E062244

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

21ST CENTURY INSURANCE COMPANY,
Defendant and Petitioner,
v.
SUPERIOR COURT OF THE STATE OF CALIFORNIA, COUNTY OF SAN BERNADINO,
Respondent.

ESTATE OF CORY ALLEN DRISCOLL AND CY TAPIA,
Plaintiffs and Real Parties in Interest

APPEAL FROM SAN BERNARDINO COUNTY SUPERIOR COURT
BRIAN S. MCCARVILLE, JUDGE • CASE NO. CIVDS 1014138

APPLICATION FOR LEAVE TO FILE *AMICI CURIAE* BRIEF IN SUPPORT OF DEFENDANT/PETITIONER AND PROPOSED *AMICI CURIAE* BRIEF

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

Cases

APPLICATION FOR LEAVE TO FILE AMICI CURIAE BRIEF

The Personal Insurance Federation of California and the Property Casualty Insurers Association of America (Amici) request leave to file the attached Amici Curiae Brief in support of Defendant/Petitioner in this matter pursuant to California Rule of Court, Rule 8.200, subdivision (c).

INTEREST OF AMICI

Personal Insurance Federation of California (PIFC) is a California not-for-profit trade association representing seven personal lines property/casualty insurers who collectively write the majority of the personal lines auto and homeowners insurance in California.

Property Casualty Insurers Association of America (PCI) is a national property casualty trade association composed of nearly 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write 29.7 percent of the personal lines insurance market and 28.9 percent of the commercial lines insurance market in California.

STATEMENT PURSUANT TO RULE 8.200(C).

This brief was written entirely by counsel named below, and no one other than Amici contributed to its funding.

NEED FOR FURTHER BRIEFING

In an Order dated January 27, 2015, this Court authorized the parties to submit briefs addressing the effect of a stipulated judgment and a covenant not to execute where the insurer was defending under one policy, but had denied coverage under other, lower limits policies.

Counsel for Amici believes that further briefing by Amici is needed to fully explore the consequences of the result sought by plaintiffs. This Court's resolution of this issue could have a significant impact on property-casualty insurers writing insurance in California. The typical auto and personal liability insurance policy provides that the insurer has not only a duty, but a *right* to defend suits against the insured. The position adopted by *Risely v. Interinsurance Exchange of Auto. Club* (2010) 183 Cal.App.4th 196, and asserted by plaintiffs here, would create strong incentives for insureds and injured parties to enter into consent judgments with covenants not to execute in order to avoid policy limits, even where the insurer is providing a full defense. As situations where more than one policy might arguably apply to a claim are common, if widely adopted and upheld by the courts, the effect of the rule sought by plaintiffs will be increased insurer loss costs and upward pressure on insurance premiums.

Amici therefore offer this brief to explore in detail the reasons why the position asserted by plaintiffs is inconsistent with the relevant case law and unsound as a matter of public policy.

DATED: March 3, 2015

Respectfully submitted,

SEDGWICK, LLP

By: 

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LEGAL DISCUSSION

This amicus brief on behalf of Personal Insurance Federation of California and the Property Casualty Insurers Association of America addresses the first and third questions posed in the Court's Order dated January 27, 2015.

SUMMARY OF ARGUMENT

The outcome sought by plaintiffs, if widely adopted by the courts, would effectively allow insureds and injured parties to increase policy limits against a defending insurer by entering into a stipulated judgment and covenant not to execute and secure extra-contractual damages without waiting for the trial of the underlying lawsuit that the insurer is defending.

Although the California Supreme Court barred this approach in *Hamilton v. Maryland Casualty Co.* (2002) 27 Cal.4th 718, plaintiffs contend that the rule in *Hamilton* can be avoided if the insured asserts the existence of potential coverage under another policy. Plaintiffs would nullify *Hamilton* even where the other potential coverage has an identical defense obligation and lower policy limits.

