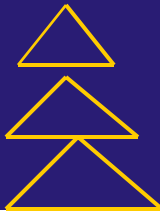


Happy  
Holidays!



# Insurance Coverage Update

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**NOYA vs.  
A. W. COULTER TRUCKING**

***(Insurer Is Barred From Intervening to Defend  
An Additional Insured Where It Had Previously)***

In *Noya v. A. W. Coulter Trucking*, 143 Cal.App.4th 838 (October 5, 2006), the California Second District Court of Appeal affirmed the trial court's order denying Zurich American Insurance Company's ("Zurich") motion to intervene and assume the defense of the California Department of Transportation ("CalTrans") in connection with an underlying personal injury lawsuit involving several plaintiffs. Zurich had previously denied CalTrans' tender of defense of the underlying lawsuit as an additional insured under its policy.

After the underlying lawsuit had been litigated for several years, CalTrans entered into a confidential settlement agreement plaintiffs, which provided for a stipulated judgment against CalTrans totaling \$29.0 million. In turn, the plaintiffs agreed to a covenant not to execute on the judgment. CalTrans also agreed that plaintiffs' counsel could represent it in any subsequent action for breach of the contract and bad faith against Zurich, and that any monies recovered would be paid to plaintiffs.

After learning of the confidential settlement, Zurich attempted to intervene in the underlying lawsuit to defend CalTrans. The trial court denied Zurich's motion for intervention based on the fact that it was untimely. The trial court noted that Zurich had taken no steps to participate in the underlying litigation until several years had passed and a comprehensive settlement agreement had been reached between CalTrans and plaintiffs.

In affirming the trial court's order, the Court of Appeal stated as follows:

Zurich is correct that it has a direct and immediate interest in the lawsuit, because it may ultimately be required to pay the judgment against CalTrans. (See Ins. Code §11580; *Reliance Ins. Co. v. Superior Court*, *supra*, 84 Cal.App.4th at p. 386.) But Zurich is in no position to complain about this circumstance when it has consistently denied coverage and refused to provide CalTrans with any defense. When an insurer denies coverage and a defense, the insured is entitled to make a reasonable, noncollusive settlement without the insurer's consent and may seek reimbursement for the settlement amount and for any breaches of the covenant of good faith and fair dealing. (*Hamilton v. Maryland Casualty Co.* (2002) 27 Cal.4th 718, 728; *Roman v. Unigard Ins. Group* (1994) 26 Cal.App.4th 177, 180, 184.) "In effect, when the insured tenders the suit, the carrier is receiving its chance to be heard. Having rejected the opportunity and waived the chance to contest liability, it cannot reach back for due process to void a deal the insured has entered to eliminate personal liability." (*Hamilton*, at p. 728.)



## **MEDILL vs. WESTPORT INSURANCE CORPORATION**

### ***(Action Against Directors and Officers For Negligence in Connection With The Default On Contractual Payment Obligations On A Series of Municipal Bonds Was Excluded By Breach of Contract, Issuance of Bonds and Failure to Pay On Financial Instruments Exclusions As Set Forth In A Non-Profit Organization Liability Insurance Policy)***

In *Medill v. Westport Ins. Corp.*, 143 Cal.App.4th 819 (October 4, 2006), the California Second District Court of Appeal affirmed the trial court's entry of summary judgment in favor of Westport Insurance Corporation with respect to the tender of defense and indemnity of underlying consolidated actions against certain directors and officers of a nonprofit organization known as Heritage Housing Development, Inc. ("Heritage"). Heritage raised money through municipal bond offerings for the purpose of financing the acquisition, operation and renovation of health care facilities for elderly and Alzheimer's patients. Under Securities and Exchange Commission Rule 131, the bonds were structured as "conduit financing" in which the obligations of the municipal issuers were assigned to the Heritage entities pursuant to indentures or loan agreements. A new Heritage entity was formed in connection with each bond offering and was considered a private issuer under Rule 131.

