Supreme Court Case No. S 157937
[2nd Civil Nos. B 179825 and B 182737]

IN THE SUPREME COURT OF

OF THE STATE OF CALIFORNIA

CECILIA ENCARNACION, et al. Plaintiffs and Appellants, vs. 20th CENTURY INSURANCE COMPANY, Defendant and Appellant	Supreme Court Case No. S 157937

From a Decision of the Second District Court of Appeal
Division One
[2nd Civil Nos. B 179825 and B 182737]

ANSWER TO PETITION FOR REVIEW

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1.

INTRODUCTION

In one of the most egregious examples of insurer bad faith on record, the trial court found on abundant evidence the 20th Century had devised a scheme to mislead its insured into believing that it would settle a wrongful death claim against him in the event that he pled to involuntary manslaughter, when in fact 20th was planning to use that very plea as a pretext to deny coverage on the basis of a criminal acts exclusion. Its execution of this fraudulent scheme, and its subsequent refusal to settle what was admittedly an excess of policy claim, subjected its insured to a $5.6 million judgment.

20th Century undertook the defense of the wrongful death action under an ambiguous reservation of rights letter which accepted coverage subject to several policy exclusions. In the trial below, plaintiffs elected to rely upon equitable doctrines to preclude 20th Century from invoking those policy defenses, thereby establishing coverage, and 20th conceded that loss of the right to rely on policy exclusions would mean that it was liable for the entire underlying judgment against its insured.

20th Century does not contend on this Petition that the evidence was insufficient to demonstrate the bad faith and intentional deception of its insured which underlies the trial court's application of equitable estoppel, forfeiture and promissory estoppel to preclude policy defenses and establish coverage. Rather, it contends that findings barring its invocation of policy defenses are meaningless because those very exclusions prevent "coverage" under the contract, and thus preclude any contractual liability for either the resulting wrongful death judgment or for the fees incurred in forcing 20th Century to pay that judgment.

This confused argument was rejected by the Court of Appeal in an Opinion in this very case in 2000 which this Court declined to review. 20th Century tacitly admits than that its insured's acts came within the scope of the ensuring clause, and fails to explain just why equitable preclusion to assert policy exclusions does not result in contractual liability. 20th Century admitted before

the trial court that a finding in plaintiffs' favor on the equitable theories would establish its liability for the underlying judgment, and it was understood throughout the litigation of this case below and on appeal that an equitable decision depriving 20th Century of coverage defenses would result in coverage under the contract and thus liability for unreasonable refusal to settle.

There is no novelty in the Court of Appeal's Opinion, and no issue even arguably requiring clarification by this Court or meriting review.

2.
STATEMENT OF THE CASE

20th Century Insurance insured Ramon Aguilera under a homeowner's liability policy. After the elderly Aguilera shot and killed Marco Gonzalez, Sr. in a confrontation at Aguilera's property, 20th Century not only failed to provide Aguilera with *Cumis* counsel and an explanation of the nature of the conflict with its insured, but formulated a secret plan to withdraw coverage based on a criminal plea which it knew was being negotiated, knowing that Aguilera was unaware of the consequences of such plea. 20th Century not only kept from the insured and the claimants (the Encarnacions) its plan to use any criminal plea to avoid coverage, it affirmatively misled them into believing that it would pay the policy in the event Aguilera pled to involuntary manslaughter.

Plaintiffs elected to rely upon equitable theories to preclude 20th Century from invoking its three coverage defenses: policy exclusions for "business pursuits," "intentional acts," and "criminal acts." In the trial of these equitable issues, the Superior Court determined that by reason of its deliberate scheme to mislead its insured Ramon Aguilera, 20th Century was barred by equitable estoppel and forfeiture from invoking policy exclusions, and that it was bound by promissory estoppel to afford coverage.

A. Trial Court Findings

As stated in the trial court's Statement of Decision ("SOD"), after Marco

Gonzalez, Sr. was shot and killed, Ramon Aguilera was charged with murder. He hired criminal attorney Jay Jaffe and asserted that the shooting was an accident or in self-defense. Gonzalez' survivors, the Encarnacions, filed a suit for wrongful death. (SOD 2:6-28)

20th accepted defense of the Encarnacion suit in a June 1994 Reservation of Rights letter which asserted certain exclusions under the policy, including one for "criminal acts" - but also suggested that only an ***intentional*** criminal act would be excluded. Both Judge Czuleger and the Court of Appeal in 2nd Civil No. B 127594 found this letter misleading. (App. 45; SOD 3:1-19, 9:25-28)

20th Century instructed its retained defense counsel to obtain from Aguilera a waiver of his right to *Cumis* counsel, but failed to advise Aguilera or defense counsel of the basis for the potential conflict of interest. (SOD 3:20-4:12) Unknown to Aguilera or the Encarnacions, 20th Century's in-house counsel Carol Brennan decided by June 3, 1994 to invoke the criminal acts exclusion to deny coverage for the Encarnacion suit if Aguilera pled guilty to *any* crime related to the death of Marco Gonzalez, even a non-intentional crime. (SOD 5:4-17) 20th Century retained an outside attorney, Michael Leahy, to provide coverage advice and monitor Aguilera's criminal case. Leahy and Brennan were aware by July 5, 1994 of a potential plea. (SOD 5:18-6:7)

