Consistently Inconsistent

Recent Supreme Court Decisions Interpreting Insurance Policies

by
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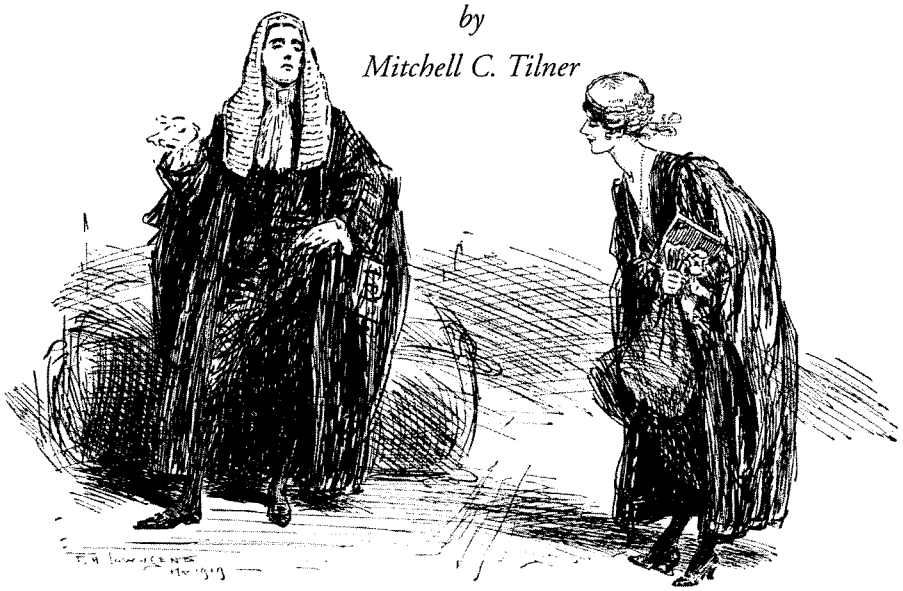

This article examines four California Supreme Court opinions, spanning the years 2001 to 2004, in which the court interpreted insurance policy language. The description of each case is followed by a brief commentary on the case. The article concludes that the court has been less than consistent in applying certain "settled" rules of insurance policy interpretation.

Safeco Ins. Co. v. Robert S. (2001) 26 Cal.4th 758: "Illegal acts" exclusion is ambiguous and unenforceable.

Insureds' 16-year-old son accidentally shot and killed a friend with a pistol that son believed was unloaded. Son was convicted of involuntary manslaughter, a felony, in juvenile court. Friend's parents brought a wrongful death action against insureds and son. Insureds' homeowners policy covered liability for bodily injury caused by an occurrence, defined as an accident resulting in bodily injury during the policy period. The policy excluded coverage for liability for bodily injury "'arising out of any *illegal act* committed by or at the direction of an insured.'" (26 Cal.4th at p. 762.)

Insurer brought an action against insureds and son seeking a declaration that it had no duty to defend or indemnify insureds in the wrongful death action. Insurer relied on the policy exclusion for losses arising from "any illegal act." Insurer argued the exclusion applied because a juvenile court had concluded that shooting constituted involuntary manslaughter. The trial court granted summary judgment for insureds, finding the exclusion ambiguous and therefore unenforceable.

The Court of Appeal reversed and directed the trial court to enter summary judgment for insurer. The court held the "illegal act" exclusion was not ambiguous as applied to the facts of this case because an average layperson would consider manslaughter to be an illegal act.

The Supreme Court (per Justice Kennard, joined by Justices George, Werdegar and Chin) reversed. It concluded that the term "illegal act" was ambiguous because it could refer either narrowly to a "criminal act" or broadly to any act prohibited by law, including the law governing negligence. The court rejected the narrow construction because the policy did not use the term "criminal act," which is a common exclusion in liability policies, but rather "illegal act." To interpret "illegal" to mean "criminal" would be to insert what the insurer omitted. The court also rejected the broad construction of "illegal" meaning a violation of *any* law, whether civil or criminal, because such a construction was "so broad as to render the policy's liability coverage practically meaningless." (26 Cal.4th at p. 764.)

The court concluded: "[B]ecause the illegal act exclusion cannot reasonably be given meaning under established rules of construction of a contract, *it must be rejected as invalid.* (Civ. Code, § 1653.)" (26 Cal.4th at p. 766, emphasis added.)

Justice Baxter wrote a dissenting opinion, joined by Justice Brown, in which he argued the exclusion was not ambiguous as applied to the son in this case because manslaughter is an "illegal act" under any definition. Justice Baxter noted that, under traditional coverage analysis, whether the exclusion might be ambiguous under other circumstances not presented by this case was irrelevant.

