APPEAL NO. 10-11513-G

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UNITED STATES COURT OF APPEALS
ELEVENTH CIRCUIT

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SOUTHERN REALTY MANAGEMENT, INC. AND
DUNWOODY FOREST ASSOCIATES, LLC,
PLAINTIFFS / APPELLANTS,
V.
ASPEN SPECIALTY INSURANCE COMPANY AND
HOMELAND INSURANCE COMPANY OF NEW YORK
DEFENDANTS / APPELLEES.

APPEAL FROM SUMMARY JUDGMENT OF THE
UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF GEORGIA, ATLANTA DIVISION

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# BRIEF OF AMICUS CURIAE UNITED POLICYHOLDERS IN SUPPORT OF APPELLANTS SOUTHERN REALTY MANAGEMENT, INC., AND DUNWOODY FOREST ASSOCIATES, LLC

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## CORPORATE DISCLOSURE STATEMENT

Pursuant to Local Rule 26.1 of the United States Court of Appeals for the Eleventh Circuit, United Policyholders, Amicus Curiae herein, states that it is a tax-exempt, not-for-profit corporation organized under the laws of the State of California and funded by donations and grants.

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## STATEMENT OF IDENTITY, INTEREST, AND SOURCE OF AUTHORITY OF AMICUS CURIAE

United Policyholders is a non-profit corporation founded in 1991 to educate the public, the judiciary, and elected officials on insurance issues and the rights of policyholders. The organization is tax-exempt under §501(c)(3) of the Internal Revenue Code. United Policyholders is funded by donations and grants from individuals, businesses, and foundations and governed by an eight member Board of Directors. United Policyholders operates in Georgia and nationwide.

While much of its work is aimed at individuals and businesses affected by disasters, United Policyholders actively monitors legal and marketplace developments affecting the interests of all policyholders. United Policyholders publishes free-of-charge materials that give practical guidance on buying coverage and claim issues to property and business owners and advocates, disaster relief personnel, attorneys and adjusters at www.unitedpolicyholders.org. The organization also 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 personal and commercial line policyholders throughout the United States regularly communicate their insurance concerns to United Policyholders. In turn, the organization advances policyholders' interests in courts nationwide by filing amicus curiae briefs in cases involving important

insurance principles. United Policyholders advances the shared interest that commercial and personal lines policyholders have in equitable insurance practices. The organization's activities are supported by donated labor and contributions of services and funds.

United Policyholders has filed amicus curiae briefs on behalf of policyholders in more than 225 cases throughout the United States in the past six years. A significant number of those cases have been adjudicated in Georgia and other jurisdictions in the Eleventh Circuit.[1] United Policyholders has filed amicus curiae briefs in numerous cases before the United States Supreme Court.[2] The U.S.

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[1] See, e.g., Gilbert v. Alta Health & Life Ins. Co., 276 F.3d 1292 (11th Cir. (Ala.) 2001); Michael Penzer, etc. vs. Transportation Insurance Company, Case No. SC08-2068, Lower Court Case No.: 07-13827-FF (Fla. 2008); Aircraft Holdings, LLC v. XL Specialty Ins. Co., 935 So.2d 1219 (Fla. 2006); Allstate Indem. Co. v. Ruiz, 796 So.2d 535 (Fla. 2001); Nationwide Mut. Ins. Co. v. Chillura, 952 So.2d 547 (Fla. Ct. App. 2007); Nationwide Mut. Fire Ins. Co. v. Beville, 825 So.2d 999 (Fla. Ct. App. 2002); International Recovery Corp. v. National Union Fire Ins. Co., 668 So.2d 619 (Fla. Ct. App. 1996); SCI Liquidating Corp. v. Hartford Ins. Co., 272 Ga. 293, 526 S.E.2d 555 (Ga. 2000); Morrill v. Cotton States Mut. Ins. Co., 293 Ga. App. 259, 666 S.E.2d 582 (Ga. Ct. App. 2008); Hoffman v. Oxendine, 268 Ga.App. 316, 601 S.E.2d 813 (Ga. Ct. App. 2004).

[2] See, e.g., Philip Morris USA v. Mayola Williams, No. 05-1256, United States Supreme Court (2006); Aetna Health, Inc. v. Juan Davila, 524 U.S. 200 (2004); Continental Cas. Co. v. Superior Court (Paragon), No. 5101679, United States Supreme Court, Appellate Case #B147084 (2001); FL Aerospace v. Aetna Cas. & Sur. Co., No. 90-289, United States Supreme Court (Sept. 13, 1990); Fuller-Austin Insulation Co., f/b/o Fuller-Austin Asbestos Settlement Trust v. Highlands Insurance Company, No. 06-94, United States Supreme Court (2005).