> In his letter of July 5, 1994 to Brennan, [Leahy] furthermore concluded, without reservation, that, "Obviously, if he [Aguilera] pleads to a lesser offense, the criminal acts exclusion should take this matter out of coverage." This letter, however, was never shared with de Montesquiou, Jaffe, Aguilera or any of the parties involved with attempts to work out a plea on the criminal case and simultaneous disposition in the civil case - a disposition which envisioned 20th Century paying out the policy limits from Aguilera's homeowner's policy.
>
> **It was, however, shared with 20th Century's claims office**. In mid-July, 1994, Robert Grabot, a claims manager, received the Leahy opinion letter discussing denial of coverage if Aguilera was convicted. Grabot forwarded the letter on to Jamie

Brown. Consequently, as of mid-July, not only were 20th Century's attorneys aware of the potential applicability of the criminal acts exclusion, but **the claims representation also knew that 20th Century's lawyers intended to exclude coverage if there was a plea. They knew, but then continued their discussions with Aguilera without letting him in on it. In other words, 20th Century had reached a conclusion of non-coverage when they knew others were assuming coverage if a plea with the District Attorney could be worked out.**
[SOD 6:2-15, emphasis added.]

The claims office stood silent in the face of this information [of the pending plea] and knowledge of the Leahy opinion letter regarding coverage. **They stood silent despite the fact that 20th Century knew that there would be no coverage if Aguilera entered a plea to the criminal charge.**
[SOD 7:20-22, emphasis added.]

But is this a case of pure mistake? Unfortunately for 20th Century, the answer is no. Going certainly back to the Brennan/Leahy exchange of letters in June/July 1994, **20th Century knew, but did not disclose, that even if Aguilera entered a plea to virtually any criminal act arising from this event, the coverage would be denied.** This opinion was adopted by its lawyers and later sent to 20th Century's claims office. **More importantly, 20th Century knew that the parties were discussing just such a plea. But knowing this, 20th Century failed to advise its insured, his counsel, the plaintiffs' counsel, the victims, the District Attorney's office, the Court or anyone that had a need to know such an important fact before the plea was entered.** Leahy only told Brennan who in turn advised the claims office. But Brennan did not tell any of the parties involved in Aguilera's plea negotiations – this despite admissions at trial that if the insurance company believed that its insured is operating under a misapprehension, the company had a duty to clear it up.
[SOD 8:21-9:3, emphasis added]

. . . 20th Century knew that any relevant criminal convictions would end Aguilera's right to coverage. 20th Century waited to inform others

> **until just after the plea. 20th Century waited too long. 20th Century's course of conduct here communicated an intent which misled its insured.** 20th Century's actions suspend its otherwise valid insurance policy exclusions.
> [SOD 9:7-11, emphasis added]

> . . . **20th Century's conduct in concealing its true intent to deny coverage evidences its subjective intent.** 20th Century employees knew that the criminal acts exclusion would be asserted regardless of whether Aguilera pled guilty to an involuntary, or negligent crime versus an intentional crime, **yet the employees consciously avoided disclosing this fact to Aguilera, the Encarnacions, deMontesquiou, Shaver, Jaffe, or [District Attorney] Wullschleger.** . . . **20th Century's employees' conduct and their intention to rely on the exclusion, despite representations to all involved that the exclusion would only apply to intentional criminal acts exhibits 20th Century's subjective intent.**
> [SOD 12:5-20, emphasis added]

> 20th Century at every opportunity engaged in conduct and made representations which would have caused any reasonable insured and his representatives to believe that a guilty plea would not foreclose coverage. Most importantly, **20th Century represented by word and action this promise of coverage, yet 20th Century knew that there would be no coverage.**
> [SOD 14:11-14, emphasis added.]

The Court found that 20th had knowingly caused Aguilera and the Encarnacions to believe that the policy would be paid in settlement of the Encarnacions' claim if Aguilera pled to involuntary manslaughter.

On August 3, 1994, the Encarnacions made a formal demand to settle the wrongful death case for the $100,000 policy limits. On August 4, Aguilera pled guilty to involuntary manslaughter under Penal Code §192(b), thinking the plea would terminate the criminal and civil actions and provide insurance money as restitution for Gonzalez' children. Defense counsel reported Aguilera's plea, as well as the policy limits demand. As it had planned, 20th Century jumped on

Aguilera's plea to deny coverage. (SOD 7:23-8:7) On August 8, 1994, Leahy wrote to Aguilera to deny coverage based on the plea.

On August 8, Leahy also replied to Jaffe's August 2 letter to 20th Century. Contradicting the reservation of rights letter, Leahy stated for the first time 20th Century's position that **any criminal plea** voided coverage.

On April 11, 1995, Encarnacion obtained summary adjudication in the civil action that Aguilera negligently shot and killed Marco Gonzalez, Sr. 20th Century rejected numerous offers to settle the case for the policy limits A jury trial of damages resulted in a $5,612,500 judgment against Aguilera. After assignment of certain rights by Aguilera to the Encarnacions, this action seeking policy benefits and bad faith damages was filed.

