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# TRENDS

**Fourth Quarter, 2003**

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## CASUALTY & COVERAGE

### CALIFORNIA COURT OF APPEAL HOLDS THAT RESPONSE COSTS ARE NOT COVERED UNDER PRIMARY AND UMBRELLA POLICIES

**Facts:** Plaintiffs owned commercial real property that they leased to tenants. In 1989, the California Water Quality Control Board (Board) ordered them to test the property for pollutants after it concluded that there were suspected dischargers of pollutants causing damage to soil and groundwater in the vicinity of the property. Plaintiffs notified its CGL and excess/umbrella insurers of the Board's order and sought insurance coverage for the costs to respond. Defendants denied coverage. Plaintiffs paid a consulting firm approximately $230,000 to comply with the order. In 1997, the Board closed its investigation without taking further action after essentially concluding that plaintiffs' property was not the source of the pollution. Plaintiffs filed an action against its insurers, alleging that coverage existed under the policies and seeking reimbursement for the response costs. The insurers demurred to the complaint.

**Procedural History:** The trial court sustained the demurrers of defendants without leave to amend. Plaintiff appealed from the resulting judgment.

**Issue:** Are costs incurred by an insured in responding to an order issued by a governmental agency to test for pollution at its property covered under standard form CGL and umbrella policies?

**Holding:** No

**Analysis:** On appeal, plaintiffs argued that the trial court misinterpreted the standard form CGL and excess/umbrella insurance policies as not providing coverage for "response costs" incurred pursuant to an administrative order that charged plaintiffs with being suspected dischargers of pollutants causing damage to soil and groundwater. In Foster-Gardner, Inc. v. National Union Fire Ins. Co. (1998) 18 Cal.4th 857, the California Supreme Court held that a CGL policy only applies to “suits” and not to administrative orders issued by an administrative agency under an environmental statute. In Certain Underwriters at Lloyd's of London v. Superior Court (Powerine) (2001) 24 Cal.4th 945, the Court held that the term “damages” in a CGL policy is limited to money ordered by a court. As such, "expenses," ordered by an administrative agency were not considered to be “damages”. Plaintiffs conceded that there was no coverage under the 1984 Great American policy because it was a pre-1986 policy governed by *Foster-Gardner* and *Powerine*. They argued, however, that Great American waived those defenses by failing to assert them in its non-waiver/reservation of rights letter and that plaintiffs relied on that “waiver” by incurring the response costs. The court rejected that argument, holding that plaintiffs failed to plead the necessary elements on an intentional waiver.

The Great American 1987 policy, as well as those issued by other insurer-defendants, defined “suit” as including a “civil proceeding” and included a pollution exclusion extending to the type of response costs incurred by the plaintiffs. Plaintiffs argued that *Foster-Gardner* and *Powerine* do not apply to these policies because the administrative orders issued by the Board were tantamount to a “civil proceeding” which necessarily included response costs. The court rejected this argument too. It held that the policy clearly states that the insurance does not apply to "[a]ny loss, cost, or expense arising out of any governmental direction or request that you test for ... pollutants" and that there was no question that the Board ordered plaintiffs to test for pollutants and plaintiffs sought reimbursement for the costs incurred to make the tests.

With respect to the umbrella policies, plaintiffs argued that those policies apply to "ultimate net loss", which broadens the coverage beyond "damages." They argued that "ultimate net loss" includes all expenses incurred by the insured in the investigation and defense of claims or suits seeking damages. The court rejected this argument, noting that the coverage clause imposing the duty to indemnify is clear in its limitation to court-rendered damages. It states: "The company will pay ... the ultimate net loss ... which the insured shall become legally obligated to pay ... *for damages*." Therefore, *Powerine's* definition of damages controls.

