S236765

SUPREME COURT OF CALIFORNIA

LIBERTY SURPLUS INSURANCE CORPORATION, et al.,

Plaintiffs and Appellees,

v.

LEDESMA AND MEYER CONSTRUCTION COMPANY, INC., et al.,

Defendants and Appellants.

9th Cir. No. 14-56120

OPENING BRIEF ON THE MERITS

After Order Certifying Question by the
U.S. Court of Appeals for the Ninth Circuit

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ISSUE FOR REVIEW

Whether there is an "occurrence" under an employer's commercial general liability policy when an injured third party brings claims against the employer for the negligent hiring, retention, and supervision of the employee who intentionally injured the third party.

INTRODUCTION

Jane Doe was sexually molested by Darold Hecht, an employee of appellant Ledesma & Meyer Construction Co., Inc. ("L&M"). She sued L&M, alleging that it had been negligent in hiring, retaining, and supervising Hecht. L&M's liability insurer, Liberty, denied coverage for Doe's claim and filed a federal declaratory-relief action to establish non-coverage. The district court granted summary judgment for Liberty, finding that there had been no "occurrence," which its policy defined as an "accident."

The court relied on twin rationales for this finding: (a) L&M's intentional acts of hiring, retaining, and supervising Hecht did not constitute an "accident" simply because they resulted in harm to Doe that L&M did not intend; and (b) L&M's negligent acts were "too attenuated" from Hecht's injury-causing conduct to qualify as an occurrence.

When the Ninth Circuit attempted to ascertain the soundness of these rulings under California law it encountered deep splits of authority and strong internal disagreements in the Court of Appeal. These fissures have spread into the California's district courts.

This is an overview of the current legal landscape:

This Court's precedents

In decisions dating to 1891, this Court has consistently defined *accident* to include the unexpected, unintended consequences of the insured's deliberate acts. Indeed, the definition of *accident* that this Court

adopted in 1989 for use in all liability policies defines that term as "an unexpected, unforeseen, or undesigned happening *or consequence* from either a known or an unknown cause."[1] The Court has applied this definition to find coverage for liability incurred by a company that sold defective doors that failed after installation,[2] and for a company that sold a defective saw that cut lumber too narrowly.[3]

These precedents plainly support a finding that claims for an employer's negligent management of its employees fall within the scope of CGL coverage. Indeed, Liberty admitted in its correspondence with L&M that the negligence claims against it "were accidental in nature."[4]

It was for this reason that Liberty relied on its "attenuation" argument. But that concept runs counter to the rule that the causation standard for liability policies mirrors the causation standard in tort. Hence, if the insured's conduct will allow the insured to be held liable to the claimant, that conduct is not too "attenuated" to be covered by the insured's liability policy.

The Court of Appeal's precedents

Some courts have held, in accordance with this Court's precedents, that damage resulting from the unforeseen consequences of the insured's

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[1] *Delgado v. Interinsurance Exchange of Automobile Club of So. California* (2009) 47 Cal.4th 302, 308, emphasis added.

[2] *Geddes & Smith, Inc. v. St. Paul-Mercury Indem. Co.* (1959) 51 Cal.2d 558, 564.

[3] *Hogan v. Midland National Ins. Co.* (1970) 3 Cal.3d 553, 559.

[4] 3ER 371. ("ER" refers to the "excerpts of record" filed by L&M in the Ninth Circuit as required by Ninth Cir. Rule 30-1.)

deliberate acts can qualify as an "accident."[5] But this has become the minority view. The prevailing view is that "the term 'accident' refers to the nature of the insured's conduct, and not to its unintended consequences."[6]

The most influential appellate opinion on this subject is *Merced Mutual Ins. Co. v. Mendez* (1989) 213 Cal.App.3d 41, 50 (*"Merced"*), which holds that the relevant inquiry focuses on whether the insured's *acts* are "unforeseen, involuntary, [and] unexpected;" not on whether the consequences of those acts are unexpected. *Merced*'s analysis of *accident* has become the template used in the California and federal courts, having been cited directly in at least 66 cases and having indirectly influenced many more.