Plaintiffs rely on *Risely v. Interinsurance Exchange of Auto. Club* (2010) 183 Cal.App.4th 196. The *Risely* decision is readily distinguishable from the situation posed here, in which the insurer is providing both defense and indemnification under the highest limits policy under which coverage is asserted by the insured. Indeed, any reading of *Risely* that is not strictly limited to its facts cannot be reconciled with the California Supreme Court's decision in *Hamilton.*

Discussion

AN INSURED AND AN INJURED PARTY THAT HAVE ENTERED INTO A STIPULATED JUDGMENT AND COVENANT NOT TO EXECUTE CAN NOT AVOID THE RULE IN *HAMILTON* BY ALLEGING THE ERRONEOUS DENIAL OF COVERAGE UNDER ANOTHER POLICY WITH LOWER LIMITS.

This brief addresses the first and third questions posed by the Court in its January 27, 2015 Order. These questions, in conjunction, frame the issue of concern to Amici: Whether the Court of Appeal decision in *Risely v. Interinsurance Exchange of Auto. Club* (2010) 183 Cal.App.4th 196 should be interpreted so as to significantly erode the California Supreme Court's ruling in *Hamilton v. Maryland Casualty Co.* (2002) 27 Cal.4th 718.

Put somewhat differently, can an insured and a plaintiff, by entering into a stipulated judgment in excess of policy limits and a covenant not to execute, defeat the right of an insurer to provide a defense, simply by asserting potential coverage under another policy? In particular, where all of the policies under which an insured asserts coverage impose an obligation on the insurer to provide a defense and the insurer is defending, without a reservation of rights, under the policy that has the highest limits, can giving any effect to the stipulated judgment be squared with the rule in *Hamilton*?

Under the outcome sought by plaintiffs, insureds and plaintiffs could generate open-ended coverage limits – after the accident occurs and without any premium charge to the policyholder. The result would be higher costs, generating upward pressure on premiums, and a perverse incentive for insureds to reduce the limits of coverage purchased.

A. The Effect of the Covenant Not To Execute Under *Hamilton v. Maryland Casualty.*

The Court authorized the parties to submit briefing on three points, the first of which was: "[T]he effect of the covenant not to execute under *Hamilton v. Maryland Casualty Co.* (2002) 27 Cal.4th 718."

Like *Hamilton*, this case involves an insurer's "duty to settle." The California Supreme Court has succinctly summarized the applicable principles as follows:

> One of the most important benefits of a maximum limit insurance policy is the assurance that the company will provide the insured with defense and indemnification for the purpose of protecting him from liability. Accordingly, the insured has the legitimate right to expect that the method of settlement within policy limits will be employed in order to give him such protection.
>
> Consistent with these principles, a liability insurance policy's express promise to defend and indemnify the insured against injury claims implies a duty to settle third party claims in an appropriate case. More specifically, the insurer must settle within policy limits when there is substantial likelihood of recovery in excess of those limits. The duty to settle is implied in law to protect the insured from exposure to liability in excess of coverage as a result of the insurer's gamble – on which only the insured might lose. An insurer that breaches its implied duty of good faith and fair dealing by unreasonably refusing to accept a settlement offer within policy limits may be held liable for the full amount of the judgment against the insured in excess of its policy limits.

(*Kransco v. American Empire Surplus Lines Ins. Co.* (2000) 23 Cal.4th 390, 400-401; citations and internal quotation marks omitted.)

In this action, the plaintiffs seek to show that 21st Century acted in bad faith by failing to settle a suit against its insured within the allegedly applicable policy limits. To prevail, the plaintiffs must show that the insured was damaged by 21st Century's refusal to settle. Their only basis for establishing damages is an agreed judgment in an amount far exceeding even the highest limits for which 21st Century might be obligated.

The question in *Hamilton* was whether a stipulated judgment, coupled with a covenant not to execute against the insured, "may be treated as a presumptive measure of the damages the policyholder has suffered as a result of the insurer's breach of contract." (*Hamilton*, *supra*, 27 Cal.4th at 725.) The Supreme Court held it could not, at least where the insurer was providing a defense to the insured.

The essential holding of *Hamilton* was as follows:

> [W]here the insurer has accepted defense of the action, no trial has been held to determine the insured's liability, and a covenant not to execute excuses the insured from bearing any actual liability from the stipulated judgment, the entry of a stipulated judgment is insufficient to show, even rebuttably, that the insured has been injured to any extent by the failure to settle, much less in the amount of the stipulated judgment. In these circumstances, the judgment provides no reliable basis to establish damages resulting from a refusal to settle, an essential element of plaintiffs' cause of action.