*CDM Investors v. American Nat. Fire Ins. Co.* (2003) 112 Cal.App.4th 791

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# COURT OF APPEAL HOLDS THAT INSURER THAT ALTERED POLICY TWO MONTHS AFTER IT WAS PURCHASED MAY BE SUED FOR UNFAIR COMPETITION

**Facts:** Plaintiffs filed a class action lawsuit claiming that they were not told of "impending material premium increases and benefit reductions under the Policies" before the policies "went into effect." The complaint further alleged that they purchased their policies after receiving the defendants' descriptions of the premiums, the lack of deductibles, and other policy benefits, but less than two months after their policies went into effect, plaintiffs were mailed notice of all the material changes to their policies. When they purchased their policies, plaintiff's allegedly gave up coverage they had through another insurance company. Plaintiffs further alleged that at the time they bought their policies, defendants knew of the impending changes to the policies, changes that defendants did not communicate to policy holders until two months after the policies had been issued. Despite such knowledge, defendants did not disclose the changes to plaintiffs prior to the purchase by plaintiffs of their policies. The cause of action for "unfair competition" incorporated these allegations.

**Procedural History:** Defendants demurred on the grounds that the complaint failed to state facts sufficient to constitute a cause of action for unfair competition, arguing that since they complied with Insurance Code section 10199.1, the statutory requirement of giving 30 days' notice of benefit changes and premium increases, the plaintiffs' unfair competition claim is without any legal basis. The trial court sustained the demurrer with leave to amend. Plaintiffs failed to amend their complaint and the trial court entered an order of dismissal. Plaintiff appealed.

**Issue:** Does a cause of action for unfair competition lie against an insurer who allegedly changed the terms of the insurance policy after it had been issued?

**Holding:** Yes

**Analysis:** Business and Professions Code section 17200 provides: "As used in this chapter, unfair competition shall mean and include any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising and any act prohibited by Chapter 1 (commencing with Section 17500) of Part 3 of Division 7 of the Business and Professions Code." The Legislature intended this "sweeping language" to include "anything that can properly be called a business practice and that at the same time is forbidden by law." Here, plaintiffs alleged upon information and belief that defendants knew of impending material changes to the insurance policies when the plaintiffs purchased the policies but failed to disclose this information to the plaintiffs until after they purchased their policies. Because this case was only at the demurrer stage, and no evidence had been exchanged, the court declined to find that the defendants did not have duty, as a matter of law, to disclose the information about impending policy changes to the plaintiffs before the plaintiffs bought their policies.

*Pastoria v. Nationwide Ins.* (2003) 112 Cal.App.4th 1490

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# COURT OF APPEAL HOLDS THAT PROPERTY POLICY DOES NOT APPLY TO LOSS OF STORED COMPUTER DATA NOT ACCOMPANIED BY THE LOSS OR DESTRUCTION OF THE STORAGE MEDIUM

**Facts:** While plaintiff was in the process of updating its computer database, human error caused the database system to "crash," resulting in the loss of plaintiff's electronically stored data used to service its clients' insurance policies. Plaintiff hired consultants to restore the database, and data was manually inputted so that plaintiff could resume its normal business operations. Plaintiff incurred extra expenses restoring its data, and also suffered the loss of business income because of the disruption. Plaintiff quantified the loss in the amount of "$53,586.83 in extra expenses to restore the database," and "$209,442.80 in business income, losses of productivity, commissions and profits." Plaintiff made a claim on its insurance policy, hoping to recover its losses. Except for a small payment of $5,000, defendant denied the insurance claim, asserting other losses were not covered by the policy. Plaintiff argued its losses were covered under the policy's "Building and Personal Property Coverage Form", among other coverages. Defendant denied coverage because each of the coverages requires a "direct physical loss of or damage to" property, and none of the loss or damage suffered by plaintiff was a "direct physical loss." Plaintiff filed an action for breach of contract and bad faith.

**Procedural History:** Defendant filed a motion for summary judgment. The court granted the motion, ruling that there was no coverage for the loss under the policy.

**Issue:** Does the loss of computer data constitute a "direct physical loss of or damage to" property which is payable under a standard business policy.