A class action was filed against Heritage alleging damages sustained by plaintiffs in 11 municipal bond offerings which raised over \$130.0 million between December 1996 and March, 1999. The monies raised were to be used to acquire, renovate and reopen former hospitals in Texas, Florida, Illinois and California as facilities designed to assist elderly persons. The class action alleged that due to wrongful disbursement, diversions of bond proceeds and improper co-mingling of funds, renovations at many of the facilities were not completed. All of the facilities went into receivership-foreclosure shortly after the bond offerings. The class action alleged that under each loan agreement between the municipal issuer and the Heritage entity as the private issuer, the Heritage entity was solely obligated to repay all principal, interest and any premium on the bonds, but defaulted on the bond repayment obligations, rendering the bonds virtually worthless. Plaintiffs further alleged that as part of an elaborate "Ponzi" scheme, proceeds from subsequent bond offerings were used to cover the short falls from prior bond offerings in that these transfers of money among the various Heritage entities violated the loan agreements and indentures. The questions of law and fact common to the members of the class were alleged to include whether the defendants violated federal and state securities laws; breach their fiduciary duties to the class; were negligent in performing their obligations and responsibilities owed to the class; made material misrepresentations in the course of the bond offerings; and breached their contracts with the class.

The Fourth Amended Complaint filed in the class action alleged that the class plaintiffs suffered approximately \$100.0 million in damages and "Heritage outside directors routinely approved matters presented to them without question and failed to perform due diligence" with respect to the bond offerings.

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An action was also filed by the trustee of the proceeds of the bonds, U.S. Trust Company of Texas, N.A. (“U.S. Trust”) against the directors and officers of Heritage. The action requested damages caused by the negligent acts, omissions and breaches of duty of the various defendants.

The directors and officers tendered the defense of the consolidated class action and U.S. Trust action to Westport under a non-profit organization liability insurance policy issued to Heritage for the period of February 16, 2000 to February 16, 2001. Heritage declined coverage of the tender of the consolidated actions based on the “breach of contract” exclusion included in the definition of loss in its policy and two exclusions which applied to the insured’s issuance of stocks, bonds, securities, annuities, or other financial instruments and the failure to honor or pay on any financial instrument or credit given for continued patronage or use of any insured’s services or products.

The trial court relied on the exclusions in the Westport policy in holding that it was not obligated to defend and indemnify the Heritage directors in connection with the underlying consolidated actions.

In affirming the trial’s court entry of judgment in favor of Westport, the Court of Appeal stated as follows:

The policy restricts coverage to “loss,” which is defined as “any amount which the “insured’ is legally obligated to pay for any ‘claim’ or ‘claims’ made against the ‘insured’ during the ‘policy period’ for ‘wrongful acts,’ . . . .” The definition of “loss” then provides that “loss shall not include “Damages ‘arising out of breach of any contract, whether oral, written or implied, except employment contracts with individuals.”

Appellants contend that the breach of contract exclusion is the policy’s definition of “loss” does not apply because none of the plaintiffs in the bond litigation asserted any claims for breach of contract against appellants or alleged any privity of contract between plaintiffs and appellants or that appellants were personally liable for any other party’s failure to pay on the bonds. Appellants argue that the plaintiffs asserted only tort claims against the directors and officers for negligence and breach of fiduciary duty, which are specifically included in the policy’s definition of “wrongful act(s).” We are not persuaded by this argument.

In essence, the plaintiffs in the underlying bond litigation are seeking to recover damages for the failure of the Heritage entities to perform their contractual obligations to make repayments on the bonds. The plaintiffs allege that these defaults were caused in part by the improper transfer of money among the various Heritage entities in violation of the terms of the loan agreements and indentures, and by the wrongful conduct of the directors and officers in connection with the issuance of the bonds and mismanagement of the bond funds

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and bond-funded projects. In other words, the bond litigation in its entirety “arises out of” breach of contract.

