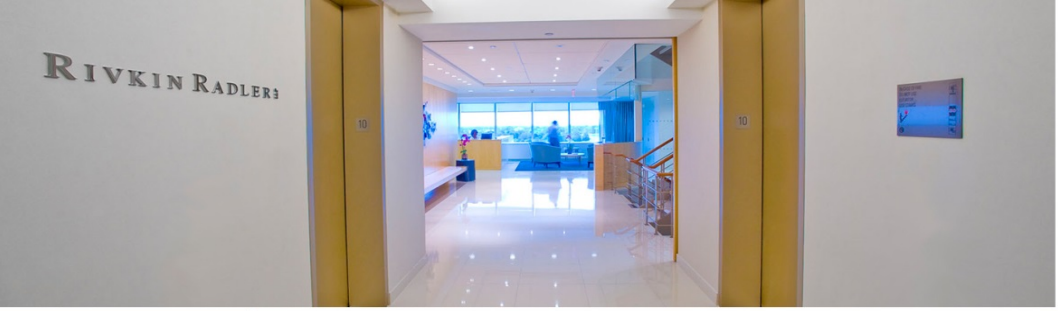

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Insurers Need Not Demonstrate Prejudice When Insureds Violate Consent Provisions in Third Party Liability Insurance Policies, California Supreme Court Rules

The Supreme Court of California has ruled that the notice-prejudice rule generally applies to consent provisions in the context of first party liability insurance policies – but not to consent provisions (also known as "no voluntary payment" provisions) in third party liability insurance policies.

The Case

On January 10, 2011, Pitzer College discovered darkened soil at the construction site for a new dormitory on campus. It determined that remediation was necessary. Under pressure to complete the dormitory prior to the start of the 2012-2013 academic year, Pitzer conferred with environmental consultants who determined that the least expensive and most expeditious option was to conduct lead removal onsite using a transportable treatment unit.

Remediation began on March 9, 2011. Pitzer had not sought its insurer's consent before beginning the remediation project. The work was completed one month later, at a total cost of nearly $2 million. Pitzer then submitted a claim to its insurer.

The insurer denied coverage, citing Pitzer's failure to obtain its consent before beginning the remediation process. The insurer based its decision on the policy's consent provision, which required Pitzer to obtain the insurer's written consent before incurring expenses, making payments, assuming obligations, or commencing remediation due to a pollution condition.

Pitzer sued and the insurer moved for summary judgment.

A federal district court in California granted the insurer's motion for summary judgment, and Pitzer appealed to the U.S. Court of Appeals for the Ninth Circuit.

The circuit court asked the Supreme Court of California to decide whether the notice-prejudice rule applied to the policy's consent provision. That rule generally allows insureds to proceed with their insurance policy claims even if they gave their insurer late notice of a claim, provided that the late notice did not substantially prejudice the insurer.

The California Supreme Court's Decision

The court instructed that the notice-prejudice rule generally applies to consent provisions in the context of first party liability insurance policies. In the court's view, there was no reason to believe that imposing the notice-prejudice rule on first party insurers would prove "so unmanageable for those suffering actual prejudice to justify a contrary conclusion."

But the court held that the no-prejudice rule did not apply to consent provisions in third party liability insurance policies.

The court explained that although first party coverage obligated an insurer to pay damages claimed by the insured itself, third party coverage obligated the insurer to defend, settle, and pay damages claimed by a third party against the insured. In the third party liability context, the court continued, the insurer was "invested with the complete control and direction of the defense."

The court added that in third party insurance policies, consent provisions were designed to ensure that insurers that promptly accepted a defense tendered by their insureds thereby gained control over the defense and settlement of the claim. The court concluded that because an insurer's right to control the defense and settlement of claims was "paramount" in the third party context, the notice-prejudice rule did not apply to third party policies.

The case is *Pitzer College v. Indian Harbor Ins. Co.*, No. S239510 (Cal. Aug. 29, 2019).

