordingly, the legal theory asserted by the claimant is immaterial to the determination of whether the risk is covered." (*Vandenberg* at 841.) Even if a breach of contract cause of action was alleged against the insured directors, as the nature of the claim was in tort arising out of mismanagement of the insured organization's funds, the breach of contract exclusion would not apply.

Under the Appellate Court's reasoning in the *Medill* case, no breach of fiduciary duty claim would ever be covered under a D & O policy. D & O insurers may next argue that officers and directors have an "implied" contract with their shareholders not to breach their fiduciary duties. The D & O policy at issue in the *Medill* case excluded claims arising from not only breach of written contracts but also implied contracts. Under the Second District Court of Appeal's reasoning, all claims against officers and directors would "arise" out of breach of an implied contract with shareholders to act in good faith, and therefore coverage would be precluded.

There must be some casual limitation on the exclusion or it would render D & O policies wholly illusory.

For the foregoing reasons, we urge this Court to depublish the above-entitled case pursuant to Rule 979 of the California Rules of Court.

Respectfully submitted,

ADLESON, HESS & KELLY, APC

By _____
RANDY M. HESS
DUANE W. SHEWAGA
Counsel for United Policyholders
and California Mortgage Association

DWS:dv

cc: See Attached Proof of Service

PROOF OF SERVICE OF RULE 14

United Policyholder's Request for Depublication of *Medill v. Westport Insurance Company (October 4, 2006) 143 Cal. App. 4th 819, 2006 Cal.App. LEXIS 1537*

I am employed in Santa Clara County, California. My business address is 577 Salmar Avenue, Second Floor, Campbell, California, 95008. I am over the age of 18 years and am not a party to this cause. I am readily familiar with the firm's practice for collection and processing of correspondence for mailing with the United States Postal Service. Such correspondence is deposited with the United States Postal Service the same day in the ordinary course of business.

On December 16, 2006, I served the foregoing Rule 14 Request for Depublication letter on the interested parties in this action by placing a true copy thereof enclosed in a sealed envelope addressed as follows and mailing it following ordinary business practices to:

Clerk for the Court of Appeal for the Second District
300 S. Spring St., Fl.2, N. Tower
Los Angeles, CA 90013-1213

See attached for additional parties.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on December 16, 2006.

_____
DEBORAH VAJRETTI

ATTACHMENT TO PROOF OF SERVICE

Attorneys for Evan Greenspan:
Marlene Diane Greenly
9454 Wilshire Boulevard, Suite 309
Beverly Hills, CA 90212

Attorneys for Westport Insurance Company:
Jennifer Mathis
Daniel C. Streeter
Ross, Dixon & Bell
5 Park Plaza, Suite 1200
Irvine, CA 92614

Lewis K. Loss
Thompson, Loss & Judge, LLP
1919 Pennsylvania Avenue, N.W.
Suite M200
Washington, DC 20006

Attorneys for Cary Medill:
Marlene Diane Greenly
9454 Wilshire Boulevard, Suite 600
Beverly Hills, CA 90212

Attorneys for Herbert T. Saltzman:
Arthur Charles Chambers
2095 Van Ness Avenue
San Francisco, CA 94109

Attorneys for Marshall Wexler:
Michael J. Schiff
Pastor, Schiff & Summers, LLP
16830 Ventura Blvd., Suite 345
Encino, CA 91436

Attorneys for Royal Indemnity Company:
Robert A. Wooten
Lewis D'Amato Brisbois & Bisgaard
221 North Figueroa Street, Suite 1200
Los Angeles, CA 90010

Attorneys for Virgil Lim:
Roman P. Mosqueda
3350 Wilshire Boulevard, Suite 735
Los Angeles, CA 90010

Attorneys for Heritage General Agency and World Wide Facilities, Inc.:
Antony Edward Buchignani
DLA Piper Rudnick Gray Cary
1999 Avenue of the Stars, 4th Floor
Los Angeles, CA 90067-6022

Attorneys for Jerold V. Goldstein; Clarke Underwood, Richard Kuhl:
William E. Crockett
Travis Robert Eagan
Dion-Kindem & Crockett
21271 Burbank Boulevard, Suite 100
Woodland Hills, CA 91367

Attorneys for Estate of Emery Rubin:
Fred A. Fenster
Rutter, Hobbs & Davidoff, Inc.
1901 Avenue of the Stars, 17th Floor
Los Angeles, CA 90067

Attorney for Larry Rubin:
David R. Schwarcz
Law Offices of David R. Schwarcz
11355 Olympic Boulevard, Suite 100
Los Angeles, CA 90064

Attorneys for Stephen Goodman:
Jeffrey D. Diamond
A Professional Corporation
21031 Ventura Boulevard, Suite 1200
Woodland Hills, CA 91364

Attorneys for Heritage Bond Class Action Plaintiffs:
Brian Barry
1801 Avenue of the Stars, Suite 307
Los Angeles, CA 90067

Peter Arthur Binkow
Law Offices of Lionel Z. Glancy
1801 Avenue of the Stars, Suite 311
Los Angeles, CA 90067