B. **The Initial Appeal**

Summary judgment was granted to 20th Century in 1999 on the basis of the coverage exclusions. In Encarnacion v. 20th Century, 2nd Civil No. B 127594 (App. 35-49), the Court found a triable issue as to whether 20th was estopped to assert policy exclusions by reason of having misled Aguilera as to the effect of a plea. That Opinion identified three theories under which 20th Century may have lost the right to invoke the policy exclusions. Referring to the exclusions, the Opinion states at page 10:

> [A]n insurer may lose a contractual right by: (1) waiver, an intentional relinquishment of a known right demonstrated expressly or implicitly; (2) estoppel, conduct by the insurer that reasonably causes an insured to rely to his detriment; or (3) forfeiture, the assessment of a penalty against the insurer for either misconduct or failure to perform an obligation under the contract." (Chase v. Blue Cross of California (1996) 42 Cal.App.4th 1142, 1151, italics added.) . . .

C. The Present Judgment for the Encarnacions

Based upon the Opinion in 2nd Civil No. B 127594, Plaintiffs elected to rest coverage upon the equitable claims that 20th Century was estopped or had forfeited the exclusions which were 20th's sole defense to liability under the policy. The trial resulted in the findings cited above.

The Court determined on motion for summary adjudication that the equity phase findings barring 20th Century from raising policy exclusions rendered it liable for the wrongful death judgment. The court also ruled that the right to attorney fees under Brandt v. Superior Court (1985) 37 Cal.3d 813, 210 Cal.Rptr. 211, was not assignable. Judgment was entered based on these two rulings.

3.

THE CASE PRESENTS NO ISSUE AS TO THE EXISTENCE OF COVERAGE OR APPLICATION OF THE JOHANSEN RULE

A. 20th Century's Coverage Argument was Raised in the First Appeal and is Barred by the Law of the Case Doctrine

The contention that the application of equity to bar policy exclusions will not render the insurer liable for failure to settle is a slightly rephrased version of 20th Century's argument on the first appeal that estoppel to invoke policy exclusions "created" coverage where there was none. This was addressed in the first Opinion as follows:

> 20th Century contends that Aguilera's estoppel argument is nothing more than a failed attempt to create coverage where none ever existed. (See Aetna Casualty & Surety Co. v. Richmond (1977) 76 Cal.App.3d 645, 652-653.) Not so. Aguilera argues that, despite 20th Century's reservation of rights, (1) its agents subsequently made representations about coverage, (2) Aguilera relied upon those representations to his detriment, and (3) 20th Century is bound by them. (See Tomerlin v. Canadian Indemnity Co. (1964) 61 Cal.2d 638.)
> [Opinion 2nd Civil No. B127594, pg. 10 fn. 17]

20th Century petitioned for rehearing, asserting that the Court of Appeal had "Erroneously Failed to Reach the Coverage Issues in this Case and the Question of Estoppel Cannot Properly be Analyzed Except in the Context of Coverage or Lack of Coverage." It then petitioned for review, asserting that equitable estoppel "cannot be used to create coverage under an insurance policy where none existed. This Court denied review on the very issue. (Supreme Court Case No. S 089242)

Hence, the question of coverage was addressed in the first appeal, and that holding is now the law of the case.

B. 20th Century Failed to Preserve Any Issue as to Johansen before the Trial Court

The claim that Johansen v. CSAA (1975) 15 Cal.3d 9, 123 Cal.Rptr. 288, does not render the insurer liable for the full amount of the underlying judgment was not preserved below. Before the trial court, 20th Century conceded that if estoppel was found, it would owe the entire underlying judgment. (RT B30:26-B31:2) On February 22, 2002, 20th stated that if it lost on estoppel, "we lose the $8 million," and acknowledged that if plaintiffs prevailed in equity, "the court could then direct a verdict on $8 million in damages." "Nobody disputes that. . . Everybody agrees that the wrongful death case was worth substantially in excess of a hundred thousand dollars and that the only defense we had was coverage. So if we lose that defense of coverage the court could direct a verdict." (RT C41:22-C42:26)

20th Century thus conceded that equitable estoppel or forfeiture of policy defenses would bar it from denying liability for the underlying judgment.

C. Equity May Bar an Insurer's Denial of Coverage Under Well-Established Precedent

As the statements above-cited from its counsel demonstrate, 20th Century never contended that the Encarnacion claim did not come within the insuring

clause of Aguilera's policy - only that the exclusions eliminated coverage. Hence, the contention that there was no finding of coverage or contract breach is no more than the claim that the exclusions apply for purposes of contractual liability even when the insurer is barred from raising them. This claim has no support in law or public policy.

It is well established that an insurer may be barred by estoppel or forfeiture from asserting policy defenses - exactly as happened here - with the result that the matter is covered under the terms of the policy. It is equally well established that an insurer breaching the duties to defend or to settle within policy limits where liability in excess of the policy is clear will be liable for the entire underlying judgment against its insured.

20th Century accepted coverage and the defense of the Encarnacion's action subject to the exclusions identified in its Reservation of Rights letter. It denied coverage solely on the grounds of the plea - the criminal acts exclusion. Estoppel and forfeiture goes to the exclusions in the policy and bar the insurer from denying coverage for the wrongful death action, just as held in the first Opinion. Estoppel to rely upon an exception to coverage, or to deny coverage, is well accepted. Canadian Ins. Co. of California v. Rusty's Island Chip Co. (1995) 36 Cal.4th 491, 498, 42 Cal.Rptr.2d 505; Tomerlin v. Canadian Indemnity Co. (1964) 61 Cal.2d 638, 648, 39 Cal.Rptr. 731 (carrier's representations estopped it from denying coverage for assault, even if willful misconduct would otherwise have precluded coverage); Sarchett v. Blue Shield (1987) 43 Cal.3d 1, 233 Cal.Rptr. 76; Chase v. Blue Cross of California (1996) 42 Cal.App.4th 1142, 50 Cal.Rptr.2d 178; Vu v. Prudential Property & Casualty Ins. Co. (2001) 26 Cal.4th 1142, 113 Cal.Rptr.2d 70.