Unlisted Resident Driver Exclusion Does Not Violate Public Policy, Pennsylvania Supreme Court Confirms

The Supreme Court of Pennsylvania has ruled that an unlisted resident driver exclusion in a personal automobile insurance policy was enforceable and did not violate public policy.

The Case

While Rachel Dixon was driving a car owned by her boyfriend (the "policyholder"), she was involved in an accident with a vehicle in which Priscila Jimenez was a passenger.

At the time of the accident, Dixon resided with the policyholder. The automobile insurance policy covering his car contained an unlisted resident driver exclusion that excluded from coverage any individual living with but not related to him and who was not specifically listed as an additional driver on the policy. Dixon was not listed as an additional driver on the policy.

The policyholder's insurer sued Dixon and the policyholder, seeking a declaratory judgment regarding the enforceability of the exclusion with respect to Dixon.

The trial court granted summary judgment in favor of the insurer, finding the exclusion unambiguous, valid, and enforceable and concluding that the insurer had no duty under the policy to defend or indemnify Dixon in the personal injury action that Jimenez and her husband filed against Dixon.

An appellate court affirmed, and the dispute over the enforceability of the exclusion reached the Supreme Court of Pennsylvania.

The Pennsylvania Supreme Court's Decision

The Pennsylvania Supreme Court affirmed.

In its decision, the court said that requiring an insurer to provide coverage for an "unlimited number of permissive users," including those who might be operating the vehicle on a regular basis, but whom the insured did not disclose or pay to insure contravened the "accepted principle that insureds are not

entitled to receive *gratis* coverage."

The court added that requiring such coverage "almost certainly" would result in an increase in the cost of insurance, as insurers would be forced to insure unknown risks.

The court rejected the contention that the exclusion violated the Pennsylvania Motor Vehicle Financial Responsibility Law (the "MVFRL") by requiring a vehicle owner to identify all regular users, or residents of the owner's household, to have them covered under the owner's insurance policy. The court reasoned that the MVFRL did not require an owner to identify all permissive users of the owners' vehicle – but that it also did "not require an *insurer* to provide coverage beyond what the insurance policy provides."

The court next decided that the exclusion did not violate public policy. It pointed out that the exclusion was "clear and unambiguous" and that although the policyholder was aware of the exclusion, he permitted his vehicle to be operated by his live-in girlfriend who, under the express terms of the exclusion, was not covered by the policy. In the court's view, the policyholder had the option of adding his girlfriend to the policy but chose not to do so. Undoubtedly, the court pointed out, this choice resulted in reduced insurance premiums – but it concluded by reiterating that an insured was "not entitled to receive *gratis* coverage."

The case is *Safe Auto Ins. Co. v. Oriental-Guillermo*, No. 26 MAP 2018 (Penn. Aug. 20, 2019).

Directors and Officers Insurance Policy Did Not Cover Restitution Payments, 11th Circuit Concludes

The U.S. Court of Appeals for the Eleventh Circuit has affirmed a decision by a federal district court in Florida that a directors and officers liability insurance policy did not cover restitution payments made by the insured as part of a settlement of criminal charges the insured reached with authorities in Florida.

The Case

Sabal Insurance Group and its president and chief executive officer (together, "Sabal") settled grand theft charges with the state of Florida and entered into a stipulated settlement agreement ("SSA"). Under the SSA, Sabal agreed to make three payments to the alleged victim and other entities. Sabal then requested indemnification from its directors and officers liability insurer.

One payment, in the amount of $183,807.87, was to reimburse the alleged victim; the second payment was a charitable donation; and the third payment was for the costs of the investigation.

The insurer denied coverage and filed a declaratory judgment action, asserting that it was not obligated to indemnify Sabal under the policy for the payments Sabal made under the SSA.

The U.S. District Court for the Southern District of Florida granted summary judgment in favor of the insurer, and Sabal appealed to the Eleventh Circuit.

The Eleventh Circuit's Decision

The Eleventh Circuit affirmed.