(*Hamilton*, *supra*, 27 Cal.4th at 726, emphasis in original.)

Hamilton approved a line of Court of Appeal cases holding that "settlements reached without the consent or participation of the defending insurer, and incorporating a covenant not to execute or similar device, are

entitled to no weight in a later action against the insurer for failure to settle." (*Hamilton*, *supra*, 27 Cal.4th at 726.)

The *Hamilton* court distinguished cases where an insurer denies a defense altogether, thereby giving up its right to contest liability. In such cases, "the denial of coverage *and a defense* entitles the policyholder to make a reasonable, noncollusive settlement without the insurer's consent and to seek reimbursement for the settlement amount in an action for breach of the covenant of good faith and fair dealing." (*Hamilton*, *supra*, 27 Cal.4th at 728, emphasis added.) The justification for this rule is that the insured, faced with the prospect of funding its own defense, is entitled to make an agreement with the claimant in order to avoid personal liability. (See *id.* at 728-729.) A stipulated judgment then becomes presumptive, but not conclusive evidence of the fact and amount of the insured's liability. (*Isaacson v. California Ins. Guarantee Assn.* (1988) 44 Cal.3d 775, 791)

Hamilton pointed out that if the insured believes a *defending* insurer has breached a duty to accept reasonable settlements, the insured may negotiate an agreement with the claimant, before trial, to assign its bad faith rights in exchange for a covenant not to execute. "'This assignment, however, is not immediately assertable, and it does not settle the third party's claim. *As long as the insurer is providing a defense, the insurer is allowed to proceed through trial to judgment.* The assignment of the bad faith cause of action becomes operative after the excess judgment has been rendered.'" (*Hamilton*, *supra*, 27 Cal.4th at 732, quoting *Safeco Ins. Co. v. Superior Court* (1999) 71 Cal.App.4th 782, 788-789 (emphasis added).)

Turning to the effect of a covenant not to execute, *Hamilton* instructs that the answer depends on whether the insured is being provided with a defense. If the insurer has refused to defend the insured, then a covenant not to execute will not preclude a finding that the insured has been

damaged in the amount of the stipulated judgment. (*See, e.g., Isaacson v. California Ins. Guarantee Assn.* (1988) 44 Cal.3d 775, 791.) But if the insurer *is* providing a defense, then the covenant not to execute precludes a finding "that the insured has been injured to *any* extent by the failure to settle." (*Hamilton, supra*, 27 Cal.4th at 726, emphasis in original.)

B. If The Existence Of Other Coverage Were Legitimately in Doubt, Risely v. Interinsurance Exchange Can Readily Be Distinguished.

The Court also asked the parties for briefing as to "[w]hether, if coverage remained legitimately in doubt, *Risely v. Interinsurance Exchange of Auto. Club* (2010) 183 Cal.App.4th 196 may be distinguished."

The initial obvious distinction between this case and *Risely* is that here, there is no dispute about whether the claims against Tapia are covered under the policy under which 21st Century is providing a defense – the only issue is whether the amount of insurance is $100,000 or $150,000. In *Risely*, the court appears to have been concerned that some of the claims against the insured – the false imprisonment claims – would not be covered under the policy which was providing a defense.

A second obvious distinction is that nowhere in *Risely* does the court state whether – as in this case – the insured received a covenant not to execute the judgment against him. But even if there were such a covenant, *Risely* cannot be reconciled with *Hamilton* and should not be followed. *Hamilton* established that where an insurer provides a defense to its insured, a stipulated judgment coupled with a covenant to execute is entitled to no weight whatsoever in determining whether the insured was damaged by a breach of the insurer's duty to settle. There is no principled

basis to deny a defending insurer its right to contest the insured's liability, simply because it disputes coverage under another policy.