The policy broadly defines “arising out of” as “based upon, arising out of, or in connection with.” Case law similarly grants a broad definition to the phrase “arising out of.” “California courts have consistently given a broad interpretation to the terms ‘arising out of’ or ‘arising from’ in various kinds of insurance provisions. It is settled that this language does not import any particular standard of causation or theory of liability into an insurance policy. Rather, it broadly links a factual situation with the event creating liability, and connotes only a minimal causal connection or incidental relationship.” (*Acceptance Ins. Co. v. Syufy Enterprises* (1999) 69 Cal.App.4th 321, 328.) “Such language ‘requires [the court] to examine the conduct underlying the . . . lawsuit, instead of the legal theories attached to the conduct.’” (*Century Transit Systems, Inc. v. American Empire Surplus Lines Ins. Co.* (1996) 42 Cal.App.4th 121, 127, fn. 4.)

\* \* \*

Similarly here, the directors’ and officers’ potential liability would not exist without the contracts Heritage and the Heritage entities entered into in connection with the issuance and financing of the bonds. All of the allegations against the directors and officers arise out of duties and obligations Heritage and the Heritage entities assumed under the bond contracts. The claims are therefore excluded from coverage.

\* \* \*

#### *B. Issuance or Endorsement of Bonds*

As noted above, under the section entitled “Exclusions,” the policy “does not apply to any ‘claim,’ or ‘loss’ alleging or ‘arising out of’ [¶] . . . [¶] I. 1. Violation of the Securities Act of 1933 as [a]mended or the Securities Exchange Act of 1934 as amended or any state blue sky or securities law or similar state or federal statute and any order or regulation issued pursuant to any of the foregoing statutes, or any ‘insured’s’ issuance or endorsement of stocks, bonds, securities, annuities, or other financial instruments.” (Emphasis added.)

Appellants claim this exclusion is inapplicable because there are no allegations in the underlying bond litigation that any of the individual directors and officers issued any bonds. We find this fact to be irrelevant. As Westport notes, there is no coverage under the policy where *any* insured engaged in the excluded activity (i.e., the bond issuances) and where the claims against the directors and officers arise out of that activity. California cases have determined that the phrases “any insured” or “an insured”

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unambiguously preclude coverage to all persons covered by the policy if any one of them engages in excludable conduct. (See, e.g., *Fire Ins. Exchange v. Altieri* (1991) 235 Cal.App.3d 1352, 1361 [finding a homeowner’s policy provided no coverage to parents whose son injured a schoolmate in a fight]; *Western Mutual Ins. Co. v. Yamamoto* (1994) 29 Cal.App.4th 1474, 1486-1487 [same]; *California Casualty Ins. Co. v. Northland Ins. Co.* (1996) 48 Cal.App.4th 1682, 1697-1698 [finding no coverage for wife whose husband engaged in excluded activity].) Thus, we must determine whether ‘any insured’ engaged in the excluded activity of issuing the bonds.

\* \* \*

### C. *Failure to Pay on Financial Instruments*

The second policy exclusion relevant here provides that the policy “does not apply to any ‘claim,’ or ‘loss’ alleging or ‘arising out of’ [¶] . . . [¶] Failure to honor or pay on any financial instrument or credit given for continued patronage or use of any ‘insured’s’ services or products.”

Appellants contend that this exclusion is inapplicable because there are no allegations in the underlying bond litigation against the individual directors and officers for failure to pay any debt. But the policy excludes claims or loss “arising out of” the failure to honor or pay any financial instrument or credit. The exclusion does not require that the obligation to pay be connected to any personal obligation of the individual director or officer seeking coverage. Rather, the exclusion bars coverage in its entirety for any claim arising out of the failure to make payments. The plaintiffs allege that they were damaged and lost their investments in the bonds because the Heritage entities defaulted on their contractual bond repayment obligations, rendering the bonds virtually worthless. The bond litigation clearly arises out of this failure to pay on the bonds and related instruments.