Estoppel in the instant case does not expand the insuring clause, but merely prevents the unfair application of exclusions. Estoppel merely preserves the reasonable expectation under the policy that the insurer's own adjustors engendered, leaving coverage to be enforced as a matter of contract and tort law. As Humetrix, Inc. v. Gemplus S.C.A. (9th Cir. 2001) 268 F.3d 910, states, estoppel to assert a defense to a contract claim does not mean that equity

provides the cause of action upon which damages is based.

> That Humetrix used equitable estoppel to defeat Gemplus's statute of frauds defense has no bearing on the damages Humetrix may recover. The kind of damages a party may recover is determined by the kind of claim it brings and by the evidence it adduces. Humetrix's claims against Gemplus are for breach of contract. That was the theory under which Humetrix brought suit, and the theory under which the jury found Gemplus liable and awarded damages to Humetrix. Accordingly, Humetrix may recover damages appropriate to a breach of contract claim. [Humetrix, *supra*, 268 F.3d 918]

Equity's limited role in barring policy defenses leaves damages to be determined according to contract and bad faith law. Humetrix, *supra*, Paularena v. Superior Court (1965) 231 Cal.App.2d 906, 913, 42 Cal.Rptr. 366.

20th Century's assertion that estoppel and forfeiture are "defenses" and not causes of action is immaterial, for 20th's own reservation of rights letter asserts that there is coverage unless the exclusions apply. Plaintiffs relied on equity to prevent the assertion of policy defenses, not as a "cause of action," and liability for the underlying judgment rests on an uncontradicted breach of the insurer's contractual duty to defend, settle and indemnify.

The cases relied upon by 20th Century are not to the contrary. Manneck v. Lawyers Title Ins. Corp. (1994) 28 Cal.App.4th 1294, 1303, 33 Cal.Rptr.2d 771, and Quan v. Truck Ins. Exchange (1998) 67 Cal.App.4th 583, 79 Cal.Rptr.2d 134, involved cases where there was no potential coverage under the policy and thus no duty to indemnify **or defend.** As discussed below, the duty to defend admittedly existed in this case (since it is broader that the duty to indemnify), and the duty to properly advise regarding coverage issues, and to consider and accept reasonable settlement offers without regard to unresolved coverage disputes is a corollary of the duty to defend. Johansen v. CSAA, *supra*, 15 Cal.3d 9; Blue Ridge Insurance Co. v. Jacobsen (2001) 25 Cal.4th 489, 504, 106 Cal.Rptr.2d 535. Liability here rests on breach of the duty to properly inform the insured regarding preservation of rights under the policy, and breach of the duty to settle,

which existed so long as there was no conclusive adjudication of non-coverage. See discussion below. Hence, there was a contractual and good faith duty (*i.e.* coverage) upon which to base liability, and no creation of a duty where none otherwise existed, as in Manneck or Quan.

This violation of an existing duty of truthfulness and a duty not to unreasonably deprive the insured of the protection of the right to a defense and the obligations attendant thereon distinguishes those cases from Tomerlin and other cases discussed below, and cases where the insurer acted so as to prejudice the insured's ability to preserve coverage. In other words, liability here *is* based on coverage - an admitted and assumed duty to defend, to properly advise on the preservation of coverage, and to provide *Cumis* advice. Hence, it is absurd to assert that it does not rest on a contractual duty which will support application of Johansen.

Calfarm Insurance Co. v. Krusiewicz (2005) 131 Cal.App.4th 273, 284, 31 Cal.Rptr.2d 619, is likewise inapposite. It says no more than that punitive damages cannot be based on promissory estoppel where the promise did not constitute a breach of the duty of good faith under the policy, and thus the promise was independent of any duty under the policy - exactly the obverse of the present situation. 20th Century's deceit and promise implicated its existing duty to defend and properly advise the insured how to preserve coverage, and was unquestionably in bad faith violation of its implied duty under the policy.

D. Decisional Law Unequivocally hold that an Insurer Which Unreasonably Refused to Defend or Settle is Liable for the Entire Underlying Judgment

20th Century claims that under Johansen v. CSAA, *supra*, 15 Cal.3d 9, an insurer which refuses a reasonable settlement offer is liable only for the amount of the policy if there is "no coverage," and that there was no coverage in the instant case upon which to premise liability. As noted above, coverage was established in equity pursuant to the principles laid down in the first Opinion in 2000. Under the trial court's findings, ***there is coverage since the exclusions***

are barred by breach of an existing duty. 20th's argument is thus irrelevant.

Contrary to the imputation of 20th's argument, there is abundant authority holding that an insurer equitably barred from denying coverage will be held liable for the entire amount of the underlying judgment. Tomerlin v. Canadian Indemnity Co., *supra*, 61 Cal.2d 638, 649, expressly held that the proper measure of damages under promissory estoppel where there was reliance on the insurer's representation of coverage was the amount of the underlying judgment.