Commentary: It is not unusual for a court to find a policy provision ambiguous. It *is* unusual for a court to find a policy provision devoid of meaning and therefore "invalid," presumably under all circumstances. Under the majority's rationale, the exclusion would not apply even if insured were convicted of first-degree murder. This anomalous result highlights the flaw in the majority's coverage analysis.

The court has often stated that it does not evaluate policy language for ambiguity in the abstract, but only in the context of the facts presented. (See, e.g., *Palmer v. Truck Ins. Exchange* (1999) 21 Cal.4th 1109, 1118 ["The mere fact that a word or phrase in a policy may have multiple meanings does not create an ambiguity." [Citation.] "[L]anguage in a contract must be construed in the context of that instrument as a whole, and in the circumstances of that case, and cannot be found to be ambiguous in the abstract;" *Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal.4th 857, 868 [same].) The majority opinion in *Robert S.* did not mention this rule and indeed seemed to flout it. The issue was not whether the "illegal acts" exclusion could be read to preclude coverage even for negligence, in the abstract. The issue was whether the exclusion was ambiguous when applied to an accidental shooting that constituted involuntary manslaughter, a felony. As Justice Baxter observed in dissent, a felony is an "illegal act" under any definition.

Rosen v. State Farm General Ins. Co. (2003) 30 Cal.4th 1070: Where policy covered collapse, defined as "actually fallen down or fallen into pieces," insurer had no duty to cover repair costs where collapse was merely imminent.

Insured sued insurer for breach of contract and bad faith after insurer denied a claim for the cost of repairing two decks following a contractor's determination that the decks were in a state of imminent collapse. Insured's homeowner's policy excluded coverage for collapse except for "'sudden, entire collapse of a building or any part of a building.'" (30 Cal.4th at p. 1073.) The policy defined "collapse" to mean "'actually fallen down or fallen into pieces.'" (*Ibid.*)

The trial court and the Court of Appeal both decided that public policy required insurer to cover the repair cost. Otherwise, the insured would be forced to await the actual collapse of a building to obtain coverage, which could lead to serious injury or loss of life.

The Supreme Court (per Justice Brown, joined by Justices George, Baxter and Chin) reversed. The court held the policy language was not ambiguous; it required an actual collapse. Courts may not rewrite a coverage provision to conform to their notions of sound public policy.

Justice Moreno (joined by Justices Kennard and Werdegar) filed a concurring opinion in which he disagreed "with the majority's conclusion that courts are forbidden from employing public policy when determining how insurance policy clauses are to be interpreted and enforced." (30 Cal.4th at p. 1080.) But the judicial power to declare public policy in the context of contract interpretation and enforcement should be exercised with great caution and only in the clearest cases. Justice Moreno concluded that this was not a case in which public policy considerations clearly outweighed the policy's plain language, hence the majority properly declined to rewrite the contract.

Commentary: Reading *Rosen* in isolation, one might conclude that, where the policy language is clear, a majority of the court will enforce it even though the insured and the public would be better served by "rewriting" the language. But this conclusion might be premature. See the discussions of *MacKinnon* and *E.M.M.I., Inc.* below.

MacKinnon v. Truck Ins. Exchange (2003) 31 Cal.4th 635: Absolute pollution exclusion applies only to "events commonly thought of as pollution."

Insured owned an apartment building. One of his tenants died after a pest control company hired by insured sprayed the building with pesticide to exterminate yellow jackets. Tenant's heirs sued insured for wrongful death. Insured tendered the defense under his CGL policy.

Insurer initially defended under a reservation of rights, then withdrew the defense on the ground the policy's pollution exclusion barred coverage for liability arising from the tenant's death. The exclusion stated: "'We do not cover Bodily Injury . . . [r]esulting from the actual, alleged, or threatened discharge, dispersal, release or escape of pollutants . . . at or from the insured location.'" (31 Cal.4th at p. 639.) The terms "pollution or pollutants" were defined to mean "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste materials." (*Ibid.*)

Insured settled the underlying action then sued insurer for breach of contract and related claims based on its failure to defend and indemnify him in the underlying action. The trial court granted summary judgment for insurer, concluding the pollution exclusion was clear and unambiguous. The Court of Appeal affirmed, also finding the clause unambiguous as applied to insured's claim.

The Supreme Court (Justice Moreno writing for a unanimous court) reversed. The court began by reviewing the historical development of the pollution exclusion. The court found that the insurance industry's "motivation" for drafting the absolute pollution exclusion was to exclude coverage for the consequences of "traditional environmental pollution rather than all injuries from toxic substances." (31 Cal.4th at p. 644.)