First, the circuit court ruled that the insurance policy was "unambiguous" and excluded coverage for the "restitution of ill-gotten gains." The circuit court also stated that, as a matter of Florida law, insurance contracts do not insure the restitution of ill-gotten gains as "one should not be able to insure against one's own intentional misconduct."

Next, the Eleventh Circuit determined that the $183,807.87 payment was the restitution of ill-gotten gains. The court was not persuaded by Sabal's argument that the payment was not restitution of ill-gotten gains because the SSA provided for Sabal's payments to be made without "any admission of guilt" and "solely for purposes of compromise and case resolution."

The court stated that the SSA was "not binding" on it and that, in any event, the provisions of the SSA in which Sabal did not admit guilt were irrelevant because an admission of guilt was "not required for a payment to be the return of ill-gotten gains."

The court ruled that the payment was "restitution," explaining that it was made to resolve a criminal information charging Sabal with grand theft and that the amount of the payment was equal to the amount of Sabal's alleged ill-gotten gains that accrued within the statute of limitations.

Moreover, the circuit court continued, it was "clear" from the language of the SSA and the surrounding circumstances that the purpose of the payment was to make the recipient whole for losses that accrued within the statute of limitations period.

The court next found that Sabal's charitable donation also was not a covered loss under the policy. It ruled that the donation was a "penalty" and reasoned that the policy excluded "criminal or civil fines or penalties imposed by law." The court observed that although the parties called the payment a "donation," it was "neither voluntary nor tax deductible."

Finally, the Eleventh Circuit agreed with the district court that the $20,000 payment also was restitution. The circuit court pointed out that this payment was made to the alleged victim, who did not conduct the investigation. It also observed that the notation on Sabal's check indicated that this amount was a "settlement."

Accordingly, the Eleventh Circuit concluded, for the same reasons that the $183,807.87 payment was not a covered loss under the policy, the $20,000 payment also was not a covered loss under the policy.

The case is *Philadelphia Indemnity Ins. Co. v. Sabal Ins. Group, Inc.*, No. 17-14844 (11th Cir. Aug. 26, 2019).

'Private Collections' Insurance Policy Did Not Cover Ponzi Scheme Loss Claimed by Insureds for Undelivered Wine, 10th Circuit Decides

The U.S. Court of Appeals for the Tenth Circuit, affirming a Colorado district court's decision, has ruled that insureds could not recover for the market value of wine they said that they had purchased but had not received where they could not show that they owned any bottles of wine that had not been delivered to them.

The Case

Malik and Seeme Hasan alleged that they lost more than $1.7 million for 2,448 bottles of wine that they had paid a retailer for but had not received from the retailer after the retailer declared bankruptcy and its principal pleaded guilty to running a Ponzi scheme. The Hasans sought to recover what they asserted was the market value of the wine under a private collections insurance policy they had obtained to cover their wine collection and other valuables.

The Hasans' insurer denied coverage in a letter that explained that the Hasans "did not experience a loss of wine because [they] did not 'own or possess' the wine" as required by the policy and "[b]ecause you never possessed or owned the wine . . . , you cannot be said to have suffered 'direct physical loss or damage' to wine that you never received or owned."

The Hasans sued.

The U.S. District Court for the District of Colorado granted summary judgment in favor of the insurer, and the Hasans appealed to the Tenth Circuit.

The Tenth Circuit's Decision

The Tenth Circuit affirmed.

In its decision, the court explained that the Hasans' policy insured against loss or damage to "valuable articles," defined under the policy as "the personal property you own or possess for which an amount of coverage is shown on the Declarations Page."

The court ruled that the policy did not cover the Hasans' loss because they failed to present adequate evidence that they were the owners of any wine bottles that were not delivered to them.

The court was not persuaded by the Hasans' argument that when they sent money to the retailer, it used the money to purchase the specified 2,448 bottles of wine for the Hasans and allocated the bottles to them, and that the fact that the bottles of wine had not been delivered to them meant that they must have been lost or damaged, and therefore, covered by the policy.