In Miller v. Elite Insurance Co. (1980) 100 Cal.App.3d 739, 161 Cal.Rptr. 322, an insurer was held to have waived and be estopped to deny coverage under the exclusionary clause of a liability policy. The Court upheld a directed verdict in the amount of the excess underlying judgment based upon the insurer's admission that it knew that an excess of policy judgment was the likely result of failure to settle, which established the insurer's bad faith.

In Gray v. Zurich Insurance Co. (1966) 65 Cal.2d 263, 54 Cal.Rptr. 104, the insurer wrongfully failed to defend an assault case on the grounds of an intentional acts exclusion. Imposing full liability for the underlying judgment, the Court refused to impose on the insured "'the impossible burden' of proving the extent of the loss caused by the insurer's breach," or even the burden of proving that the underlying judgment was rendered on a theory within policy coverage, for such a burden "'would tend . . . to encourage insurance companies to similar disavowals of responsibility with everything to gain and nothing to lose.'" (*Id.* at 280, quoting Arenson v. National Auto. & Cas. Ins. Co. (1957) 48 Cal.2d 528, 539, 310 P.2d 961) See also Amato v. Mercury Casualty Co. (1997) 53 Cal.App.4th 825, 832-833, 61 Cal.Rptr.2d 909 (insurer tortiously breaching duty to defend may be liable even if claim is not covered.)

20th's position is that the insurer should be allowed to gamble that it can beat coverage, and then be free of responsibility for the excess judgment if it loses. Public Policy holds that when the insurer plays games with the insured's financial security, the risk of loss must fall on the carrier. Amato v. Mercury Cas., *supra*, 53 Cal.App.4th 825, holds that an insurer which breaches the duty to

defend is liable for the underlying judgment even if claim is not covered, following Mullen v. Glens Falls Ins. Co. (1977) 73 Cal.App.3d 163, 140 Cal.Rptr. 605, where the insured was allowed to recover both costs of defense and the underlying judgment - notwithstanding a judgment that vindicating the insurer's belief in non-coverage - because the insurer denied coverage without a proper investigation and so could not rely on a subsequent coverage adjudication.

> May an insurance company, without making an investigation of any kind, deny an insured a defense at a time when it has reason to believe that there is a potential liability under the insurance policy, and then rely upon the results of the personal injury lawsuit and subsequent factors to prove that there was in reality no potential liability in the first instance?
>
> We believe that public policy alone mandates a negative answer . . .; otherwise an insurance carrier could refuse to defend its insured on the slightest provocation and then resort to hindsight for the justification
> [Mullen, 77 Cal.App.3d at173, quoted by Amato, *supra,* 53 Cal.App.4th at 832]

The duty to settle - to accept a reasonable settlement offer when there is a clear risk of an excess judgment *without regard to coverage disputes* - is a corollary of the duty to defend. Johansen v. CSAA, *supra*, 15 Cal.3d 9; Blue Ridge Insurance Co. v. Jacobsen, supra, 25 Cal.4th 489, 504; Commercial Union Ins. Cos. v. Safeway Stores, Inc. (1980) 26 Cal.3d 912, 916-918, 164 Cal.Rptr. 709. The failure to secure a conclusive adjudication of non-coverage meant that 20th retrained the duty to defend and to accept a reasonable settlement offer in an excess liability situation: "An insurer that breaches its duty of reasonable settlement is liable for all the insured's damages caused by the breach, regardless of policy limits." Hamilton v. Maryland Casualty (2002) 27 Cal.4th 718, 725, 117 Cal.Rptr.2d 318.

Liability for the underlying judgment also follows as a matter of law from equity phase findings which establish that 20th's withdrawal of coverage and refusal to settle were in bad faith, rendering it liable under tort damages rules. Bad faith was inherent in the forfeiture finding, and was found by clear and

convincing evidence. (JA 6271:16-19) Forfeiture of rights under the policy

> occurs when the insurer ***breaches the duty of good faith and fair dealing by engaging in bad faith conduct designed to mislead the insured.***
> [Chase v. Blue Cross, *supr*a, 42 Cal.App.4th at1149, 1157 (emphasis added.)]

Chase comprehensively examined the insurer's duty to advise the insured how to preserve coverage when aware that the insured is likely to lose benefits if not properly informed (*e.g.* Walker v. Occidental Life Insurance Co. (1967) 67 Cal.2d 518, 523-524, 63 Cal.Rptr. 45, Sarchett v. Blue Shield, *supra*, 43 Cal.3d 1), concluding that forfeiture rests on breach of the covenant of good faith and fair dealing. (*Id.* 1151-1153, 1157-1158) See 6 Witkin Cal. Procedure 4th, *Proceedings Without Trial* (2004 Supp.) §507, stating that forfeiture "requires that the insurer breach the covenant of good faith and fair dealing by engaging in bad faith conduct designed to mislead the insured."

20th knew that the wrongful death action would result in a judgment against Aguilera far in excess of the policy. (JA 6824:22-6825:10, 7212:25-28; 7639:1-21; 5315, 5382; RT C42:19-23) It breached the duty to accept reasonable settlement offers by rejecting settlement opportunities from July 1994 on, based on a plea which had no conclusive effect, knowing that an excess judgment would result. Liability for the underlying judgment follows from breach of the duty to settle established by the equitable findings. Amato, *supra*, 53 Cal.App.4th 832-835; Gray v. Zurich Ins. Co., *supra*, 65 Cal.2d 263, 279-280. As Johansen states, "The decisive factor in fixing the extent of [the insurer's] liability is not the refusal to defend, it is the refusal to accept an offer of settlement within policy limits." (*Id.* 17, quoting Comunale v. Traders & General Ins. Co. (1958) 50 Cal.2d 654, 659, 328 P.2d 198.)

