Court of Appeal No. E041425

IN THE COURT OF APPEAL OF CALIFORNIA
FOURTH APPELLATE DISTRICT, DIVISION TWO

STATE OF CALIFORNIA,
Appellant,

vs.

CONTINENTAL INSURANCE COMPANY as successor-in-interest to the policy issued by Harbor Insurance Company, CONTINENTAL CASUALTY COMPANY, CNA CASUALTY COMPANY OF CALIFORNIA, EMPLOYERS INSURANCE OF WAUSAU, HORACE MANN INSURANCE COMPANY, STONEBRIDGE LIFE INSURANCE COMPANY, formerly known as J.C. Penney Life Insurance Company, successor to Beneficial Fire & Casualty Insurance Company, and YOSEMITE INSURANCE COMPANY,
Respondents.

CONTINENTAL INSURANCE COMPANY as successor-in-interest to the policy issued by Harbor Insurance Company, CONTINENTAL CASUALTY COMPANY, CNA CASUALTY COMPANY OF CALIFORNIA, EMPLOYERS INSURANCE OF WAUSAU, HORACE MANN INSURANCE COMPANY, STONEBRIDGE LIFE INSURANCE COMPANY, formerly known as J.C. Penney Life Insurance Company, successor to Beneficial Fire & Casualty Insurance Company, and YOSEMITE INSURANCE COMPANY,
Cross-Appellants.

vs.

STATE OF CALIFORNIA,
Cross-Respondent.

Riverside County Superior Court Case No. 239784, c/w Case No. RIC-381555
The Honorable E. Michael Kaiser

APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF

AMICUS CURIAE BRIEF OF CENTER FOR COMMUNITY ACTION & ENVIRONMENTAL JUSTICE AND UNITED POLICYHOLDERS IN SUPPORT OF THE STATE OF CALIFORNIA

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APPLICATION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF OF CENTER FOR COMMUNITY ACTION & ENVIRONMENTAL JUSTICE AND UNITED POLICYHOLDERS

Pursuant to Rule 8.200(c) of the California Rules of Court, Center For Community Action & Environmental Justice ("CCAEJ") and United Policyholders ("UP") (collectively "*Amici*"), jointly as amicus curiae, request leave to file an *amicus curiae* brief in support of Plaintiff, Appellant, and Cross-Respondent the State of California. *Amici's* counsel is familiar with the issues in this case and with the scope of their representation.

CCAEJ is a non-profit organization with its main office located in Riverside, California. The CCAEJ's goal is to bring groups of people together to find opportunities for cooperation, agreement and problem solving. CCAEJ works with community groups in developing and sustaining democratically based, participatory organizations that promote involvement of a diverse segment of the community in ways that empower. CCAEJ accomplishes this by facilitating and providing assistance in the following areas: information/publications; direct, "hands-on" assistance with groups; outreach, referral and network development; and training and leadership development. CCAEJ creates partnerships with organizations that are working on issues related to environmental justice, social justice and economic development. The partnerships are created to broaden agendas and effectively disseminate resources. The goal of CCAEJ is to build a strong movement for change that recognizes the connections between environmental and worker exploitation, and oppression on the basis of race, gender, sexual orientation and class, and incorporates that connection in the primary activities of

CCAEJ. CCAEJ accomplishes this goal by actively seeking opportunities to bring together groups of people working on a variety of social, economic and environmental justice issues.

UP was founded in 1991 as a non-profit, 501(c)(3) organization dedicated to educating the public on insurance issues and consumer rights. UP is funded by donations and grants from individuals, businesses, and foundations. The organization monitors legal and marketplace developments that impact policyholders and participates in formulating public policy on insurance transactions. UP offers practical guidance on coverage and claims issues to property and business owners and advocates, including disaster relief personnel, attorneys, and adjusters at www.uphelp.org.