The Tenth Circuit found no evidence that the retailer actually had purchased the ordered bottles for the Hasans. Indeed, it pointed out that the retailer "regularly failed" to use money it received from customers to purchase bottles they ordered. The court said that although the retailer did not necessarily treat the Hasans the same way it treated other customers, the Hasans failed to provide evidence that they were treated the way they said they were treated.

The court concluded that, absent evidence that any of the 2,448 ordered bottles of wine actually were purchased by the retailer, much less specifically purchased for the Hasans, the Hasans failed to carry their burden on an essential element of their insurance claim: that there were bottles of wine that they owned that were unaccounted for.

The case is *Hasan v. AIG Property Casualty Co.*, No. 18-1309 (10th Cir. Aug. 27, 2019).

Assault and Battery Exclusion Precluded Coverage of Claims Arising from Shooting at Club, 6th Circuit Affirms

The U.S. Court of Appeals for the Sixth Circuit, affirming a Kentucky district court's decision, has ruled that an assault and battery exclusion in a nightclub's insurance policy precluded coverage of negligence claims filed against the nightclub's owner by shooting victims.

The Case

Six people were shot on one night at a nightclub in Louisville, Kentucky. They sued the club's owner, Cole's Place, Inc., in Kentucky state court, alleging that it had negligently failed to protect them from a foreseeable harm.

The club's insurer asked the U.S. District Court for the Western District of Kentucky to declare that it had no duty to defend or indemnify Cole's Place in the state court lawsuits.

The district court granted summary judgment in favor of the insurer, ruling that the policy's assault and battery exclusion applied to the state court lawsuits. Cole's Place appealed to the Sixth Circuit.

The Sixth Circuit's Decision

The Sixth Circuit affirmed.

The court found that all of the state court complaints alleged a battery. It pointed out that several of the complaints used the word "attack" to describe the shooting.

Another complaint alleged that Cole's Place should have known "that there were previous violent incidents on [the] property" and that it "had notice of previous dangerous and violent acts on its property during events."

The Sixth Circuit then ruled that the state court plaintiffs' claims based on failure to protect "clearly" constituted claims "arising out of or resulting" from the alleged battery within the meaning of the policy's assault and battery exclusion.

Accordingly, the court concluded, given that the state court complaints alleged a battery and asserted claims "arising out of or resulting" from the alleged battery, Cole's Place's policy excluded coverage for those lawsuits.

The case is *United Specialty Ins. Co. v. Cole's Place, Inc.*, No. 18-5545 (6th Cir. Aug. 22, 2019).

Criminal Acts Exclusions Even Bar Coverage for Negligence Claims, 6th Circuit Says

The U.S. Court of Appeals for the Sixth Circuit, affirming a Kentucky district court's decision, has ruled that an insurance company had no obligation to defend or indemnify a constable sued after a fatal shooting.

The Case

A county constable in Kentucky shot and killed Bill Stanley's son, was convicted of reckless homicide, and was sentenced to one year in prison. Stanley subsequently sued the constable, asserting claims under federal and state law.

The county's insurer went to court, seeking a declaratory judgment that it was not obligated to defend or indemnify the constable with respect to the death of Stanley's son.

The U.S. District Court for the Eastern District of Kentucky granted summary judgment to the insurer, and Stanley appealed to the Sixth Circuit. Among other things, he argued that the term "criminal act" in the coverage forms' criminal acts exclusions was ambiguous and that the exclusions were overbroad, rendering them "confusing" as to whether they excluded negligent acts from coverage.

The Sixth Circuit's Decision

The Sixth Circuit affirmed.

In its decision, the circuit court first ruled that the criminal acts exclusions in the law enforcement liability coverage form and in the public officials errors and omissions coverage form were "not ambiguous." It stated that a "plain and ordinary reading" of these provisions indicated that, if an insured committed a criminal act – whether the act was committed negligently, recklessly, or otherwise – and a judgment or adjudication confirmed that the insured committed such an act, then the insured was "excluded from coverage under the clear language of the exclusions."

That, the court stated, was "precisely what happened here."

The court reached the same result with respect to the commercial general liability coverage form.