Supreme Court cited United Policyholders' amicus curiae brief in Humana, Inc. v. Forsyth, 525 U.S. 299 (1999). United Policyholders was the only national consumer organization to submit an amicus curiae brief in the landmark case of State Farm v. Campbell, 538 U.S. 408 (2003).

United Policyholders has a vital interest in ensuring that insurance companies fulfill the promises they make to their policyholders. While insurance companies are in business to earn profit through risk assumption, businesses and individuals rely on insurance to protect property and livelihoods. United Policyholders seeks to prevent insurance companies from shifting risk back to policyholders through schemes that are not authorized by insurance contracts or public policy. The organization works to counterbalance the widely-represented interests of insurance companies by serving as an advocate for large and small policyholders in forums throughout the country.

In the case at bar, United Policyholders seeks to appear as amicus curiae to address certain questions before the Court that are of significance well beyond the application of law to the specific facts of this litigation. These important issues will affect policyholders nationwide. It should be noted that no

party to this case has contributed directly or indirectly to the preparation of this brief.[3]

## ARGUMENT

### I. IN ORDER FOR A POLICYHOLDER'S BREACH TO BE MATERIAL, THE INSURANCE COMPANY MUST BE ACTUALLY HARMED BY THE BREACH.

An insurance company must meet a "heavy burden" of proof to establish that its policyholder has breached the policy's cooperation clause. 14 Couch on Ins. §199:23 (3d ed. 2009); Robert E. Keeton & Alan I. Widiss, Insurance Law, § 7.3(a) (1988). Georgia law does not use a "prejudice" standard; instead Georgia law requires that a breach voiding coverage be "material—not merely technical or inconsequential in nature." St. Paul Fire & Marine Ins. Co. v. Albany Emergency Ctr., Inc., 184 Ga. App. 469, 361 S.E.2d 687, 689 (Ga. Ct. App. 1987) (Carley, J., concurring) (citing H.Y. Akers & Sons v. St. Louis Fire & Marine, Ins. Co., 120 Ga. App. 800, 172 S.E.2d 355 (1969)). In its opinion in this case, the District Court stated that the Policyholders' breach of the cooperation clause was a material breach of contract, but the District Court did not detail what constitutes a material breach of an insurance contract aside from that "Georgia courts take 'a broad view of materiality.'" See Opinion and Order, dated Apr. 28,

[3] Anderson Kill's subsidiary, Anderson Kill Loss Advisors, has a relationship with several public loss adjusters. None of those adjusters are involved in this case.

2009, at 10-11 (citing Meyers v. State Farm, 801 F. Supp. 709 (N.D. Ga. 1992)). This Brief argues that, regardless of whether Georgia law requires an insurance company to prove that it was actually harmed by a policyholder's breach, basic tenets of Georgia contract law require that, in order for the policyholder's breach to be material, the insurance company must have been prejudiced by the breach. It follows that the District Court should have considered whether the insurance company defendants here have been actually harmed by the Policyholders' breach of the cooperation clause in order to determine whether that breach was material such that it could be the basis for voiding coverage under the policy at issue in this litigation.

### A. A Material Breach Goes To The Heart Of The Agreement.

Georgia courts hold that insurance policies are contracts and should be interpreted according to the rules of contract law. See Owners Ins. Co. v. James, 295 F. Supp.2d 1354, 1361 (N.D. Ga. 2003) ("Under Georgia law, contracts of insurance are interpreted by ordinary rules of contract construction.") (citing Boardman Petroleum, Inc. v. Federated Mut. Ins. Co., 269 Ga. 326, 327, 498 S.E.2d 492, 494 (1998)); Martin v. Cotton States Mut. Ins. Co., 210 Ga. App. 32, 435 S.E.2d 258 (Ga. Ct. App. 1993) (stating that "insurance is a matter of contract, and contract law rules and interpretations apply") (citing Rothell v. Continental Cas. Co., 198 Ga. App. 545, 402 S.E.2d 283 (1991)). Accordingly, an examination

of Georgia contract law is instructive in determining what constitutes a material breach of an insurance policy.

