

Insurance Law Update

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The final quarter of 2011 saw a volume of published and unpublished insurance related cases handed down by both the state and federal courts. Among the more interesting or unique cases are those which evaluated policy and statutory arbitration, direct actions against carriers by judgment creditor plaintiffs, and whether the seizure of medical marijuana triggered coverage under the “theft” provision of a homeowners’ policy – all of which are discussed more fully below.

To the Extent There Is a Dispute Between the Parties Concerning the Amount of Independent Counsel Fees Owed in the Defense of an Insured in a Third Party Suit, That Dispute Ultimately Must Be Resolved by Arbitration as Required by the Statute Governing a Liability Insurers’ Duty to Provide Independent Counsel, but Where an Insured Raises in a Bad Faith Action the Duty to Defend, That Issue must Be Resolved First in the Trial Court Before Any Such Arbitration.

In the opinion styled Janopaul + Block Companies, LLC, et al., v. the Superior Court of San Diego County (St. Paul Fire and Marine Insurance Company), (Nov. 17, 2011) (2011 WL 5581840), Acting P.J. Benke, writing for the Court of Appeal, Fourth District, Division 1, held that to the extent there is a dispute between the parties concerning the amount of independent counsel fees owed in the defense of an insured in a third party suit, that dispute ultimately must be resolved by arbitration as required by the statute governing a liability insurers’ duty to provide independent counsel, but where an insured raises in a bad faith action the duty to defend, that issue must be resolved first in the trial court before any such arbitration.

Factually, Janopaul was the owner of the historic El Cortez Hotel in San Diego (“El Cortez”), which Janopaul planned to restore. Janopaul contracted with St. Paul Fire and Marine Insurance Company’s (“St. Paul”) named insured, Ninteman Construction Company, now known as The Sundt Companies, Inc. (together, “Sundt”), to serve as the general contractor for the El Cortez project (“Janopaul contract”). In the Janopaul contract, Sundt agreed under an express indemnity provision to defend Janopaul for claims arising from Sundt’s work. When the El Cortez Owners Association later filed suit against Janopaul for construction defects at the El Cortez project, Janopaul timely requested that Sundt defend and indemnify it in the El Cortez action. When Sundt failed to do so, Janopaul cross-complained against Sundt alleging several causes of action including breach of express indemnity. Janopaul retained Golub & Morales, LLP (“Golub”) to represent it. Golub thereafter tendered Janopaul’s defense and indemnity in the underlying action to St. Paul, which acknowledged receipt of the Janopaul tender. However, St. Paul stated it was investigating the matter and was then unable to “either decline or accept all or part of this tender.”

More than two years after Janopaul’s original tender, Janopaul informed St. Paul that it intended to file a bad faith complaint against St. Paul because of the latter’s “complete failure” to respond to Janopaul’s defense and indemnity tender. Three days later, St. Paul agreed to defend Janopaul under a reservation of rights. Although Janopaul had never requested appoint-

ment of independent counsel, St. Paul nonetheless agreed as follows to provide Janopaul “Cumis counsel,” advising that “Civil Code [section] 2860 provides the right to independent counsel where the outcome of a coverage issue may be controlled by counsel first retained by the insurer. In light of the allegations of intentional conduct, St. Paul concludes that Janopaul is entitled to independent counsel and understands that your [Golub’s] office has been selected by the insured to represent its interests in this matter. However, St. Paul’s obligation to pay defense fees and costs incurred by independent counsel is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended. Thus, St. Paul agrees to contribute to the defense of Janopaul at the rate of \$150 an hour for [p]artners, \$135 an hour for associates and \$75 an hour for paralegals.” St. Paul further stated in its reservation of rights letter that it was not obligated to reimburse Janopaul for any fees and costs Janopaul incurred pursuing any “affirmative claims” against Sundt or any other party in the underlying action; that it only agreed to pay costs and fees that were “reasonable and necessary” to Janopaul’s defense in the underlying action; and demanded “to the extent reasonably possible, [Golub] segregate its billing entries so that tasks performed in defense of potentially covered claims are delineated from those associated with the uncovered and affirmative claims outlined herein.”