The court next considered arguments for and against a "narrow" interpretation of the pollution exclusion, i.e., an interpretation limiting its application to "traditional environmental pollution." The court noted that the history of the exclusion supported the narrow interpretation. "We would be remiss . . . if we were to simply look to the bare words of the exclusion, ignore its raison d'etre, and apply it to situations which do not remotely resemble traditional environmental contamination." (31 Cal.4th at p. 645.)

The court also noted that a broad interpretation of "pollutant" to mean literally "'any contaminant or irritant'" (as the policy stated) would have "absurd or otherwise unacceptable results." (31 Cal.4th at pp. 645-646.) For example, a broad interpretation

would exclude coverage in a "hypothetical" case involving an "allergic reaction to pool chlorine." (*Id.* at p. 650.) "Chlorine certainly contains irritating properties that would cause the injury. Its dissemination throughout a pool may be literally described as a dispersal or discharge." (*Ibid.*) Yet, the court noted, "no court or commentator that has concluded such an incident would be excluded under the pollution exclusion." (*Ibid.*)

The court then turned to the task of interpreting the exclusion in this case. The court stated that to ascertain the scope of the exclusion, the court must first consider the policy's coverage language. Here, the policy covered "all sums for which the insured becomes legally obligated to pay as damages caused by bodily injury." This language supported insured's reasonable expectation that insured would be covered for ordinary acts of negligence resulting in bodily injury. Accordingly, "[c]overage will . . . be found unless the pollution exclusion conspicuously, plainly and clearly apprises the insured that certain acts of ordinary negligence, such as the spraying of pesticides in this case, will not be covered." (31 Cal.4th at p. 649.)

Based on the history of the exclusion, the common connotative meanings of "discharge," "dispersal," "release," "escape" when used in conjunction with "pollutant," and the potentially absurd results in hypothetical cases if the exclusion were given a broad reading, the court concluded the exclusion applied only to "conventional environmental pollution" by irritants and contaminants commonly though of as pollution. "The normal application of pesticides around an apartment building in order to kill yellow jackets would not comport with the common understanding of the word 'pollute.'" (31 Cal.4th at p. 654.)

Commentary: The *MacKinnon* court's analysis is difficult to square with at least three settled principles of policy interpretation, principles the court itself acknowledged:

(a) *When language is clear and explicit, it governs.* The courts turn to extracontractual interpretative aids only when the policy language is ambiguous. (*Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1264-1265; *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 822.) The *MacKinnon* court never found the exclusion's language to be ambiguous. In the absence of a finding of ambiguity, the court's resort to the historical background and purpose of the policy provision was questionable.

(b) *Language cannot be found to be ambiguous in the abstract.* (See discussion above in connection with *Robert S.*) Thus, the *MacKinnon* court's reliance on "hypothetical" situations to show that a broad interpretation of the exclusion would lead to absurd results was questionable.

(c) *A policy must be construed to give effect to all its terms. (Palmer v. Truck Ins. Exchange, supra,* 21 Cal.4th at p. 1115; Civ. Code, § 1641.) The *MacKinnon* court explained that the terms "discharge, dispersal, release or escape" describe traditional environmental pollution over a considerable area, rather than a localized toxic accident occurring in the vicinity of intended use. But this explanation fails to account for the language of the exclusion stating that it barred coverage for "discharge, dispersal, release or escape of pollutants . . . *at . . . the insured location" (MacKinnon, supra,* 31 Cal.4th at p. 639, emphasis added).

E.M.M.I., Inc. v. Zurich American Ins. Co. (2004) 32 Cal.4th 465: Where jeweler's block policy excluded coverage for theft of jewelry from a vehicle unless insured or authorized person was "actually in or upon such vehicle at the time of the theft," policy covered theft of jewelry from vehicle where salesman was crouching behind vehicle and attending to it at time of theft.

Insured's jeweler's block policy covered risks of direct physical loss to jewelry but excluded coverage for loss by theft from any vehicle "'unless, you, an employee, or other person whose only duty is to attend to the vehicle are *actually in or upon* such vehicle at the time of the theft.'"(32 Cal.4th at pp. 468-469.) Insured's salesman stepped out of a vehicle containing jewelry, leaving the engine running, and walked to the rear of the vehicle to investigate an unusual noise. While the salesman was crouching behind the vehicle, a thief jumped into the vehicle and drove it away. The jewelry was never recovered.