The Court of Appeal also rejected the insured’s arguments that the underlying consolidated actions involved “concurrent coverage” under the insuring provision of the policy for claims of negligence. The Court of Appeal held that the officers’ and directors’ alleged negligence and breach of fiduciary duties did not exist independently of the policies other excluded risks. Lastly, the Court of Appeal rejected the insured’s arguments that the policy afforded “a illusory coverage.”



# **STATE FARM GENERAL INSURANCE COMPANY vs. WELLS FARGO BANK**

## ***(“Superior Equities” Rule Applies to Subrogation Claim Brought By State Farm For Damages Sustained By Its Insured’s Apartment Building Due to the Negligence of an Adjoining Property Owner)***

In *State Farm General Ins. Co. v. Wells Fargo Bank, N.A.*, 143 Cal.App.4th 1098 (October 10, 2006), the California First District Court of Appeal reversed the trial court’s entry of summary judgment in favor of Wells Fargo Bank, N.A. with respect to an underlying subrogation action brought by State Farm General Insurance Company (“State Farm”). State Farm had paid a loss for fire damage sustained by its insured’s condominium complex. The fire had started in an adjoining property owned by the Estate of Sherwood J. Allen (“The Allen property”). Wells Fargo Bank, N.A. (“Wells Fargo”) was the executor of the Allen Estate.

On January 5, 2002, a fire started in a trash can in the light well area of the Allen property and spread to the neighboring condominium complex. It was undisputed that the fire was not started by the owner or the property manager for the Allen property. Rather, the property did not afford tenants a metal trash bin for the disposal of ashes from fireplaces located in the building. Ashes from a fireplace caused the fire.

In response to the property claim, State Farm paid approximately \$2.0 million to the owners of the condominium complex. State Farm then filed a subrogation action against Wells Fargo alleging that its negligence in managing the adjoining property caused the fire to its insureds’ condominium complex. In response, Wells Fargo filed a motion for summary judgment arguing that based on the “doctrine of superior equities”, State Farm was barred from bringing a subrogation against it.

The Court of Appeal characterized the doctrine of superior equities as follows:

The most restrictive principle is the doctrine of superior equities, which prevents an insurer from recovering against a party whose equities are equal or superior to those of the insurer.

The Court of Appeal held that the doctrine of superior equities applied to subrogation actions under California law. In that regard, the Court of Appeal noted that an insurer must satisfy the following elements in asserting a claim for subrogation under California law:

The essential elements of an insurer’s cause of action for subrogation are as follows: “(a) the insured suffered a loss for which the defendant is liable, either as the wrongdoer whose act or omission caused the loss or because the defendant is legally responsible to the insured for the loss caused by the wrongdoers; (b) the claimed loss was one for which the insurer was not primarily liable; (c) the insurer has compensated the insured in whole or in part for the same loss for which the defendant is primarily liable; (d) the insurer has paid the claim of its insured to protect its own interest and not as a volunteer; (e) the insured has an existing, assignable cause of action against the defendant which the insured could have asserted for its own benefit had it

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not been compensated for its loss by the insurer; (f) the insurer has suffered damages caused by the act or omission upon which the liability of the defendant depends; (g) justice requires that the loss be entirely shifted from the insurer to the defendant, whose equitable position is inferior to that of the insurer; and (h) the insurer's damages are in a liquidated sum, generally the amount paid to the insured." (*Fireman's Fund Ins. Co. v. Maryland Casualty Co.*, *supra* 65 Cal.App.4th at p. 1292, italics omitted.)

After considering the doctrine of superior equities and the elements for asserting a subrogation claim, the Court of Appeal found that the facts developed in connection with the underlying fire did not support Wells Fargo's argument that such doctrine barred State Farm's subrogation claim. Rather, the Court of Appeal reversed the trial court's entry of summary judgment and ordered the trial court to evaluate whether Wells Fargo's alleged negligence in causing the fire supports the defense of superior equities, so as to bar State Farm's subrogation claim.