Some time later, St. Paul notified Golub that it was in the process of reviewing invoices Golub had submitted for defending Janopaul in the underlying action and expressed concerns over Golub’s alleged “objectionable billing practices,” including “excessive hourly rates, block billing entries and tasks which did not appear reasonable and/or necessary to the defense of Janopaul.” St. Paul thus invoked arbitration to resolve the disputed legal fees and costs under section 2860(c), claiming there was a “dispute[] concerning attorney[] fees” between the parties. Specifically,

because St. Paul had previously acknowledged Golub as independent counsel to Janopaul, St. Paul claimed the attorney fee dispute “must be submitted to a single auditor for resolution.” St. Paul also claimed the scope of such arbitration included “(1) the applicable rate; (2) the extent the fees submitted to St. Paul are reasonable and necessary to the defense of Janopaul; and (3) any reimbursement right St. Paul may have against Janopaul for overpayment of defense fees after the audit process is complete.” St. Paul initially requested Janopaul and Golub voluntarily agree to arbitrate. St. Paul suggested any such arbitration be stayed pending resolution of the underlying action in order for Golub to focus solely on Janopaul’s defense. When Janopaul and Golub refused to arbitrate, St. Paul filed a petition to compel arbitration. Writing for the trial court, Judge Steven R. Denton denied the motion by Golub and Janopaul to dismiss the arbitration petition and granted St. Paul’s competing motion to compel arbitration. Judge Denton thereafter requested supplemental briefing which did not change his opinion. Before the supplemental briefing was concluded, Janopaul filed

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a “bad faith” action against St. Paul.

As relevant here, Civil Code § 2860(c) provides in part: “Any dispute concerning attorney’s fees not resolved by [an alternative procedure set forth in the policy] shall be resolved by final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.” In reversing Judge Denton, the Court found that before granting St. Paul’s request to compel fee arbitration between Golub and Janopaul, Judge Denton was required to first examine the allegations contained in Janopaul’s “bad faith” complaint and make a preliminary determination of whether St. Paul had a duty to defend Janopaul and if so, whether St. Paul breached that duty and engaged in bad faith conduct. If, as alleged by Janopaul, the delay of more than two years by St. Paul in responding to the original tender was a breach of St. Paul’s duty to defend Janopaul, then St. Paul’s breach of that duty resulted in St. Paul’s forfeiture of the right to control the defense of the action or settlement, including the ability to take advantage of the protections and limitations set forth in the statute governing liability insurers’ duty to provide independent counsel.

Consequently, to the extent there was a dispute between the parties concerning the amount of independent counsel fees owed in the defense of an insured in a third party suit, that dispute ultimately must be resolved by arbitration as required by the statute governing a liability insurers’ duty to provide independent counsel, but where an insured raises in a “bad faith” action the duty to defend, that issue must be resolved first in the trial court before any such arbitration.

In *Order for a Plaintiff, Who Has Obtained a Judgment Against an Insured Defendant, to Recover on That Judgment Against the Insured Defendant’s Insurer as a Judgment Creditor under Insurance Code § 11580(b)(2)*, the Defendant must Be an Insured of the Insurer.

In *Estate of Cartledge v. Columbia Casualty Company*, (Nov. 23, 2011) (2011 WL 5884255), the United States District Court, E.D. California, held that in order for a plaintiff, who has obtained a judgment against an insured defendant, to recover on that judgment against the insured defendant’s insurer as a judgment creditor under Insurance Code § 11580(b)(2), the defendant must be an insured of the insurer.

Factually, Sierra Manor Associates, Inc. was a residential elder care facility. Cartledge obtained a default judgment in state court against Sierra Manor Associates, Inc., individually and doing business as Sierra Manor, in the amount of \$2,000,471.50 for claims arising from injuries allegedly sustained by Emma Cartledge while a resident at Sierra Manor. Columbia Casualty Company (“Columbia”) issued a commercial liability policy to Attwal Enterprises, Inc., a corporation that used two fictitious business names - Sierra Manor and Woodson Lodge. That policy was valid at the time of the acts under which the underlying state action arose. Sierra Manor Associates, Inc. was not listed as an insured on the policy. Interestingly, Balwinder Attwal was the CEO of both Attwal Enterprises and Sierra Manor Associates, Inc. Cartledge alleged that Columbia was aware of the underlying action, but did not participate in the underlying action and rejected Cartledge’s offers to settle within policy limits. Claiming that Sierra Manor Associates, Inc. was an insured under the Columbia policy, Cartledge brought this action in federal court against Columbia as a judgment creditor pursuant to Insurance Code section 11580, seeking to collect on the default judgment against Sierra Manor Associates, Inc. and bringing

a claim for breach of the implied covenant of good faith and fair dealing.