4.

THE RIGHT TO SEEK BRANDT FEES FLOWS DIRECTLY FROM THE DETERMINATION THAT 20TH LOST COVERAGE DEFENSES AND THUS WAS LIABLE FOR FAILURE TO SETTLE

20th Century's argument concerning Brandt fees suffers from the same logical defect as its argument under Johansen. 20th assumes that equity provided "a cause of action" independent of the policy, when in fact equity merely prevented the assertion of policy exclusions based upon breach of an existing duty with the result that there was contractual liability, supporting recovery of the underlying judgment under Johansen and recovery of attorneys fees under Brandt v. Superior Court, supra, 37 Cal.3d 813.

Just as in the typical Brandt scenario, plaintiffs had to sue to recover the benefits denied under the policy due to the unreasonable refusal to settle, and the expenses of that action are a distinct element of economic damages. Cassim v. Allstate Insurance Co. (2004) 33 Cal.4th 780, 16 Cal.Rptr.3d 374.

5.

NOTHING IN CASE LAW OR PUBLIC POLICY SUGGESTS THAT CIVIL CODE §47 IMMUNIZES AN INSURER'S MISREPRESENTATION TO ITS INSURED CONCERNING PENDING LITIGATION

20th Century's contention that conduct which violates the duty to defend and advise the insured in litigation is privileged is manifestly absurd. It would eliminate any duty of fiduciary care or honesty in a great many cases of legal malpractice or breach of the duty to defend. 20th Century's claim that it has a license to deceive its insured so long as the deception is litigation-related has been rejected by every court to consider it.

An insurer which has a duty to defend or settle cannot be privileged to act in bad faith as to the defense or settlement of that case, or the duty of good faith

under a liability policy would be meaningless.

A. A Liability Insurer's Breach of the Duty to Defend, Settle or Properly Advise its Insured is Not Privileged

It should be obvious that the litigation privilege does not protect bad faith or dishonest conduct by a liability insurer in breach of the duty to defend or indemnify, whether or not it employs communications related to litigation. To the contrary, under a liability policy, the occurrence of litigation against an insured *triggers* the contractual duty to defend, to properly inform the insured, and to act in good faith.

Statements - even in the course of litigation - which violate a contractual obligation are not privileged. In Mattco Forge, Inc. v. Arthur Young and Co. (1992) 5 Cal.App.4th 392, 6 Cal.Rptr.2d 781, plaintiff sued experts it had hired to perform forensic accounting work in support of litigation. The litigation privilege did not protect the accountants from liability for either negligence or breach of contract: the case involved "causes of action sounding in contract and in tort against an expert witness hired by plaintiffs themselves to support their case in the underlying litigation. . . In such a situation, policy considerations that would usually favor the privilege here argue against applying it." (5 Cal.App.4th 403-404) The Court noted that if an expert's neglect caused loss of the underlying action by the party who had hired the expert, that did not expand freedom of access to the courts and applying the privilege would not encourage witnesses to testify truthfully. Indeed, it would have the opposite effect and would scarcely encourage the future presentation of truthful testimony.

Mattco held that while the litigation privilege had been applied in suits against experts who functioned *adversely* to the plaintiff, it would not protect an expert against liability to the party to whom he had a contractual duty. The court noted "the analogy between a party bringing a suit against its own expert witness and a party bringing a suit against its own attorney," and observed that §47 does not protect "statements made in a judicial proceeding that violate a contractual provision not to disclose a former employees trade secrets." See ITT Telecom

Products Corp. v. Dooley (1989) 214 Cal.App.3d 307, 262 Cal.Rptr. 773 (privilege does not apply to voluntary disclosure of trade secrets in violation of confidentiality agreement.)

The number of cases holding false or bad faith statements or concealment relative to litigation actionable against an insurer or attorney when made to an insured or client is enormous and utterly inconsistent with 20th Century's claim that Civil Code §47 protects such conduct. Innumerable legal malpractice cases involve communications which are "litigation related" under 20th Century's interpretation, but which are clearly actionable because they violated the insurers or attorney's duty to the client in regard to the prosecution of that very action. See, *e.g.*, Tomerlin, *supra*, which was based on a representation of coverage, and Betts v. Allstate Insurance Company (1984) 154 Cal.App.3d 688, 201 Cal.Rptr. 528, upholding a claim by the insured against her carrier and a defense firm retained by the insurer to defend her, based on failure to disclose the probability of an excess of policy judgment, failure to render sound advice, and efforts to manipulate the insured against her own best interests so as to protect the interests of the insurer.

Stacy & Witbeck, Inc. v. City of County of San Francisco (1996) 47 Cal.App.4th 1, 54 Cal.Rptr.2d 530, observes that where a communication performs dual purposes as both a duty under the terms of a party's contract and as an administrative prerequisite to a legal action, "that claim does not become privileged simply because the contractor also anticipated suing the agency for the sums detailed in the contract claim." Thus, the contractual function of a communication renders it actionable even if it had a "quasi-judicial" use.