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## **COMBS vs. STATE FARM FIRE & CASUALTY COMPANY**

### ***(Insurance Code §533 Excludes Coverage of Attorneys' Fees Awarded in Connection With Underlying Judgment for Intentional Discrimination)***

In *Combs vs. State Farm Fire & Cas. Ins. Co.*, 143 Cal.App.4th 1338 (October 16, 2006), the California First District Court of Appeal affirmed the trial court's entry of summary judgment in favor of State Farm regarding a claim for reimbursement of attorneys' fees and expenses awarded to plaintiff against insured, Jack Combs, in an underlying discrimination lawsuit. Combs contended that State Farm was obligated to pay for plaintiff's attorney fees and expenses awarded in an underlying discrimination lawsuit against him because such fees and costs constituted "supplementary costs" as defined in the State Farm policy.

The State Farm policy promised to pay all costs taxed against the insured in the defense of a suit.

The parties' dispute arose out of State Farm's defense of an underlying intentional discrimination lawsuit filed against Combs. Ultimately, a judgment was entered against Combs for intentional discrimination in connection with the rental of apartments. The District Court also awarded plaintiff in the underlying lawsuit \$508,000 in attorneys' fees pursuant to federal and state statutes governing the award of such fees in connection with discrimination lawsuits. Combs contended that the award of attorneys' fees constituted "costs" taxed against him and covered by the State Farm supplementary payment provisions in its policy.

The trial court disagreed with Combs and held that Insurance Code §533 precluded coverage for the attorneys' fees.

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In affirming the trial court's decision, the Court of Appeal held as follows:

We do not question the first premise of Combs' argument, that section 533 does not necessarily preclude insurance coverage for the defense of an action in which the insured ultimately is found liable for willful misconduct. (*Downey, supra*, 66 Cal.App.4th at pp. 506-510; *Melugin v. Zurich Canada, supra*, 50 Cal.App.4th at pp. 664-665; *B&E Convalescent Center v. State Compensation Ins. Fund, supra*, 8 Cal.App.4th at pp. 92-93.) But the fact that the supplemental payment of costs taxed against the insured is viewed as arising from the insurer's defense obligation, and under the supplementary payments provision of the insurance policy arises with respect to claims that the insurer defends, does not mean that section 533 permits the insurer to indemnify the insured for such costs and fees. As the trial court correctly observed, none of the cases cited by Combs so holds, or even considers the application of section 533. Rather, each deals in one context or another with the interpretation of policy provisions affecting coverage."

As indicated above, section 533 prohibits coverage for any "loss" caused by the willful misconduct of the insured. Liability for the adversary's costs and attorney fees in this case is a loss caused by and incurred as a result of the insured's intentional racial discrimination. Attorney fee awards may not normally be considered as "damages" in that they do not compensate claimants for the injury for which they brought suit (*San Diego Housing Com. v. Industrial Indemnity Co., supra*, 95 Cal.App.4th at p. 689; *Cutler-Orosi Unified School Dist. v. Tulare County School etc. Authority, supra*, 31 Cal.App.4th at pp. 631-632), nor may they ordinarily be awarded for the purpose of punishing the defendant (*Simpson v. Sheehan* (7<sup>th</sup> Cir. 1997) 104 F.3d 998, 1003; *Corder v. Gates* (19<sup>th</sup> Cir. 1991) 947 F.2d 374, 383). Nonetheless, the term "loss" is not limited to damages. (See, e.g., *Essex Ins. Co. v. Five Star Dye House, Inc.* (2006) 37 Cal.4th 1252, 1255; *County of San Diego v. Ace Property & Casualty Ins. Co.* (2005) 37 Cal.406, 417-421; *CDM Investors v. Travelers Casualty & Surety Co.* (2006) 139 Cal.App.4th 1251, 1262-1266.) While providing a legal defense pursuant to the terms of an insurance policy does not constitute indemnification for a loss (*Gray v. Zurich Insurance Co., supra* 65 Cal.2d at p. 277), providing a defense is hardly the same as indemnifying the insured for the other party's costs and attorney fees that the insured becomes obligated to pay only as the result of being found liable for the underlying misconduct. As the court observed in *Gray*, providing an insured with a defense "does not offend the statute [section 533 and Civil code section 16681]; a contract to defend an assured upon mere accusation of a wilful tort does not encourage such wilful conduct." (*Gray v. Zurich Insurance Co., supra*, at p. 278.) But supplementary coverage