The opinion began with a statement of the law: under Insurance Code § 11580(b)(2), “whenever judgment is secured against the insured ... in an action based upon bodily injury, death, or property damage ... an action may be brought against the insurer on the policy and subject to its terms and limitations, by such judgment creditor to recover on the judgment.” At issue was whether plaintiff could be said to have obtained a judgment against a party insured by Columbia. In deciding that the response to that issue was a resounding “no,” the Court noted that the Columbia policy was issued to Attwal Enterprises, Inc. dba Sierra Manor. In the underlying action, the only named defendant was “Sierra Manor Associates, Inc., individually and doing business as Sierra Manor.” Plaintiff argued that because Sierra Manor Associates, Inc. also did business under the fictional name “Sierra Manor,” Sierra Manor Associates, Inc. should be considered as an insured under the Columbia policy. A fictional business name, or dba, explained the Court, does not create a separate legal identity. Other than sharing a similar “dba,” there was no evidence that the insured, Attwal Enterprises, Inc., doing business as Sierra Manor and as Woodson Lodge, was the same entity as Sierra Manor Associates, Inc., doing business as Sierra Manor. In finding for the insurer, the Court concluded that plaintiff had not obtained a judgment against Attwal Enterprises, Inc. and, therefore, had not become a third-party beneficiary of the policy issued to Attwal Enterprises, Inc. and could not therefore bring a claim for breach of good faith and fair dealing.

Police Officers’ Seizure and/or Destruction of Insured’s Medical Marijuana Was Not a Covered “Theft” under a Homeowners’ Insurance Policy, and That the Insurer Did Not Commit “Bad Faith” in Failing to Wait for the Outcome of Pending Criminal Proceedings Before Denying Coverage.

In *Barnett v. State Farm General Insurance Company* (2011) 200 Cal. App.4th 536, the Court of Appeal, Fourth District, Division 3, held that a police officers’ seizure or destruction of an insured’s marijuana was not a covered “theft” under a homeowners’ insurance policy, and that the insurer did not commit “bad faith” in failing to wait for the outcome of pending criminal proceedings before denying coverage.

Factually, Officers from the Costa Mesa Police Department executed a search warrant at Barnett’s residence, digging up Barnett’s marijuana plants from his backyard, and also seizing two freezer bags of marijuana and a tray containing loose marijuana and rolling papers. At the time of the search and seizure, Barnett had a homeowners’ insurance policy issued by State Farm. Barnett thereafter filed a claim with State Farm under his homeowner’s policy for the “items” taken from his home during the search. Barnett included in his claim an appraisal of \$98,000 for the seized marijuana and marijuana plants. State Farm initially denied the claim but reopened the file for reconsideration because of then pending possession charges filed against Barnett. Because Barnett was able to prove this his possession was lawful under California’s medical marijuana laws, all charges were eventually dropped against him, though the quantity of his marijuana was in excess of the legal limit. All of the property taken by the police was thereafter destroyed. When State Farm denied the claim, Barnett filed his “bad faith” complaint against State Farm.

The State Farm policy included coverage for personal property on a

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named perils basis. Specifically, that policy covered “direct physical loss to property” caused by enumerated hazards, including theft. The theft provision in the policy extended coverage to: “theft, including attempted theft and loss of property from a known location when it is probable that the property has been stolen.” An additional provision specified that the insurance policy covered losses to personal property owned or used by Barnett if stolen “away from [his] residence premises,” with certain exemptions inapplicable to the Court’s analysis. That policy expressly covered “Trees, Shrubs and Other Plants,” specifying: “We cover outdoor trees, shrubs, plants or lawns, on the residence premises, for direct loss caused by the following: ... Vandalism or malicious mischief or Theft.”

The Court began its analysis by noting that the word “theft” in a property insurance policy should be given the usual meaning and understanding employed by persons in the ordinary walks of life, and should be construed as common thought and common speech now imagine and describe it. In other words, the words “theft” and “steal” involve the idea of a knowingly unlawful acquisition of property; that is, a felonious taking of it. Consequently, the police officers’ seizure of Barnett’s marijuana at his home pursuant to a search warrant did not constitute a “theft” within the coverage of his homeowners’ insurance policy when there was no specific language – including or excluding – governmental acts within that policy, regardless of whether Barnett lawfully possessed the marijuana under California law, because the seizure was not criminal, nor was there any evidence of an intent to deprive Barnett of his property in a criminal manner, rather than by due process of law. This is because a claim of right to take disputed property negates the criminal intent necessary for “theft” for purposes of theft coverage in a homeowner’s insurance policy. *Penal Code § 511*.