Georgia courts interpret a material breach of contract to be one that goes to the heart of the contract. That is, under Georgia law, "a material breach [of contract] only occurs when the failure to perform is so fundamental it goes to the root or essence of the contract and defeats its central purpose." See Clower v. Orthalliance, Inc., 337 F. Supp.2d 1322, 1333 (N.D. Ga. 2004) (citing Lager's LLC v. Palace Laundry, Inc., 247 Ga.App. 260, 263, 543 S.E.2d 773 (2000); 13 Williston on Contracts § 63.3 (4th ed. 2003)) (holding there was no material breach of contract because "the underlying purpose of the contract was not thwarted" and the non-breaching party still made a large profit from the contract). See also General Steel, Inc. v. Delta Bldg. Systems, Inc., 2009 WL 792908, at *3 (Ga. App. Ct. 2009) ("A breach which is incidental and subordinate to the main purpose of the contract does not warrant termination nor does a mere breach of contract not so substantial and fundamental as to defeat the object of the parties in making the agreement.") (internal citations and quotations omitted).

Indeed, Georgia contract law reveals that in order for a breach to be material it must prejudice the non-breaching party. See, e.g., General Steel, 2009 WL 792908. In General Steel, 2009 WL 792908, at *1, the Georgia Court of Appeals assessed a factual scenario analogous to the issue at hand in this case.

There, the court found that because there was no material breach of contract, the non-breaching party was not excused from performance. Id. at *2.

The facts of General Steel are as follows. The owner of a construction company guaranteed the sale of building materials to his company on a line of credit from the supplier. Id. at *1. A condition of the guarantee was that the supplier was to send copies of the monthly invoices for the materials directly to the construction company owner. Id. The construction company did not pay the supplier's bills and eventually, the supplier sued the construction company owner for the $30,000 due. Id. The construction company owner defended on the basis that the supplier's failure to send him directly the monthly bills was a material breach of contract which barred it from recovering for the unpaid invoices. Id.

The General Steel court rejected the construction company owner's assertions. Id. at *2. It held that the supplier's failure to send the invoices did not constitute a material breach of the guarantee contract. Id. at *3. The court reasoned:

> Eichholz [the construction company owner] claims that General Steel's failure to provide billings directly to him on a monthly basis prevented or impeded him from making sure that invoices were paid and from monitoring his personal obligation. But the evidence does not show that Eichholz was so injured; nor does it show that his risk was thereby increased. Rather, Eichholz deposed that he was president and sole shareholder of Delta; that he was aware that Delta was receiving materials from General Steel to complete a certain construction project; that had he received copies of General Steel's invoices, he would

> have made sure that his company paid General Steel; and pertinently, that he could have obtained from his company at any time copies of General Steel's invoices. Furthermore, given that Eichholz's liability under the guaranty was expressly capped at $30,000, there is no evidence that General Steel's failure to comply with the cited provision exposed Eichholz to greater liability.

Id. In short, the Court determined that because the construction company owner was not actually harmed by the breach, the breach was not material.

In the insurance context, the Georgia Court of Appeals has recognized the importance of actual harm in determining whether a cooperation clause breach allows an insurance company to avoid its duties under the policy. See Nat'l Union Fire Ins. Co. v. Carmical, 99 Ga. App. 98, 107 S.E.2d 700 (Ga. Ct. App. 1959). In Carmical, the Georgia Court of Appeals held that when a policyholder breaches a cooperation clause, the policyholder "must prejudice the rights of the insurer in order to the release the latter from its duty" under the policy. Id. at 103, 107 S.E.2d at 704. The Carmical case concerned the question of whether a policyholder's misrepresentation to an insured in investigating the facts of his claim actually harmed the insurance company's defense of the policyholder in the underlying trial. Id. Even though the policyholder corrected his statement after the injured parties brought the underlying claim (but before the insurance company had filed an answer to the complaint), the court specifically stated that the policyholder's misrepresentation was not prejudicial because he had corrected the

statement before the insurance company's defense was harmed. Id. at 108, 107 S.E.2d at 706. The court explained that a demonstration of actual harm to the insurance company would have included presenting evidence that "(a) the [insurance company] could have settled the [] claim for less than they will recover in the suits filed by them, or even less than the amount for which they sued; (b) that there was merit in the [] claims; or that they can legally recover in the suits they have filed; (c) or that defenses could not be made after the suits were filed as could have been made prior thereto." Id. at 107, 107 S.E.2d at 706. Because the insurance company did not present any such evidence in its petition to the court, no prejudice was shown and the court held that the policyholder had not materially breached the policy so that the insurance company would be released from defending the policyholder. Id. at 108, 107 S.E.2d at 706.