**Holding:** No

**Analysis:** Plaintiff's motion asserted that during the updating of its database, the database system "crash[ed], resulting in the compromise, corruption and/or loss of all electronically stored data relating to [plaintiff's] business operations." Plaintiff did not claim the replacement or repair cost for any item of hardware or the storage medium. Instead, plaintiff limited its claim to the extra labor expenses incurred to recover from loss of the database as well as income lost during the period of recovery. The provisions of the insurance policy relied upon by plaintiff do not provide coverage unless a "direct physical loss" to property covered by the policy has been suffered. The losses claimed by plaintiff would not be covered by the policy unless the phrase "physical loss" is interpreted to include the loss of electronically stored data, without any loss or damage to the storage media or to any other property. The court refused to adopt that interpretation. The loss of plaintiff's database does not qualify as a "direct physical loss," unless the database has a material existence, formed out of tangible matter, and is perceptible to the sense of touch. The court failed to see how pure information can be said to have a material existence, be formed out of tangible matter, or be perceptible to the sense of touch.

*Ward General Ins. Services, Inc. v. Employers Fire Ins. Co.* (2003) ___ Cal.Rptr.3d ___

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## GENERAL TORTS

### COURT OF APPEAL UPHOLDS PRIVETTE DOCTRINE UPON LACK OF EVIDENCE THAT GENERAL CONTRACTOR RETAINED CONTROL OVER OPERATIONS THAT CAUSED INJURY TO EMPLOYEE OF SUBCONTRACTOR

**Facts:** Plaintiff, an employee of a masonry and tile subcontractor, was injured while working at a construction site when he tripped on construction debris while climbing stairs while carrying a large tile saw that blocked his view. Plaintiff received workers compensation benefits, but sued defendant, the general contractor, for premises liability, alleging it was negligent in supervision.

**Procedural History:** Defendant moved for summary judgment under the Privette doctrine, which holds that where an employee of an independent contractor is injured within the scope of his employment, his exclusive remedy is workers compensation unless the owner or general contractor retained direct control over the jobsite or affirmatively contributed to the injuries. The trial court granted the motion and plaintiff appealed.

**Issue:** May an employee of a subcontractor injured on a worksite sue the general contractor where absent evidence that the general contractor retained control over the site in a manner that affirmatively contributed to the injury?

**Holding:** No.

**Analysis:** Under Privette and its progeny, a hirer of an independent contractor cannot ordinarily be held liable for injuries sustained by employees of that contractor. One exception to that rule is where the hirer retained control over the construction operations in a manner that affirmatively contributed to the injury of the contractor's employee. Here, plaintiffs presented no evidence of retained control over the jobsite - a general contractor's right or power of general supervision and control is not enough. In addition, there was no evidence that defendant created the dangerous condition or was aware of it.

*Sheeler v. Greystone Homes, Inc.* (2003) 113 Cal.App.4th 908

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## PRODUCTS LIABILITY

### COURT OF APPEAL HOLDS THAT "IMPUTED SIMULTANEOUS DISCOVERY" RULE DOES NOT APPLY TO A PRODUCTS LIABILITY DEFENDANT IN A MEDICAL MALPRACTICE CASE WHERE SUIT IS TIMELY FILED

**Facts:** Plaintiff filed a medical malpractice action against her surgeon, asserting his negligence during surgery caused a perforation of her small intestine and subsequent complications. During his deposition, the surgeon first raised the possibility that the perforation was caused by a malfunctioning stapler. Plaintiff then filed an amended complaint asserting a products liability cause of action against the manufacturer of the stapler, Ethicon Endo-Surgery, Inc. (Ethicon). The amended complaint was filed three months after the deposition, but 31 months after the initial surgery. Ethicon filed a demurrer, asserting the cause of action was time barred by the one-year statute of limitations.

**Procedural History:** The trial court sustained the demurrer without leave to amend based on the principle of imputed simultaneous discovery of causes of action, i.e., "[w]hen a plaintiff has cause to sue based on knowledge or suspicion of negligence the statute [of limitations] begins to run as to all potential defendants.

**Issue:** Should the rule which holds that when a plaintiff has cause to sue based on knowledge or suspicion of negligence the statute starts to run as to **all** potential defendants apply to a product liability defendant in a medical malpractice suit where suit was promptly filed against that defendant upon discovery of its negligence?

**Holding:** No

**Analysis:** The court reversed the trial court's ruling. It rejected a "bright line" rule of imputed simultaneous discovery of causes of action and concluded the delayed discovery of Fox's products liability claim should be analyzed based on the facts and circumstances relevant to that claim. Therefore, plaintiff should be given an opportunity to allege facts explaining why she did not have reason to discover earlier the factual basis of her products liability claim. The more proper question would be whether plaintiff knew, actually suspected, or had reason to suspect a factual basis for the elements of her products liability cause of action against Ethicon more than one year prior to the filing of her first amended complaint. There was no evidence that prior to the deposition of her doctor, plaintiff knew about a possible products liability claim.