Based upon the above analysis, the Court concluded that State Farm did not commit “bad faith” by delaying its coverage decision and waiting for the outcome of the criminal proceedings against Barnett before making its determination that the police officers’ seizure and destruction of Barnett’s marijuana were not a covered “theft” under his homeowners’ policy, since the issue was not whether Barnett’s conduct was lawful, but rather whether the police officers’ actions constituted theft within the meaning of the policy.

When the Amount of Loss in a Homeowners’ Policy for Property Damage Repairs Is Not Disputed, the Arbitration Appraisal Provision Does Not Apply to Policy Interpretation Issues Such as Whether the Insurance Company Can Exclude the General Contractor’s Overhead and Profit And/or Depreciate the Sales Tax.

In the unpublished opinion styled *Sarkisyan v. Newport Insurance Company et al.*, (Nov. 28, 2011) (2011 WL 5995990), the Court of Appeal, Second District, Division 2, held that when the amount of loss in a homeowners’ policy for property damage repairs is not disputed, the arbitration appraisal provision does not apply to policy interpretation issues such as whether the insurance company can exclude the general contractor’s overhead and profit and/or depreciate the sales tax.

Factually, Serozh Sarkisyan purchased a homeowners’ insurance policy (“Policy”) from Newport Insurance Company (“Newport”). During the Policy period, Sarkisyan suffered a covered loss to his home. Sarkisyan submitted a claim, on which Newport initially paid \$6,764.50 and later revised its estimate of the loss to \$14,779.29. From that amount, Newport deducted

the contractor’s overhead and profit (\$2,373.95) and depreciated the sales tax (\$132.28). The amount of injury, destruction or damage to Sarkisyan’s property was not in dispute. Sarkisyan accepted Newport’s assessment of the cost to repair his home and accepted Newport’s computation of the sales tax and contractor overhead/profit. He challenged, however, Newport’s reduction of the amount owed for property damage by withholding the entire amount of the general contractor’s overhead and profit and by depreciating the sales tax.

Sarkisyan thereafter filed a putative class action suit for “bad faith” based upon those reductions and withholdings by Newport. Newport unsuccessfully moved to stay the proceedings and compel an appraisal, arguing that Sarkisyan was required to submit to an appraisal in any dispute regarding the amount of his claim, including disputes over deductions. The trial court embraced Sarkisyan’s opposition in which he argued that an appraisal cannot be used to resolve a coverage dispute when the amount of loss is not at issue.

The issue giving rise to this matter was whether the Policy or state law imposed on Newport a duty to pay the contractor’s overhead/profit and/or the sales tax. That issue, stated the Court, can only be resolved by interpreting the Policy provision relating to “Actual Cash Value” and applicable state law. The Newport Policy provided in pertinent part that “If you and we fail to agree on the amount of loss, then, either party may make a written request for an appraisal. In this event, each party will select a competent and impartial appraiser. Each party shall notify the other of the appraiser selected within 20 days of the request. Where the request is accepted, the two appraisers will select a competent and impartial umpire. If they cannot agree upon an umpire within 15 days, you or we may request that the choice be made by a judge of a court of record in the state where the ‘residence premises’ is located. The appraisers will appraise the loss, stating separately the loss to each item. If they fail to agree, they will submit their differences to the umpire. An award in writing, agreed to by any two, will set the amount of loss.” That Policy covered “physical loss” to the insured property. While that Policy did not define the word “loss,” it described “property damage” as “physical injury to, destruction of, or loss of use of tangible property.” A “loss” in connection with insurance means injury, destruction or damage to property that gives rise to liability on the part of the insurer. The Newport Policy allowed for an appraisal when the “amount of loss” was in dispute. Using the commonly accepted definition of “loss,” the Policy’s appraisal clause came into effect when the amount of injury, destruction or damage to the property was in dispute. Additionally, Newport was required to pay “no more than the actual cash value of the damage....” The Policy defined “Actual Cash Value” as “the amount it would take to repair or replace the damaged property, at the time of the loss, with material of like kind and quality subject to a deduction for deterioration, depreciation or obsolescence and contractor’s overhead and profit. Actual cash value applies to the valuation of property whether that property has sustained partial or total loss.”

The Court noted that because both state law (Insurance Code § 2051 and title 10 of the California Code of Regulations section 2695.9.5) and the Policy language directed the appraisers to evaluate the loss, “stating separately the loss to each item,” the only reasonable interpretation of the Policy language was that the appraisal was limited to examining the value of “each item” of damaged property, and to not consider issues such as sales tax or contractor profits.