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for the costs incurred by the prevailing party is not a necessary component of providing the insured with a defense, the obligation to provide which “is discharged when the action is concluded.” (*Buss v. Superior Court* (1997) 16 Cal.4th 35, 46.) Like the duty to indemnify, the obligation to pay costs taxed to the insured “arises only after liability is established.” (*Ibid.*) The attorney fees of the opposing party become payable only if and when the insured has been found liable, in this case as a statutory consequence of its liability. Permitting the wrongdoers to insure against this consequence would, no less than permitting the wrongdoer to be indemnified for the damages he or she must pay as a result of willful misconduct, undercut the public policy behind section 533 and permit the offender to avoid what may be a significant consequence of the wrongdoing. (See *Downey, supra*, 66 Cal.App.4th at p. 511; *Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co.*, *supra* 14 Cal.App.4th at p. 1604; *Martocchio, supra*, 11 Cal.App.4th at p. 1535.) Thus, despite its contractual agreement to pay these costs, section 533 prohibits State Farm from doing so. (*Id.* at p. 1535 [“section 533 bars insurance recovery for any willful acts –as a matter of statutory, not contractual, interpretation”].)

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## **CHEVIOT VISTA HOMEOWNERS ASSOCIATION vs. STATE FARM FIRE & CASUALTY COMPANY**

### ***(Damages Sustained By Condominium Complex Due to Northridge Earthquake Within Policy Deductible Did Not Support a Claim For Bad Faith Against Property Insurer)***

In *Cheviot Vista Home Association v. State Farm Fire & Casualty Co.*, 143 Cal.App.4th 1486 (October 19, 2006), the California Second District of Appeal affirmed the trial court’s entry of summary judgment in favor of State Farm Fire & Casualty Company (“State Farm”) in connection with a Homeowners Association’s (“Association”) bad faith and breach of contract lawsuit arising out of a claim for earthquake property damage sustained by a condominium complex during the 1994 Northridge earthquake. Immediately after the earthquake, the Association submitted a claim for damage sustained by the complex. State Farm and the Association retained contractors to determine the extent of the damage sustained by the complex. The deductible applicable to the State Farm policy was \$261,239.00. The repair estimates provided to the Association were in the \$75,000 to \$80,000 range. As such, State Farm closed its file noting that the cost of repair was well within the deductible under the Association’s policy.



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Subsequently, the Association renewed its claim for earthquake damage on April 20, 2001 under the provisions of Code of Civil Procedure §340.9 which revives certain Northridge earthquake claims for policy benefits against insurers that otherwise would be time-barred in cases in which “an insured contacted an insurer or an insurer’s representative prior to January 1, 2000 regarding potential Northridge earthquake damage. Subsequently, State Farm declined coverage of the Association’s renewed claim for damages sustained by the complex. Thereafter, the Association filed its complaint for breach of contract and bad faith.

In response to the Association’s lawsuit, State Farm filed a motion for summary judgment arguing that since the damages sustained by the condominium complex were within the amount of its policy deductible, summary judgment should be granted in its favor with respect to the Association’s lawsuit. The trial court agreed and entered judgment in favor of State Farm.