Risely purported to distinguish *Hamilton* on the following grounds:

> Auto Club contends that Turner could not have suffered any damages, as a matter of law, from Auto Club's alleged breach of its duty to defend because Auto Club provided Turner a defense under a separate policy. However, the situation in this case differs from that in *Hamilton* because in *Hamilton*, the insurer accepted its defense obligations under all relevant policies. [Citation] The *Hamilton* court thus did not have occasion to consider the issue in this case, i.e., whether an insured can establish damages stemming from an insurer's breach of its duty to defend where the insured is owed a duty to defend under more than one policy. *Hamilton* is not therefore controlling on this issue."

(*Risely v. Interinsurance Exch. of Auto. Club* (2010) 183 Cal.App.4th 196, 214.)

Thus, *Risely* essentially treated the Auto Club's *full* defense of its insured as no defense at all, merely because there was a coverage dispute under a second policy. Risely thus utterly ignored the key principle recognized in *Hamilton*: the *defending* insurer's right to contest the insured's liability. If followed to its logical conclusion, the rule adopted by *Risely* would essentially eviscerate the insurer's right to defend its insured in any case where there is a coverage dispute.

The duty to defend "entails the rendering of a service, viz., the mounting and funding of a defense." (*Buss v. Superior Court* (1997) 16 Cal.4th 35, 46.) The court in *Buss* explained that "[t]o defend meaningfully, the insurer must defend immediately. To defend immediately, it must defend entirely." (*Id.* at 49, citations omitted.) As a

practical matter, an "entire" defense by an insurer under one policy is no less "entire" than a defense under multiple policies. In *Risely*, there was no dispute that the insurer provided an "entire" defense to its insured, even though it disputed coverage under one of the two policies at issue. Thus, the only possible rationale for the *Risely* court's decision is not that the insured was left without a defense, but that the insurer's position potentially exposed the insured to non-covered liability. (See *Risely*, 183 Cal.App.4th at 215, noting that "the rationale for permitting an insured to enter into a settlement that may bind the insurer without the insurer's consent upon an insurer's breach of the duty to defend" is to "allow the insured to minimize the insured's potential exposure to liability.")

But *Risely* stands entirely alone in concluding that "potential exposure to liability" is sufficient to negate an insurer's right to defend. Insurers commonly defend suits in which their insureds are potentially exposed to non-covered liability, and indeed the California Supreme Court has developed case law that encourages them to do so.

It is axiomatic that "[o]nce the defense duty attaches, the insurer is obligated to defend against all of the claims involved in the action, both covered and noncovered, until the insurer produces undeniable evidence supporting an allocation of a specific portion of the defense costs to a noncovered claim." (*Horace Mann Ins. Co. v. Barbara B.* (1993) 4 Cal.4th 1076, 1081.) Thus, it is not at all uncommon for an insurer to provide a complete defense to a lawsuit, but reserve the right to deny indemnity for one or more claims within the lawsuit. Indeed, part of the Supreme Court's rationale for permitting insurers to seek reimbursement for defense and settlement is that such a right "encourages insurers to defend and settle cases for which insurance coverage is uncertain." (*Blue Ridge Ins. Co. v. Jacobsen* (2001) 25 Cal.4th 489, 503.)

As a hypothetical variation on the facts of *Risely*, suppose the Auto Club had issued a single comprehensive policy providing both auto and homeowners coverage. And further suppose that the Auto Club provided a complete defense to its insured for Ms. Risely's claims while relying on an exclusion to dispute coverage for false imprisonment, which would otherwise be covered. Suppose further that the insurer, in bad faith, rejected a reasonable settlement offer within the limits of its policy on the ground that the false imprisonment claim was not covered, but continued to defend. Under the rule adopted by *Risely*, an insured being provided with a defense would be entitled to enter into a stipulated judgment with the claimant, over the objections of the insurer, and assign its bad faith rights to the claimant. In effect, *Risely* held that a defending insurer gives up its right to defend, merely by denying an obligation to indemnify.

But under *Hamilton*, a *defending* insurer's liability for breach of its settlement duties can *only* be determined after the case against the insured has proceeded to trial. *Risely* does not explain why the result should be any different where the insurer is asserted to have erroneously disclaimed coverage under multiple policies rather than a single policy.