Based on the above-cited caselaw, there exists a basis in Georgia law for a clear statement that actual harm is a required element of materiality in the context of insurance policy breach. Materiality and actual harm are two sides of the same coin. It is therefore appropriate that this Court consider whether the insurance company defendants here were actually harmed (or in the contract context "prejudiced") in determining whether the Policyholders here have engaged in a material breach of the cooperation clause.

## II. OTHER JURISDICTIONS USE A PREJUDICE STANDARD TO DETERMINE WHETHER A DUTY TO COOPERATE HAS BEEN BREACHED.

Courts in other jurisdictions, including other states in the Eleventh Circuit, have found that actual harm and the materiality of a breach are interrelated.

### A. Other Jurisdictions Recognize That The Concepts of Prejudice and Materiality are Intertwined.

Courts outside Georgia rightly have recognized that the concepts of materiality and prejudice are intertwined. They support the notion that it is unreasonable to allow an insurance company to deny coverage based on a non-prejudicial breach. For example, Texas law recognizes that only a breach which causes prejudice is material and therefore excuses performance. Griffin v. Fidelity & Cas. Co., 273 F.2d 45, 47 (5th Cir. 1959) ("[T]he insurer has the burden to show a substantial and material breach, that is that some prejudice to the company has resulted therefrom."). See also Hernandez v. Gulf Group Lloyds, 875 S.W.2d 691 (Tex. 1994) (explaining that where the insurance company is not prejudiced by settlement, insured's breach is not material). In determining the materiality of a breach, Texas courts will consider, among other things, the extent to which the non-breaching party will be deprived of the benefit that it reasonably could have anticipated from full performance. Id. That is, whether it will be actually harmed by the breach. Restatement (Second) of Contracts § 241 (1981).

In Hernandez v. Gulf Group, 875 S.W.2d 691, 694 (Tex. 1994), the Texas Supreme Court stated that there must be actual harm for a breach to be material. The court employed the rationale that insurance policies are subject to the general principles of contract law and as such a material breach of the contract by one party discharges or excuses the other party from performance. Id. at 692. If the insurance company is not actually harmed by the breach then the breach is not material, the insurance company has not been deprived of the benefit of the bargain and should not be allowed to avoid its obligations under the policy. Id. at 694.

### B. Other States In The Eleventh Circuit Require Insurance Companies To Show Actual Harm In Order To Prove A Breach Was Material.

This Court should consider that other jurisdictions, including states in the Eleventh Circuit require that an insurance company show actual harm in order to contest liability on the basis of failure to cooperate. Florida law states that "'[t]he rule is that to constitute the breach of such a policy the lack of co-operation must be material and the insurance company must show that it was substantially prejudiced in the particular case by the failure to co-operate.'" American Universal Ins. Co. v. Stotsberry, 116 So.2d 482, 484 (Fla. Ct. App. 1959) (quoting American Fire & Casualty Co. v. Vliet, 148 Fla. 568, 571, 4 So.2d 862, 863 (Fla. 1941)). See also Continental Cas. Co. v. City of Jacksonville, 283 Fed. Appx. 686

(11th Cir. 2008) ("Not every failure to cooperate will release the insurance company. Only that failure which constitutes a material breach and substantially prejudices the rights of the insurer in defense of the cause will release the insurer of its obligation to pay.") (internal citations and quotations omitted); Bontempo v. State Farm Mut. Auto. Ins. Co., 604 So.2d 28, 28-29 (Fla. Ct. App. 1992).

Like Florida, Alabama also follows the rule that a breach of the cooperation clause must cause actual harm in order to void coverage. See General Acc. Fire & Life Assur. Corp. v. Rinnert, 170 F.2d 440, 442 (5th Cir. (Ala.) 1948) ("[I]n order that there may be a breach of the conditions requiring the insured to cooperate with liability insurer, so as to avoid the latter's liability under the policy, lack of cooperation must be material; and it has been held necessary, in order to establish a defense under such a provision, that the insurer show that the failure of the insured to co-operate with it was of such gravity as to prejudice it, but there is authority to the effect that a violation releases the insurer regardless of actual prejudice.") See also Williams v. Alabama Farm Bureau Mut. Cas. Ins. Co., 416 So.2d 744, 747 (Ala. 1982) ("We do not hold that any noncooperation affecting credibility is ipso facto prejudicial. Our holding is limited to the facts of this case, where, from the trial judge's findings, it appears that the insured's noncooperation largely negated the only evidence the insurer could offer in defense.")