*Fox v. Ethicon Endo-Surgical, Inc.* (2003) 112 Cal.App.4th 1572

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# COURT OF APPEAL HOLDS THAT EXPERT MEDICAL OPINION REGARDING CAUSATION OF INJURY IS ADMISSIBLE DESPITE OFFERING NEW MEDICAL THEORIES

**Facts:** The parents of an autistic child sued a pest control company claiming that his autism was caused by a pesticide it used in plaintiff's house shortly before the minor's birth. In support of his theory that the pesticide caused his autism, plaintiff presented expert testimony of several toxicologists and medical doctors in which each stated the opinion to a reasonable degree of medical or scientific certainty that plaintiff's injuries and damages were caused by his household exposure to the pesticide used by defendant. The experts based their opinions on plaintiff's medical records, including results of neuropsychological testing, and in utero and postpartum medical history, as well as on numerous peer-reviewed articles in scientific journals.

**Procedural History:** Defendant filed a number of motions in limine regarding this testimony, including one which argued that the expert testimony was based on novel methodologies of scientific proof unsupported by peer-reviewed scientific literature, i.e., did not meet the admissibility test set forth in People v. Kelly. The trial court granted the motion, ruling that "[t]he plaintiff's experts' analysis and causation opinions are not derived from any accepted scientific methodology, are not scientifically valid, and do not possess the evidentiary reliability required by Kelly. . . ." Judgment was entered in defendant's favor and plaintiff appealed.

**Issue:** Did the trial court improperly exclude the expert testimony regarding the cause of plaintiff's medical condition under the Kelly test?

**Holding:** Yes.

**Analysis**: In Kelly, the California Supreme Court held that evidence obtained through a new scientific technique may be admitted only after its reliability has been established under a three-pronged test. The first prong requires proof that the technique is generally accepted as reliable in the relevant scientific community. The second prong requires proof that the witness testifying about the technique and its application is a properly qualified expert on the subject. The third prong requires proof that the person performing the test in the particular case used correct scientific procedures. Thus, it is applicable only to "new scientific techniques." It only applies to that limited class of expert testimony which is based, in whole or part, on a technique, process, or theory which is new to science and, even more so, the law. Here, the experts relied on research papers and studies in peer review journals regarding pesticide and its effects, as well as physical examination of the minor. They did not rely upon any new scientific technique, device, or procedure that has not gained general acceptance in the relevant scientific or medical community. Rather, it was the theory of causation, that the pesticide caused plaintiff's autism, that has not gained general acceptance in the relevant medical community. The Kelly test is not applicable even though the proffered evidence presents a new theory of medical causation.

*Roberti v. Andy's Termite & Pest Control, Inc.* (2003) 113 Cal.App.4th 893

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# CALIFORNIA COURT OF APPEAL PERMITS SUBSTANTIAL PUNITIVE DAMAGE AWARD IN PRODUCTS LIABILITY CASE

**Facts:** Plaintiffs, consisting of six family members, were killed or seriously injured in a single-car rollover accident while they occupied a 1978 Ford Bronco. Plaintiffs filed a product liability suit against Ford. Plaintiffs prevailed at trial and were awarded damages of nearly $5 million. In addition, the jury awarded the Romos punitive damages in the amount of $290 million.

**Procedural History:** Ford appealed the punitive damage award, arguing that they were unconstitutionally excessive in violation of the due process clause of the 14th amendment.

**Issue:** Was the punitive damage award of $290 million based on a $5 million judgment for compensatory damages excessive?