CCAEJ and UP are unaffiliated national organizations mutually concerned with the important insurance coverage issues in this case which will have a widespread impact on policyholders, third-party beneficiaries entitled to the policyholder's insurance recovery, and the general public, not only in California, but also nationwide.

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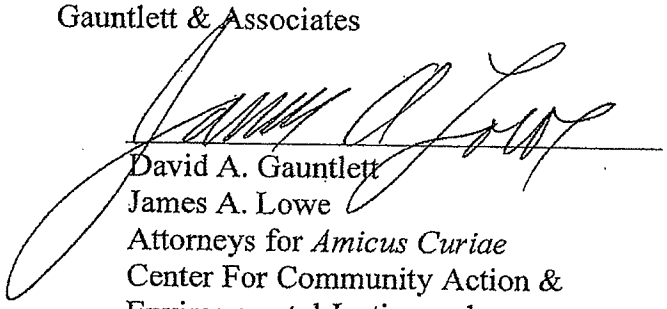
Amici believes it can bring additional perspective to certain issues that were not addressed in the parties' briefs. Because of their substantial interest in the issues before the Court in this case, *Amici* respectfully request permission to file the brief submitted herewith for the Court's consideration.

Dated: May 21, 2008

Respectfully submitted,
Gauntlett & Associates



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I. INTRODUCTION

Although the general liability insurance policies at issue and California law more than adequately support a ruling against Respondents, *Amici* respectfully brings to this Court's attention the following issues in further support of the legal arguments set forth in the briefs submitted by Appellant the State of California:

- Considerations of public welfare and the potential widespread impact of the issues being decided on this appeal;
- The overreaching nature of the erroneous offset as applied against Appellant without first making the policyholder whole;
- Respondents' opportunistic breach of their insurance policies in the face of well established California law and the policyholder's reasonable expectations.
- Drafting history support for California's well established application of "all sums" to general liability occurrence policies;
- Stonebridge's attempt to benefit from its own affirmative destruction of historical policies available to pay historical long-tail claims; and
- The clear annualization of limits given Appellant's course of dealings with Respondents.

Although some of these issues may not be dispositive for the resolution of this case, the principles underlying all of them place the complex insurance issues on appeal in a broader context. Moreover, the arguments presented before this Court by Respondent insurance companies seek to overturn longstanding California law and minimize coverage, not only for remediation of the Stringfellow Class I Hazardous Waste Facility, but to the detriment of policyholders and the general public in connection with all insurance policies sold in California.

II. ARGUMENT

A. Respondents' Unsupported Reinterpretation Of The Express Language In General Liability Policies Has Far Reaching Detrimental Effects.

Insurance has long been recognized in California as a vital asset to protect the public interest, especially in the remediation of long-term environmental contamination under State and Federal laws and regulations. Thus, all of the issues in this appeal have significant impact upon the public at large, from parents caring for a child involved in a car accident who potentially would be limited in their ability to recover the full amount of their damages under the offset rule espoused by Respondents, to families who will find that parties liable for remediation of hazardous wastes in their community suddenly no longer have adequate general liability insurance because the broad "all sums" insuring language of general liability policies was tossed aside by the insurance companies.

It has long been understood that the purpose of liability insurance is not only to protect policyholders, but also to protect third party beneficiaries to whom policyholders are liable. *See, e.g., Price v. Wells Fargo Bank*, 213 Cal. App. 3d 465, 475 (1989) (including insurance among businesses "being highly regulated industries performing vital public services substantially affecting the public welfare."). The Supreme Court of California has recognized that the insurance industry must be concerned with the public welfare and interest:

> The insurers' obligations are ... rooted in their status as purveyors of a vital service labeled quasi-public in nature. Suppliers of services affected with a public interest must take the public's interest

> seriously, where necessary placing it before their interest in maximizing gains and limiting disbursements ....

Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820 (1979) (approvingly quoting William M. Goodman & Thom Greenfield Seaton, *Foreword: Ripe for Decision, Internal Workings and Current Concerns of the California Supreme Court*, 62 Cal. L. Rev. 309, 346-347 (Mar. 1974)).