In affirming the trial court’s decision, the Court of Appeal noted that State Farm met the initial burden required by the State’s summary judgment statute in establishing undisputed facts that the cost of repair for earthquake related damage sustained by the complex was within the policy deductible. The Court of Appeal also found that the trial court had properly held that the Association failed to submit admissible evidence creating a triable issue of fact relative to whether the complex had sustained newly discovered earthquake damage in excess of the State Farm deductible.

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## **PACIFIC GAS & ELECTRIC COMPANY vs. SUPERIOR COURT**

### ***(Insurer Lacked Standing to Pursue Subrogation Claim Which Includes Policyholder’s Deductible Notwithstanding California Code of Regulations, Title 10, Section 2695.7, i.e., California Fair Claims Settlement Practices Act)***

In *Pacific Gas & Electric Co. v. The Superior Court of San Joaquin County (American Guarantee & Liability Insurance Company Real Party In Interest)*, 144 Cal.App.4th 19 (October 24, 2006), the California Third District Court of Appeal found that American Guarantee lacked standing to prosecute a subrogation lawsuit which included its insured’s deductible in the amount of \$50,000. Rather, the Court of Appeal held that American Guarantee was limited to prosecuting its subrogation lawsuit for the amount of money that it had paid out under its policy to settle a claim for property damage arising from an industrial power plant failure that injured its insured, Pack-West Telecom, Inc. American Guarantee argued that California Code of Regulations, Title 10, Section 2695.7 (§2695.7, also known as the California Fair Claims Settlement Practices Act) required it to include the insured’s deductible in its subrogation lawsuit. Section 2695.7, subd. (q) states as follows:

Every insurer that makes a subrogation demand shall include in every demand the first party claimant’s deductible.

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In affirming the trial court's decision that Section 2695.7 did not confer standing on American Guarantee to pursue a subrogation action including the insured's deductible, the Court of Appeal held that such section governs the conduct of insurers in the settlement of claims, and not the pursuit of litigation. Hence, American Guarantee lacked standing to pursue a subrogation claim which included the insured's deductible.

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## **PAN PACIFIC RETAIL PROPERTIES, INC. vs. GULF INSURANCE COMPANY**

### ***(Underlying Shareholder Lawsuit Alleged Potential “Damages” In Addition to Restitutory Relief Triggering Duty Defend Under Insurer’s Policy)***

In *Pan Pacific Retail Properties, Inc. v. Gulf Ins. Co., et al.*, 466 F.3d 867 (9<sup>th</sup> Cir. Court of Appeals October 26, 2006), the United States Court of Appeals for the Ninth Circuit reversed, in part, and affirmed in part, the District Court's entry of summary judgment in favor of Gulf Insurance Company (“Gulf”) and Twin City Fire Insurance Company (“Twin City”) in connection with a claim for breach of contract and bad faith brought by Pan Pacific Retail Properties, Inc. (“Pan Pacific”) and Western Properties Trust (“Western”). The parties' dispute arose out of the tender of an underlying class action shareholder lawsuit challenging the merger of Pan Pacific and Western. In particular, the class action alleged that the directors and officers breached their fiduciary obligations to the shareholders by failing to negotiate the highest possible price for the Western Shares, by engaging in related transactions between Pan Pacific and Western that created a conflict of interest, and by failing to disclose all material information to the shareholders before they voted overwhelmingly to approve the merger.

Twin City and Gulf denied coverage of the shareholder class action based on the position that the shareholder claims for additional consideration constituted claims for restitutionary relief uninsurable under California law. In other words, the lawsuit did not allege “damages” which constituted “loss” as defined in the Gulf and Twin City policies. The District Court agreed with Gulf and Twin City and entered summary judgment against Pan Pacific and Western with respect to their complaint for breach of contract and bad faith.

In reversing, in part, and affirming in part, the District Court's entry of summary judgment, the Court of Appeals held that the underlying class action lawsuit alleged potential damages relating to the “value of information” withheld by the directors. According to the Court of Appeals, the information withheld by the directors involved a component of “intrinsic value” of the information withheld which would have been in addition to the additional consideration sought by the shareholders in their lawsuit.