The court found that the constable intentionally shot Stanley's son, with the "expectation and intention to cause bodily injury" to him. It then decided that the "reasonable force" exception to the bodily injury exclusion did not apply, given that the jury concluded that the force used by the constable was not necessary. The court concluded that, "[a]n unnecessary constabulary use of force" was "inherently unreasonable."

The case is *Atlantic Specialty Insurance Co. v. Stanley*, No. 19-5259 (6th Cir. Aug. 23, 2019).

Illinois Appellate Court Holds That Insurers Had No Duty to Defend Insured in Environmental Mediation

An appellate court in Illinois, affirming a trial court's decision, has ruled that insurers did not have to defend their insured in a mediation, which was not a "suit."

The Case

In August 2004, Illinois Tools Works, Inc. ("ITW") received a letter from General Dynamics Ordnance and Tactical Systems, Inc. ("GD-OTS") providing notice of liability "with respect to environmental contamination" at a Superfund site that ITW owned through an affiliated manufacturing company.

The letter explained that GD-OTS also had manufacturing facilities at the site and that it had entered into an administrative order on consent with the United States pursuant to which it agreed to pay for the cleanup costs related to the site.

The letter stated that ITW was a potentially responsible party and invited it to participate in the remediation of the site and share the costs, but explained that if ITW declined to do so, GD-OTS would file a lawsuit against ITW.

ITW agreed to participate in the remediation and entered into mediation with the United States to allocate the response costs among ITW, GD-OTS, and other potentially responsible parties.

ITW notified its insurers about the mediation and submitted its defense bills, but the insurers did not make any reimbursements to ITW regarding the mediation.

Thereafter, ITW filed an action against its insurers, seeking a declaration that they had a duty to defend ITW in the mediation.

The trial court found that the mediation did not trigger the insurers' duty to defend because it was not a "suit."

ITW appealed. It argued that its insurers had a duty to defend it in the mediation because the mediation and a separate lawsuit against ITW involving a nearby site arose out of the same alleged misconduct.

The Appellate Court's Decision

The appellate court affirmed.

In its decision, the appellate court found that the lawsuit and the mediation did not arise out of the same occurrence and that the mediation did not involve any allegations regarding the site that was the subject of the lawsuit.

Moreover, the appellate court added, the insurance policies explicitly distinguished the terms "suit" and "claim," and provided a duty to defend only where there was a suit.

The mediation, the court ruled, was not a suit or a continuation of the lawsuit relating to the other site. It concluded that to hold that the insurers had a duty to defend ITW in the mediation merely because it involved claims *related to* the lawsuit "would lead to an absurd result."

The case is *Illinois Tool Works, Inc. v. Ace Specialty Ins. Co.*, No. 1-18-1945 (Ill. Ct. App. Aug. 23, 2019).

Texas Appellate Court Holds That Exclusion for Aerial Herbicide-Spraying Negated Duty to Defend

A Texas Appellate Court, reversing the trial court, has ruled that an aerial herbicide-spraying exclusion contained in an endorsement negated an insurer's duty to defend a lawsuit against the insured for damages caused by spraying performed on the insured's behalf.

The Case

The insured, RiceTec, produces and sells rice seeds. In April 2015, it retained Twin County Air-AG to spray herbicide over its rice farm. Its neighbor, the Dishmans, claimed that the herbicide was over sprayed and drifted onto their property, allegedly harming over 740 acres of Dishmans' rice crop.

In September 2015, the Dishmans sued RiceTec in Texas state court, asserting several causes of action, including trespass and negligence. RiceTec tendered the suit to its commercial general liability insurer, StarNet Insurance Company.

The policy contained a pollution exclusion for property damage arising out of the actual "discharge, dispersal, seepage, migration, release or escape" of pollutants at or from any premises, site, or location on which the insured or its contractors working on the insured's behalf are performing operations.