Insurance industry representatives leave no doubt as to the significant regulatory function in our society served by insurance companies:

> One function of insurance is 'surrogate regulation'. When an insurer chooses to insure a given activity, it evaluates and monitors the insured's performance. When the insured risk is adequately defined, the insurer, by offering reduced premiums or conditioning the sale of insurance on adequate loss-control measures, can encourage the insured to take steps to minimize the potential for loss or to internalize costs.

Brief of *Amici Curiae* Ins. Envtl. Litig. Assoc. Brief of *Amici Curiae* Insurance Environmental Litigation Association, New York State Insurance Association, Utica Mutual Insurance Company, Utica Fire Insurance Company of Oneida County, N.Y. and Empire Insurance Company at 36-37, (dated May 10, 1989) *Technicon Elec. Corp. v. Atlantic Mutual Ins. Co.*, (N.Y.) (No. 08811/85) *cited in* Eugene R. Anderson *et al.*, *A.B.A. Manual for Complex Insurance Coverage Litigation: A Prescription for Insurance Nullification*, 7 Fordham Envtl. L.J. 55, 64 n.53 (1995) (Fall, 1995) ("A group of insurance companies and anti-policyholder advocacy organizations filed an amicus brief stating that, '[o]ne function of insurance is 'surrogate regulation.'").

Similarly, a textbook used to train insurance industry professionals confirms that insurance companies have an obligation to the public interest:

> Insurance contracts are different from other commercial contracts because insurance is more a necessity than a matter of choice. Therefore, insurance is a *business affected with a public interest*, as reflected in legislative and judicial decisions.

1 James J. Lorimer, *et al.*, *The Legal Environment of Insurance* at 179 (4th ed. 1993) (emphasis in original).

As insurance companies have long profited[1] from their public service status, so must they meet their public service obligations. Instead, as demonstrated in Appellant's briefs, the positions taken by Respondents disregard and attempt to overturn well established California law with respect to:

- "Offset" – by allowing insurance companies to completely escape any payment at all at the expense of the policyholder and regardless of whether or not the policyholder has been paid for its entire underlying loss and thus been "made whole";
- "All Sums" – by significantly reducing the value of policies purchased over multiple years (e.g., construction defects, bodily injury or property damage resulting from pollution, asbestos or other continuous or progressive conditions) intended to cover very high-value liability exposures triggering multiple policy periods;

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[1] The insurance industry is "a $2.3 trillion financial industry," with a $1 billion yearly allowance for "coverage litigation," that is, funds specifically earmarked to pay attorneys, to fight policyholders. U.S. House of Representatives, Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, 103rd Cong., 2d Sess., Wishful Thinking: A World View of Insurance Solvency Regulations, at iii (Letter of Transmittal) (Comm. Print Oct. 1994); *see also Miller v. Fluharty*, 500 S.E.2d 310, 318 n.10 (W. Va. 1997) ("This disparity [of bargaining power between an insurance company and claimants] is apparent in the fact that insurance companies spend over $1 billion annually in litigation battles against policyholders."); Leslie Scism, *Tight-Fisted Insurers Fight Their Customers to Limit Big Awards*, Wall St. J., Oct. 15, 1996, at 1.

- "Stacking" – by eliminating all but a single policy year worth of coverage despite separate insurance contracts being sold for separate premiums in different policy periods by different parties;
- "Number of Occurrences" – by restraining policyholders with very high value claims from accessing "per occurrence" limits promised by their insurance companies;
- "Annualization" – by limiting policyholders with multi-year policies to single year limits without supporting insuring language; and
- "Lost Policies" – by allowing insurance companies to benefit from their decision to destroy insurance policies they knew were still effective for long-term liabilities.