On the other hand, the Court of Appeals affirmed the trial court's entry of summary judgment in favor of Twin City based on the theory that since Twin City's insured, Western, was completely indemnified by Pan Pacific, it had not sustained a loss entitling it to indemnity under the Twin City policy.

# **TRB INVESTMENTS, INC. vs FIREMAN'S FUND INSURANCE COMPANY**

## **(Supreme Court Holds That the Phrase "Under Construction" Includes Renovation and Additions Such That the Vacancy Exclusion In a Commercial Property Policy Does Not Apply to Exclude Coverage of Water Damage Sustained By Building)**

In *TRB Investments, Inc., et al. v. Fireman's Fund Ins. Co.*, 40 Cal.4th 19 (November 13, 2006), the California Supreme Court reversed the Court of Appeal's holding that the vacancy exclusion applied to exclude coverage of a building that sustained water damage due to a burst pipe. The building had been undergoing renovation in order to ready it for use by a tenant. The Court of Appeal found that the exception to the vacancy exclusion for buildings under construction only applied to "new construction" as opposed to activity involving renovation or additions to existing property.

In reversing the Court of Appeal's decision, the California Supreme Court held as follows:

As did the Court of Appeal, we begin our analysis by examining the "under construction" language at issue here to ascertain its common meaning. "Under means "receiving or undergoing the action or effect of." (Webster's Collegiate Dict. (10<sup>th</sup> ed. 2000) p. 1283.) "Construction" means "the act of putting parts together to form a complete integrated object" (Webster's 3d New Internat. Dict. (2002) p. 489); "[t]he creation of something new, as distinguished from the repair or improvement of something already existing" (Black's Law Dict. (6<sup>th</sup> ed. 1990) p. 312); [t]he act of building by combining or arranging parts or elements" (Black's Law Dict. (7<sup>th</sup> ed. 1990) p. 308); and "[t]he action of framing, devising, or forming, by the putting together of parts; erection, building" (3 Oxford English Dict. (2d ed. 1989) p. 794). As the Court of Appeal observed, there is no doubt that the term "construction," as commonly understood, includes the building of a new structure. Contrary to that court's suggestion, however, the "plain meaning" of that term would not seem to exclude other types of building endeavors short of erecting a new structure, such as substantial improvements or modifications to an existing structure, including projects that transform a hovel into a mansion, raze and replace the entire interior of a structure, or otherwise fundamentally transform a building. Under certain circumstances, such endeavors may be seen as comprising an "act of putting parts together to form a complete integrated object" or "building by combining or arranging parts or elements "as much as the erection of a new structure.

Indeed, the Legislature, in defining the term "construction" in various contexts, has recognized that the term may have a broad meaning encompassing a spectrum of building endeavors. For

example, the Legislature has defined the “construction” of state buildings as “including] the extension, enlargement, repair, renovation, restoration, improvement, furnishing, and equipping of any public building.” (Gov. Code., § 15802, subd. (b); see also *id.*, § 53800, subd. (d) [providing an identical definition of “construction”].) Certain administrative regulations likewise define “construction” as including substantial renovation, repair, or alteration efforts. (Cal. Code Regs., tit. 2, § 8102 [defining “construction” as “the process of building, altering, repairing, improving, or demolishing any public structure or building . . . It does not include the routine operation, routine repair, or routine maintenance of existing structures, buildings, or real property”]; Cal. Code Regs., tit. 5, §57152 [defining “construction project” as “includ[ing] new construction, alternation, and extension or betterment of existing structures”]; Cal. Code Regs., tit. 8, § 11160 [defining “construction occupations” as “all job classifications associated with construction, including but not limited to, work involving alteration, demolition, building, excavation, renovation, remodeling, maintenance, improvement, and repair work“].) These definitions suggest that laypersons do not limit the phrase “under construction” to the erection of completely new buildings.

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