**Holding:** Yes

**Analysis:** The court of appeal (fifth district), based on the recent U.S. Supreme Court case of State Farm vs. Campbell, reversed as to the size of the punitive damage award, but otherwise affirmed. The court focused on the BAJI instructions that were used during the trial. Preliminarily, it held that BAJI 14.00 was confusing in this case where there are plaintiffs suing in a representative capacity (on behalf of the decedents) as well as for their own injuries. BAJI 14.00 does not properly distinguish between the two capacities in a combined personal injury/wrongful death case, and is therefore potentially confusing. With regard to punitives, the instructions focused on the deterrent effect to the manufacturer in a way that punishes it for marketing the product in general so as to make its conduct unprofitable or prohibitively costly, whereas under current law the instructions should have restricted the jury's focus on punishment and deterrence based solely on the harm caused to the plaintiffs in this incident. The court ordered that the punitive award be reduced to $23 million on condition of acceptance by plaintiffs, or a new trial on punitives if they fail to accept.

*Romo v. Ford Motor Co.* (2003) 113 Cal.App.4th 738

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## PROFESSIONAL LIABILITY

### COURT OF APPEAL HOLDS THAT ATTORNEY-CLIENT PRIVILEGE DOES NOT EXTEND TO UNPRIVILEGED INFORMATION COMMUNICATED TO AN ATTORNEY

**Facts:** Plaintiff sued a title company following the issuance of a title insurance policy which disclosed encumbrances not disclosed during escrow. In that litigation, it served two sets of requests for production of documents, seeking all documents related to the title insurance policy, the preliminary title report, plaintiff's claim on the policy, and defendant's investigation and handling of plaintiff's claim. Defendant objected to the production of certain documents on the ground they were protected by the attorney-client or attorney work product privileges. The majority of the documents it refused to produce were identified as (1) correspondence amongst claims handlers, (2) correspondence between claims handlers and individuals and entities involved in the issuance of the title policy; (3) memos to the file by claims adjusters concerning the claim; and (4) transmittal of information concerning plaintiff's claim by claims adjusters to their superiors. Claims handlers, who were also licensed attorneys, refused to answer certain questions at their depositions. Plaintiff brought a motion to compel production of this discovery, arguing that the dominant purpose of Chicago Title's claims handlers was the investigation and settlement of claims, and they could not shield their activities from discovery by hiring attorneys to perform those functions. Chicago Title opposed the motion, arguing that the information was protected by the attorney-client and attorney work product privileges because its claims handlers were licensed attorneys who were acting as attorney advisors and legal advocates for Chicago Title, not merely claims adjusters.

**Procedural History**: The court concluded that the attorneys employed by Chicago Title were not "engaged in activity beyond claims review and analysis" and that assertion of the attorney- client privilege "may interfere with a clear understanding of the circumstances of this matter." However, it found that the attorney-client and attorney work product privileges were "appropriate and must be upheld."

**Issue:** Where an insurance company uses attorneys as claims handlers, does their otherwise unprivileged material become privileged?

**Holding:** No

**Analysis:** The attorney-client privilege does not protect "independent facts related to a communication; that a communication took place, and the time, date and participants in the communication." Further, the privilege "does not protect disclosure of underlying facts which may be referenced within a qualifying communication" and it does not extend to individuals who are no more than witnesses to the matter at issue in the litigation. Knowledge which is not otherwise privileged does not become so merely by being communicated to an attorney.... While the privilege fully covers communications as such, it does not extend to subject matter otherwise unprivileged merely because that subject matter has been communicated to the

attorney. Documents that are independently prepared by a party "do not become privileged communications ... merely because they are turned over to counsel." The attorney-client privilege only protects confidential communications between a client and his or her attorney during the course of an attorney-client relationship. The court concluded that evidence reflecting the factual investigation of plaintiff's claim is subject to discovery. Only those communications reflecting the requesting of, or rendering of, legal advice are protected by the attorney-client privilege, and only the attorney's legal impressions, conclusions, opinions, or legal research or theories are subject to the attorney work product privilege. The work which was done by the claims handlers, and sought to be protected from discovery, was work which need not have been done by attorneys. Cloaking such an adjuster's factual investigation in privilege would shield from discovery information that otherwise would not be entitled to any protection if communicated by an adjuster who was not an attorney but performed the same duties. "To apply the privilege in such a situation would have the effect of placing a premium upon use of attorneys as [adjusters], nonattorneys or clients acting for themselves having no such right to protect their" communications.

*2,022 Ranch, L.L.C. v. Superior Court* (2003) 113 Cal.App.4th 1377