Although legal authority and a plain reading of the liability policies at issue are sufficient to reject Respondents' arguments, as further detailed herein, established California law should not be overturned merely to minimize existing coverage obligations and provide a windfall to the insurance companies while at the same time failing to satisfy the policyholder's underlying loss. Especially where, as here, the adoption of Respondents' arguments would harm not only Appellant, but vast numbers of other policyholders, third-party beneficiaries, and the general public.

B. Respondents' Misapplication Of Offsets Is Overreaching And Harmful To All Policyholders And The General Public.

1. Offsets Must Only Be Taken Against The Underlying Liability.

Respondents' liability for breach of their general liability insurance policies must not be "offset" by settlements until Appellant recovers all of the State's own liability for cleanup of the Stringfellow Class I Hazardous Waste Facility. It is well established under California law that a policyholder must be "made whole" prior to any reduction of the insurance companies' obligation:

> 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.

Hodge v. Kirkpatrick Dev., Inc., 130 Cal. App. 4th 540, 553 (2005) (emphasis added) (citing *Barnes v. Independent Auto. Dealers of California*, 64 F.3d 1389, 1394 (9th Cir. 1995) and *Sapiano v. Williamsburg Nat. Ins. Co.*, 28 Cal. App. 4th 533 (1994).

Accordingly, any equitable offset allowed by Respondents against Appellant, must be taken against the Appellant's underlying liability as opposed to Respondents' own liability to Appellant for breach of contract. *See Plut v. Fireman's Fund Ins. Co.*, 85 Cal. App. 4th 98, 106 (2000) (offset against insurance company's limits allowed only after determination that policyholder was made whole for its losses).

The Trial Court's ruling, therefore, upsets the fundamental purpose of the remedy of an equitable offset. An equitable remedy should not be applied so that a breaching insurance company escapes paying a single penny of its policy limits whereas the policyholder is awarded nothing despite covered losses well in excess of any of its recoveries for those losses. The Trial Court's inequitable ruling not only is contrary to California law, but, if adopted by other Courts, potentially has far reaching deleterious effects upon all types of insurance policies.

2. All Policyholders From Individual Homeowners To Large Corporations Potentially Are Harmed By Respondents' Disregard For The "Make Whole" Rule.

An offset may only be applied against a policyholder's total underlying loss. Offsets against policy limits as proposed by Respondents have the potential to

devastate not only the policyholder, but also tort claimants who would not be compensated if the Courts do not enforce the policies of otherwise impecunious entities. The United States Supreme Court has considered the public interest of insurance and the resultant public responsibilities imposed upon insurance companies. Similar to the California Supreme Court's recognition of the public interest component to insurance as set forth above, the United States Supreme Court stated:

> The contracts of insurance may be said to be interdependent.
>
> They cannot be regarded singly, or isolatedly [sic], and the effect of their relation is to create a fund of assurance and credit, the companies becoming the depositories of the money of the insured, possessing great power thereby, and charged with great responsibility.

German Alliance Ins. Co. v. Lewis, 233 U.S. 389, 414 (1914).

The special nature of an insurance company's relationship with its policyholders and the public has also been long recognized even by insurance industry outsiders. At least as far back as 1921, Dean Roscoe Pound recognized the public duties of insurance companies beyond solely contractual obligations:

> [W]e have taken the law of insurance practically out of the category of contract, and we have established that the duties of public service companies are not contractual, as the nineteenth century sought to make them, but are instead relational; they do not flow from agreements which the public servant may make as he chooses, they flow from the calling in which he has engaged and his consequent relation to the public.

Roscoe Pound, *The Spirit Of The Common Law* at 29 (1921), http://digitalcommons.unl.edu/lawfacpub/1.