As the above-referenced Florida and Alabama cases demonstrate, relying on actual harm to determine whether a policyholder's breach is material comports with notions of fairness and judicial sensibility. As will be detailed in Section III of this Brief, it is the courts' duty and the object of contract law to prevent insurance companies from taking advantage of the nature of insurance policies as aleatory agreements by which the parties perform their duties in sequence. That is, the policyholder performs first by paying the premium, and subsequently must depend upon the good faith of the insurance company when its performance is needed to pay a claim. It is respectfully submitted that this Court should bear in mind these principles when considering the Policyholders' appeal.

## III. THE INSURANCE COMPANIES' DENIAL OF COVERAGE HERE CONSTITUTES IMPERMISSIBLE POST-LOSS UNDERWRITING.

Denying coverage on the basis of the Policyholders' failure to cooperate when that failure has not prejudiced the insurance companies constitutes impermissible post-loss underwriting. Post-loss underwriting describes the situation where the insurance company attempts to avoid coverage for a risk after a claim is made because it has failed to adequately assess the value of the risk it was undertaking when it issued a policy to its policyholder. See Thomas C. Cady & Georgia Lee Gates, Post Claim Underwriting, 102 W. Va. L. Rev. 809, 829-30 (2000) [*hereinafter* "Post Claim Underwriting"]. Post-loss underwriting is per se bad faith. See Anderson v. Continental Ins. Co., 271 N.W.2d 368 (Wis. 1978).

Because Georgia law recognizes that insurance companies can be held liable for bad faith refusal to pay their policyholders' claims, the whether the insurance company defendants in this case have engaged in post-loss underwriting should be considered here. See Ga. Code Ann. § 33-4-6.

Scholars have explained that the law must deter insurance companies—who have a distinct advantage in bargaining power over policyholders—from taking advantage of the "sequential character of contractual performance" embodied in insurance contracts. See Post Claim Underwriting at 826 (citing Richard A. Poser, Economic Analysis of Law § 4.1, at 103 (5th ed. 1998)). Sequential performance under an aleatory agreement creates a delay in the insurance company's performance of its duty in fulfilling the policy, in this case, indemnifying the Policyholders for a covered fire loss. See id. Specifically,

> An insurer engaged in post claim underwriting tries to take advantage of the postponement in fulfilling its promise, made possible by sequential performance, by waiting until after a claim has been filed to determine [a policyholder's] eligibility. It takes advantage of the [policyholder] because it continues to accept premiums from the [policyholder], knowing that it will later challenge the [policyholder]'s eligibility for coverage to avoid contract performance. As a consequence, the law of contracts should protect the [policyholder] from an insurer's efforts to implement post claim underwriting as a means of taking advantage of the vulnerabilities created by sequential performance.

Id. at 827.

Post-loss underwriting harms policyholders like the plaintiffs-appellants in this case because "it culminates in either an irresponsible decision not to pay, or an unwarranted delay in payment." Id. at 830. Engaging in post-loss underwriting renders the insurance company liable for actual, compensatory and punitive damages. Id. at 834. Not only should this Court reverse the District Court's decision and hold that the Policyholders have not engaged in material breach of the policy, this Court should instruct the District Court to consider the award of such damages here for the insurance companies' bad faith denial of the Policyholders' claim.

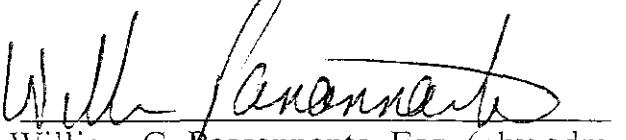
## CONCLUSION

For the foregoing reasons, amicus curiae United Policyholders respectfully requests that this Court reconsider and reverse its decision.

Dated: June 29, 2010
New York, New York

Respectfully submitted,

ANDERSON KILL & OLICK, P.C.

By: 

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## CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that on June 29, 2010 a copy of the foregoing was served on the following counsel via United States Mail, by placing same in U.S. postage pre-paid envelopes into a United States mail collection site:

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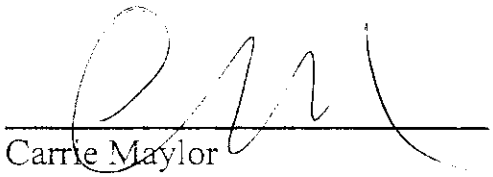

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