The critical point, of course, is the existence of a duty of care to the plaintiff, either as a client or insured. No privilege protects the insurer against a breach of **obligations to its insured under its policy**. 20th Century relies upon cases where a claimant who was **not an insured or beneficiary under the policy** sues the insurer on a tort theory not based on a breach of contractual duty by the insurer, such as Doctors' Company v. Superior Court (1989) 49 Cal.3d 39, 260 Cal.Rptr. 183, where a medical malpractice claimant sued his physician's

insurer for deceit in litigation of the malpractice action.

Home Ins. Co. v. Zurich Ins. Co. (2002) 96 Cal.App.4th 17, 116 Cal.Rptr.2d 583, is exactly such a case. An under-insured motorist carrier sued a liability insurer with which it had no contractual relation to recover for fraudulently misrepresenting liability coverage limits to induce settlement of a claim covered by the plaintiff's UIM carrier. The action sounded in fraud, not bad faith, and the misrepresentation was the sole basis for liability. There was no breach of a contractual, professional or fiduciary duty to protect the UIM carrier in that litigation. The deceit was not part of a scheme extending beyond resolution of the underlying litigation, and was made by an *adverse* party, *not by a party with a duty to protect the interests of the plaintiff in that very litigation.* There is nothing new in Home, and nothing relevant to the instant case.

As Home explained, actions between *adversaries* are in essence a collateral attack on the resolution of the underlying litigation by one adverse to the insured. It is not a claim *by the insured* that the contractual duty to defend had been breached by his carrier. While a party may not sue his or her adversary's attorney or insurer for communicative torts occurring during litigation (Doctor's Company, Home Ins.), they can most certainly sue its **own attorney or insurer** for malpractice and breach of duty to protect them in that very litigation, as in Betts and Tomerlin.

Shafer v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone (2003) 107 Cal.App.4th 54, 131 Cal.Rptr.2d 777, is consistent with this principle: it involves a claimant's action against a third party's insurer and counsel in the underlying arbitration. The Court of Appeal concluded that "the litigation privilege does not shield [the attorney] from liability for [fraudulent statements about the third party's coverage] because his alleged misrepresentations were made to a party standing in the shoes of an insured, and the application of the litigation privilege in this case would be inconsistent with the purpose" of Insurance Code §11580, making a judgment creditor a beneficiary of the insured's policy. (*Id.* 78) Shafer and Home thus agree that Civil Code §47 does not immunize an insurer for misrepresentations to its insured or to a third party to

whom it has an equivalent statutory duty.

> Just as an insurer may be held liable for defrauding its insured . . .so an insurer should not be allowed to deceive a third party beneficiary of the insurance policy.
> [*Id* at 80]

Whether or not one agrees with the extension of third party rights to a judgment creditor under Insurance Code §11580, the rule that an insurer will be liable in fraud or bad faith for deceiving an insured concerning litigation which it has undertaken to defend is uniformly recognized.

B 20th Century's Liability is Based on Breach of the Duty to Settle, Not Just a Communicative Act

The defendant assumes that its liability for the underlying judgment is based upon a statement made in the course of litigation, to wit its representation that there would be coverage in the event of a plea. Not so. The plea was merely a pretext for 20th century to deny coverage and to refuse to settle. The excess judgment resulted not from 20th Century's statement but from its refusal to settle in a situation where it had forfeited policy defenses.

The plea did not entitle 20th Century to deny coverage since a plea bargain has no preclusive effect. Teitelbaum Furs, Inc. v. Dominion Ins. Co. (1962) 58 Cal.2d 601, 605-606, 25 Cal.Rptr. 559; 7 Witkin, Cal. Procedure 4th *Judgment*, §332. 20th was obliged to defend Aguilera until a determination *conclusively* negating coverage. Montrose Chemical Corp. v. Superior Court (1993) 6 Cal.4th 287, 295, 24 Cal.Rptr.2d 467. The plea was thus a mere pretext for denying coverage, and the source of injury to the insured was the failure to settle - exposing him to a huge excess judgment - not any statement by 20th Century, though those statements evidenced bad faith.

In White v. Western Title Ins. Co. (1985) 40 Cal.3d 870, 221 Cal.Rptr. 509, the insurer claimed that bad faith failure to settle the underlying claim was protected by the privilege of Civil Code §47. This Court first held that the onset

of litigation did not shield the insurer from liability for conduct occurring even after litigation had commenced.

> It is clear that the contractual relationship between insurer and the insured does not terminate with the commencement of litigation . . . [I]t is not unusual for an insurance company to provide policy benefits, such as the defense of litigation, while itself instituting litigation to determine whether and to what extent it must provide those benefits. It could not reasonably be argued under such circumstances that either the insurer no longer owes any contractual duties to the insured, or that it need not perform those duties fairly and in good faith.
> [40 Cal.3d 885-886]

White observed that a sharp distinction between conduct before and after suit was filed would be undesirable since it would encourage insurers to use litigation as a shield behind which to conduct tortious activities (*Id.* at 886), and rejected the claim that the litigation privilege bars prosecution of a bad faith claim evidenced by conduct during and relating to litigation. (*Id.* at 887-888)

Gruenberg v. Aetna Ins. Co. (1973) 9 Cal.3d 566, 108 Cal.Rptr. 480, stated in an action against an insurer that while in some circumstances individual acts of the insurer's agents might be privileged, that would not render them non-actionable when they were part of a broader scheme or conspiracy to violate the plaintiffs' rights under the policy, a breach which extends beyond mere litigation tactics or communications. Rejecting a defense under Civil Code §47(2), the Court stated that the defendants could not benefit from the litigation privilege