The impact of an affirmation of the Trial Court's ruling and a decision supporting Respondents' position that insurance companies can offset settlements directly against their own policy limits, despite the policyholder's larger liability, impacts insurance policies of every type. For example, the concept that offsets can only be taken against a policyholder's total liability was described in a "Practice Note" in a California practice guide in the context of uninsured motorist claims. Cal. Civ. Prac. Torts, § 38:5 (2008) *("To determine what offset or reduction is to be given the uninsured motorist carrier, the policy must be analyzed. If it speaks in terms or "damages" to the insured, the offset or reduction is from the total amount of the injury, and not the policy amount.").* (emphasis added) Uninsured motorist claims limit the cases in which an insurance company's uninsured motorist liability may operate against other liabilities to three situations in which uninsured motorist payments may be reduced. These reductions, however, potentially allow insurance companies to receive a windfall at the expense of their policyholder if the amount offset is against the policy limits instead of the injury. Only a rule requiring offsets to be taken after the policyholder is made whole can protect a policyholder's right to receive full compensation for the total amount of an injury resulting from an accident with an uninsured motorist.

The significance of examining the entire liability was addressed by the California Court of Appeals with respect to an uninsured motorist claim brought by Lonny Cothron, a claimant injured in an automobile accident with an uninsured motorist. *Cothron v. Interinsurance Exch. of the Auto. Club of S. Cal.,* 103 Cal. App. 3d 853 (1980). In that case, the Court of Appeals held that: "The total amount of a claimant's

damage appear to be relevant to the extent the determination thereof is necessary to arrive at an award up to and including the policy limit ...." *Cothron* at 861. Respondents' position taken in this appeal would alter this analysis by allowing an insurance company to offset an individual policyholder's settlement with other parties regardless of whether or not the policyholder was fully compensated for injuries resulting from an automobile accident.

During the course of the case and this appeal, Respondents specifically have cited to and misapplied leading California cases applied to individual consumers. In their appellate brief, Respondents misrepresented the law of offsets allowed under an individual homeowners' policy in *Plut v. Fireman's Fund Ins. Co.*, 85 Cal. App. 4th 98 (2000). In *Plut*, John and Karen Plut's home was damaged when Roto-Rooter flooded the first floor of their home during the course of toilet repairs. Additionally, during the course of restoring their personal belongings using ISI, an interior services company, the truck containing the Plaintiffs' belongings was stolen. The Pluts entered into settlements with Roto-Rooter and ISI and brought a claim against their homeowners' insurance company.

In *Plut*, the Court only permitted the insurance companies to offset settlements after the policyholder was compensated for its "total" property loss and thus made whole. *Plut* at 106 (emphasis added) ("The jury's finding regarding breach of contract damages is well within the policy limits, and the record otherwise indicates that this finding is an assessment of the Pluts' total property losses. Accordingly, we conclude that the award against Fireman's Fund for breach of contract was intended to make the

Pluts whole with regard to their property losses."). Respondents' arguments, if adopted, would have allowed the insurance company to offset the Pluts' Roto-Rooter and ISI settlements for a windfall, even if the Pluts did not recover sufficient funds to repair their home or replace their stolen property.

Respondents' arguments would force every policyholder in California – including individual accident victims such as Lonny Cothron and homeowners such as the Pluts – with a contested coverage claim to engage in litigation prior to any other settlements in order to avoid having an offset taken off the policy limits. In the mean time, those same policyholders would be unprotected and required to fend for themselves.

The *Plut* case's "make whole" rule was relied upon in other cases such as *Chong v. State Farm Mutual Automobile Insurance Co.*, 428 F. Supp. 2d 1136, 1139 (S.D. Cal. 2006). In that case, Kathleen Chong filed a putative class action regarding the application of the "make whole" rule to her automobile insurance policy. Among other things, the United States District Court for the Southern District of California attempted to predict the breadth of the make whole rule under state law. Specifically, whether or not attorney's fees and expenses should be accounted for prior to an offset. The District Court predicted that, "the California Supreme Court would follow the well-reasoned out-of-state decisions which hold that the policyholder's litigation expenses must be taken into account when determining whether the policyholder has been made whole." *Chong* at p. 1144.