Insurer denied the claim for the lost jewelry under the exclusion for theft from a vehicle, taking the position that the exception did not apply because the salesman was not "actually in or upon such vehicle at the time of the theft." Insured sued for breach of contract and bad faith. The trial court granted summary judgment for insurer. The Court of Appeal affirmed.

The Supreme Court (per Justice Moreno, joined by Justices George, Baxter and Werdegar) reversed, holding that the exception to the exclusion was ambiguous and did not clearly apprise insured that coverage would be lost merely by stepping out of the

car. The policy uses the word "upon" as an alternative to "in." "[A] reasonable insured would likely interpret the exception to mean that the insured must be either inside the vehicle, or in some other location relative to the vehicle." (32 Cal.4th at p. 473.) "Upon" is ambiguous when used in connection with "vehicle."

"Construing the ambiguous language in favor of the insured, in a manner consistent with the insured's reasonable expectations, and keeping in mind that exclusionary provisions are narrowly interpreted while exceptions are broadly construed, we hold that the exception to the vehicle theft exclusion applies when an insured is in close proximity to the vehicle and is attending to it." (32 Cal.4th at p. 476.)

Justice Kennard wrote a dissenting opinion, faulting the majority for failing to respect the clear and unambiguous policy language. "The ordinary, common, and popular understanding of the words 'actually upon' mean in fact on a vehicle." (32 Cal.4th at p. 484 (dis. opn. of Kennard, J.). The word "actually" eliminated any doubt that the policy exception requires the salesman to be actually in or on the vehicle "We should enforce the contract between the parties as it is written, not rewrite its terms." (*Id.* at p. 483.)

Justice Chin also wrote a dissenting opinion, joined by Justice Brown, which likewise found the policy language unambiguous and faulted the majority for failing to enforce the language as written. Under the policy language, the salesman's intent, whether to abandon the vehicle or to attend to it, is irrelevant. When the insured leaves the vehicle for any reason, the risk of theft increases. The majority of other state courts agree that the insured or its employee must actually, literally, be in or on the vehicle in order for the exception to apply. "Upon" is interchangeable with "on." In certain contexts, "on" may mean "in close proximity" (e.g., "a village on the sea"), but no definition of "on" or "upon" includes close proximity *to a vehicle.* Justice Chin explained that, from a historical perspective, "upon" applied to a horse or a horse-drawn carriage. In modern times, "upon" would apply to a motorcycle. The word "actually" belies any argument that the exclusion may be avoided when the insured is merely near the vehicle or watching it. "The majority also cites many rules of insurance policy interpretation to support its holding. They all favor the view that there is no coverage here." (32 Cal.4th at p. 489 (dis. opn. of Chin, J.).

Responding to Justice Chin's argument that word "upon" was not ambiguous because it historically referred to a horse or horse-drawn carriage, the majority ruled that the "historical meaning of the words used in the policy . . . does not illuminate the meaning of the policy language to a reasonable layperson in contemporary times, who may well be unaware of this historical meaning." (32 Cal.4th at pp. 472-473, fn. 2.)

Commentary: Compare the majority's treatment of the "historical meaning" of "upon" in *E.M.M.I.* (historical meaning does not illuminate the meaning of policy language) with the court's treatment of the historical meaning of the absolute pollution exclusion in *MacKinnon* (historical meaning "useful" in interpreting policy language, and court would be "remiss" in failing to consider it; no suggestion reasonable layperson would be aware of exclusion's history).

Also, compare the differing treatments accorded the word "actually" in *Rosen* (by defining term "collapse" to mean "actually fallen down or fallen into pieces," policy removed any ambiguity in term "collapse") and in *E.M.M.I.* ("actually in or upon such vehicle" was ambiguous). Only Justices Kennard, Chin and Brown were consistent on the effect of the word "actually" in the two cases.

Conclusion

In recent cases, the court has given lip service to the principle that insurance policy language will not be deemed ambiguous in the abstract, but the court does not always take the principle seriously. It is difficult to square this principle with the court's willingness to construe policy language in light of hypothetical cases involving facts different from those before the court (e.g., *Robert S.; MacKinnon*).

Likewise, the court's oft-repeated statement that policy language will govern when it is clear and explicit seems to fall by the wayside when the court believes the language on its face, however clear and explicit, varies from its historical meaning, purpose or function (e.g., *MacKinnon*).

The court's apparent inconsistencies may reflect a broader, perhaps insurmountable, problem in cases involving policy interpretation: ambiguity is often in the eye of the beholder. Except when the policy language is indisputably clear (e.g., *Rosen*), one justice's clarity may be another's ambiguity (e.g., *E.M.M.I.*).

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