Indeed, *Risely* in this regard is plainly contrary to *Safeco Ins. Co v. Superior Court* (1999) 71 Cal.App.4th 782, which was cited with approval by *Hamilton*. In *Safeco*, a homeowners insurer provided a defense in a wrongful death action arising out of a shooting from a motor vehicle, while reserving the right to deny coverage based on motor vehicle exclusion. The insured and the injured party stipulated to a judgment and sought to enforce the judgment against the homeowners insurer. The Court of Appeal granted the insurer's writ petition, finding that the trial court erroneously denied the insurer's motion for summary judgment. The court found:

> When, as here, the insurer is providing a defense but merely refuses to settle, the insured has no immediate remedy. A cause of action for bad faith refusal to settle arises only after a judgment has been rendered in excess of the policy limits. If the insurer declines to settle and decides to go to trial and then obtains a judgment below the settlement offer or obtains a complete defense verdict, then the insured would have no cause to complain, and the insurer would have no liability. *Until judgment is actually entered, the mere possibility or probability of an excess judgment does not render the refusal to settle actionable.*

(*Safeco Ins. Co v. Superior Court*, *supra*, 71 Cal.App.4th at 788; citations omitted, emphasis added.) Thus, *Risely* erred in finding that uninsured liability is sufficient to defeat an insurer's right to defend.

A defense under *any* policy is a complete defense, and entitles the insurer to contest the insured's liability. There is no difference between a single-policy insurer that provides a defense despite disputing coverage under its single policy, and a multiple-policy insurer that provides a defense while disputing coverage under one or more of its other policies. In either case, the defending insurer is entitled to reject settlement offers and contest the insured's liability. If the insurer is wrong as to coverage or the amount of the insured's liability, the remedy, as explained in *Hamilton*, is a post-judgment bad faith suit.

Adoption of the position asserted by plaintiffs would create a strong incentive for the use of stipulated judgments in conjunction with covenants not to execute as a mechanism to avoid the limits of coverage and defeat the insurer's right to defend, in any case where there is a colorable argument for coverage under one or more additional policies. The

expansion of the rule created by *Risely* would inevitably result in additional liability for insurers, that in turn would put upward pressure on premiums.

Situations in which there is potential coverage under multiple policies are common. If the rule in *Hamilton* becomes so eroded that a practice of entering into stipulated judgments with covenants not to execute becomes widespread, there could be an adverse impact on both policyholders and accident victims. There would be perverse incentives for insureds to purchase lower limits of coverage, in the confidence that they can be protect themselves from judgments by entering into covenants not to execute rather than purchasing adequate insurance.

CONCLUSION

The California Supreme Court articulated a sound and sensible rule for addressing stipulated judgments and covenants not to execute in *Hamilton*. Allowing an end run around *Hamilton* through an assertion of coverage under another policy with lower limits involves an expansive reading of *Risely v. Interinsurance Exchange, supra.* As it is difficult to reconcile *Risely* with *Hamilton*, the extension of *Risely* sought by plaintiffs is inappropriate and would create perverse incentives for litigants.

DATED: March 3, 2015

Respectfully submitted,

SEDGWICK, LLP

By: 

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Attorneys for Amici Curiae Personal Insurance Federation of California and Property Casualty Insurers Association of America

CERTIFICATION OF PAGE COUNT

Pursuant to California Rules of Court, Rule 8.204(c)(1), the undersigned hereby certifies that this application and brief consists of 3,485 words, excluding the cover, the tables of contents and authorities, the signature blocks, the proof of service and this certification page.

DATED: March 3, 2015

Respectfully submitted,

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PROOF OF SERVICE

I am a resident of the State of California, over the age of eighteen years, and not a party to the within action. My business address is Sedgwick LLP 333 Bush Street, 30th Fl., San Francisco, CA 94104. On March 3, 2015, I served the within document(s):

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Elizabeth S. Verano

Elizabeth S. Verano

Verano, Elizabeth

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Sent: Tuesday, March 03, 2015 10:40 AM
To: Verano, Elizabeth
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The following Appellate Document has been submitted.

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Name of Attorney or Self-Represented Party Who Prepared Document: Hilary Rowen; Michael Topp

Bar Number of Attorney: SBN 152932; SBN 148445

List of Attachment(s):

E062244_AmicusCuriaeBrief.pdf