> because their alleged scheme to avoid liability under the policies . . . transcends the individual acts of their agents. Consequently, defendant insurers cannot be heard to say that they are privileged to act in bad faith and deal unfairly with their insured.
> [9 Cal.3d 575 fn. 5]

Similarly, Kupiec v. American International Adjustment Co. (1992) 235 Cal.App.3d 1326, 1331, 1 Cal.Rptr.2d 371, observes that the litigation privilege "applies only to communicative acts and does not privilege tortious courses of

conduct. . . . The key in determining whether §47(b)(2) applied is whether the harm alleged was the result of a communicative act or a course of conduct." See also Fletcher v. Western National Life Ins. Co. (1970) 10 Cal.App.3d 376, 89 Cal.Rptr. 78, approved by White v. Western Title, 40 Cal.3d at 887-888.

Contrary to defendant's assumption, in the instant case the breach is not simply 20th Century's "lying in wait," deceit and failure to disclose, but the **denial of a defense and indemnity** which was the objective of its deceitful conduct - **avoidance of its duty to settle a claim which was clearly in excess of policy limits.** Any communications with the insured were not related to litigation *between the insured and the carrier*, but to its duty to defend and indemnify against liability in the suit brought by the Encarnacions. Any communication was part of a broader actionable scheme to deny policy benefits, and such communications vaguely "related" to litigation will not immunize a broader "scheme to avoid liability under the policies . . [which] transcends the individual acts" of the carrier. Gruenberg, *supra*, 9 Cal.3d 575 fn. 5. See also Limandri v. Judkins (1997) 52 Cal.App.4th 326, 245-246, 60 Cal.Rptr.2d 539.

Denial of benefits, withdrawal of coverage, and **refusal to settle or indemnify** with the result that a $5.6 million judgment was entered against its insured is not a "communication." Civil Code §47 has repeatedly been held not to apply to the adjustment of insurance claims. Slaughter v. Friedman (1982) 32 Cal.3d 149, 185 Cal.Rptr. 244; Hickman v. London Assurance Corp. (1920) 184 Cal. 524, 532, 195 P. 45; Cummings v. Fire Ins. Exchange (1988) 202 Cal.App.3d 1407, 249 Cal.Rptr. 568.

C. The Litigation Privilege in No Way Impairs the Courts' Ability to Grant Relief Based on Insurer Bad Faith During Litigation

The contention that the courts will not apply equitable remedies to dishonest conduct occurring during the course of litigation is frivolous. Home Insurance Co. v. Zurich Ins. Co., *supra*, 96 Cal.App.4th 17, for example, states that "The litigation privilege does not apply to an equitable action to set aside a settlement agreement for extrinsic fraud," citing Silberg v. Anderson (1990) 50

Cal.3d 205, 214, 266 Cal.Rptr. 638. See also Wilton v. Mountain Wood Homeowners Assn. (1993) 18 Cal.App.4th 565, 571, 22 Cal.Rptr.2d 471 (§47 does not prevent those subject to statutory liens from seeking equitable relief.)

Equitable relief based on statements related to or during litigation has never been precluded under §47. In fact, judicial estoppel is based exclusively on unfair conduct **during litigation**. Cloud v. Northrop Grumman Corp. (1998) 67 Cal.App.4th 995, 79 Cal.Rptr.2d 544; Billmeyer v. Plaza Bank of Commerce (1995) 42 Cal.App.4th 1086, 1092, 50 Cal.Rptr.2d 119.

Cases imposing liability through equitable remedies for "communicative" conduct during or related to litigation are innumerable. See Chase v. Blue Cross, *supra*, 42 Cal.App.4th 1142, 1149 (forfeiture of rights to arbitration when insurer breached duty of good faith by misleading insured); Ramirez v. USAA Casualty Ins. Co. (1991) 234 Cal.App.3d 391, 397-399, 285 Cal.Rptr. 757; Miller v. Elite Ins. Co., *supra*, 100 Cal.App.3d 739 (liability based on insurer's failure to inform insured of its position on coverage or its position on exclusion from coverage.)

6.
CONCLUSION

The Court of Appeal did not depart from established case law, and none of 20th Century's proposed issues raises any matter requiring a statement by this Court. The Petition should accordingly be denied.

Respectfully submitted,

Dated: November 26, 2007

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By:_____
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CERTIFICATE OF COMPLIANCE

Counsel of Record hereby certifies that pursuant to Rule 8.504(d) of the California Rules of Court, the enclosed Answer to Petition for Review is produced using 13 point Times New Roman type and contains approximately 7,491 words, which is less than the 8,400 words permitted by this Rule. Counsel relies on the word count of the computer program used to prepare this brief.

Dated: November 26, 2007

_____

Evan D. Marshall

PROOF OF SERVICE

I am over the age of 18 and not a party to this action. I am employed at.233 Wilshire Blvd., Suite 550, Santa Monica, CA 90401. On November 26, 2007, I served the attached ANSWER TO PETITION FOR REVIEW on the parties in this action by placing a true copy in a sealed envelope with proper postage in the U.S. mail at Santa Monica, California, addressed as follows

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I declare under penalty of perjury, that the foregoing is true and correct. Executed at Santa Monica, California on November 26, 2007.

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