The policy also contained an Agricultural Chemicals Applicator Coverage Endorsement, which modified the policy by making inapplicable certain sections of the pollution exclusion where injury arose out of the application of herbicides. But the endorsement itself excluded "[t]he application of herbicides, pesticides, fertilizers or similar agricultural chemicals by aircraft owned, operated by, rented or loaned to you or by any non-owned aircraft."

StartNet denied coverage based on these provisions and RiceTec sued. Each party moved for summary judgment on the question of whether StarNet owed RiceTec a duty to defend the Dishmans' lawsuit.

The trial court ruled in favor of RiceTec and StarNet appealed.

The Appellate Court's Decision

The appellate court reversed, finding that StarNet was not obligated to defend RiceTec.

RiceTec argued that the Endorsement was irrelevant because it only applied if the policy's pollution exclusion applied. It argued that the pollution exclusion did not apply at all.

But the court concluded that the Dishmans' lawsuit alleged facts falling within the pollution exclusion. The court reasoned that the Dishmans' lawsuit alleged an actual "discharge" or "release" of pollutants – herbicides – at or from a premises, site, or location on which a contractor working on RiceTec's behalf, performed operations.

The court then turned to the Agricultural Chemicals Applicator Coverage Endorsement. The court held that the allegations in the Dishmans' lawsuit were broad enough to encompass the exception to the Endorsement for application of herbicides by aircraft owned or not owned by RiceTec. The court noted that it was undisputed that the herbicides that damaged the Dishmans' rice crops were applied aerially.

The court also rejected RiceTec's argument that because it had not authorized Twin County to spray the Dishmans' property, Twin County was not acting on RiceTec's behalf. The court noted that it was immaterial whether the Dishmans' lawsuit alleged that RiceTec authorized Twin County to spray the Dishmans' crops. The court noted that Dishmans' lawsuit alleged that RiceTec authorized Twin County to spray its own crops, and that in the course of that activity, the Dishmans' crops were damaged.

Therefore, the court concluded, StarNet did not owe RiceTec a duty to defend in the Dishmans' lawsuit.

The case is *StarNet Ins. Co. v. RiceTec, Inc.,* No. 01-18-00536-CV (Tex. Ct. App. Aug. 27, 2019).

Court Rejects Insurance Coverage for Consent Judgment Reached Without Insurer's Consent

A federal district court in Tennessee has ruled that an umbrella insurer had no obligation to cover a consent judgment its insured reached without its consent.

The Case

A couple sued a hotel in Pigeon Forge, Tennessee, alleging that they were injured when a malfunctioning pool heating and ventilation system emitted carbon monoxide that poisoned them as they slept. After the trial court entered a $20 million consent judgment in their favor, the couple, as assignees of the hotel's rights against its insurers, sued the umbrella insurer for breach of contract.

The insurer moved for summary judgment.

The District Court's Decision

The district court granted the insurer's motion.

In its decision, the court ruled that the consent judgment was unenforceable against the insurer because the hotel entered into it in violation of policy provisions.

The court explained that the policy's voluntary payment clause prohibited the hotel from voluntarily assuming any obligation covered by the insurance policy without the insurer's consent, but that the hotel did just that when it "unilaterally" agreed to the $20 million consent judgment.

The court added that the policy's no action clause required that the insurer agree to damages owed, or that those amounts be determined at trial, but that the hotel also violated this clause when it voluntarily assumed liability for $20 million in damages via the consent judgment and without the insurer's agreement.

The court was not persuaded by the couple's contention that the hotel did not have to perform its obligations under the policy because the insurer refused to defend the hotel in their lawsuit. The court reasoned that the umbrella insurer did not have a duty to defend the hotel in the couple's lawsuit as the policy's retained limit was not reached. But the hotel "retained its obligations" under the policy, "which it then breached."

The court concluded that the hotel entered into the consent judgment in violation of the insurance policy, giving the insurer a defense to liability that it could assert against the couple as their rights were no greater than the hotel's rights.

The case is *Fritz v. St. Paul Fire and Marine Ins. Co.*, No.: 3:17-cv-433-TAV-HBG (E.D. Tenn. Aug. 12, 2019).