Unfortunately, the *Merced* court was unwittingly using the wrong definition for *accident*. The rules that it cited actually define a different, more limited insurance concept, called "accidental means." The distinguishing feature of "accidental means" coverage is that it does not cover the unintended consequences resulting from the insured's deliberate acts. This is why the insurance industry created it, and why this Court has consistently rejected attempts to merge the two types of coverage.

The result of *Merced* having done so is akin to having the courts apply the test for "actual agency" in every case where "ostensible agency" is asserted. The results may turn out correctly on occasion, but not for the right reasons.

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[5] *See, e.g., State Farm Fire and Cas. Co. v. Superior Court (Wright)*(2008) 164 Cal.App.4th 317, 328.

[6] *See, e.g., Albert v. Mid-Century Insurance Company* (2015) 236 Cal.App.4th 1281, 1291.

The Court of Appeal's hostility to the idea that an "accident" can include the unexpected consequences of the insured's deliberate acts is unjustified. It results from an understandable reluctance to embrace a test for *accident* that might allow insureds to preserve insurance coverage for patently harmful conduct, like sexual assault, by claiming that they intended no harm.

But the proper way to avoid making repugnant acts insurable is not to adopt an overly restrictive definition of "accident." It is to recognize that courts have other tools at their disposal to deal with the problem. This Court's precedents already hold that an accident does not include the *intended* consequences of the insured's intentional acts; nor does it include cases where the insured's deliberate conduct is inherently harmful, regardless of what the insured expects. Courts can also rely on the policy's exclusions if they bar coverage, without first having to decide whether the conduct was accidental in the first instance.

The type of negligence at issue in this case — an employer's negligent acts in managing its workforce — constitutes precisely the type of negligent conduct that CGL policies routinely cover and were designed to cover. If insurers want to exclude coverage for negligent-supervision claims and their ilk, they can, but only if they place clear exclusions in their policies.

The courts should not allow insurers to skirt the strict scrutiny that exclusions normally receive by placing the "occurrence" limitation in the policy's insuring clause and then relying on that limitation as a vague multi-purpose exclusion for some undefined universe of claims.

STATEMENT OF THE CASE

A. Factual Summary

1. The underlying judgment against L&M in the *Doe* action

For the most part, the following factual summary is drawn directly from the Ninth Circuit's request to this Court to answer the certified question ("Cert. Req."), which is published at 834 F.3d 998, 1000 (9th Cir. 2016):

> "In April of 2002, Ledesma & Meyer Construction Company, Inc., Joseph Ledesma, and Kris Meyer (collectively "L&M") entered into a Construction Management Contract with the San Bernardino County Unified School District to complete construction work at the Cesar E. Chavez Middle School (the "Project"). . . .
>
> "In 2003, L&M hired Darold Hecht and assigned him to the Project as an Assistant Superintendent. On January 12, 2010, L&M received notice that a tort claim had been filed against the School District, arising out of allegations that Hecht sexually abused a 13-year old student at the Middle School beginning in October of 2006. The School District tendered the defense and indemnification of the claim to L&M pursuant to the Construction Contract.
>
> "In May of 2010, Jane JS Doe, filed a complaint in state court (the "Underlying Action"), naming as defendants, L&M, the School District, Hecht, Joseph Ledesma, Kris Meyer, and others. Doe amended the complaint twice. The operative complaint in the underlying action alleged claims for Negligence; Negligent Hiring/Retention and Supervision; Violation of the

California Education Code; Violation of California Civil and Penal Codes; Intentional Infliction of Emotional Distress; Violation of 42 U.S.C. § 1983; and Battery. (Cert. Req., 834 F.3d at p. 1000, all ellipses and material in brackets and parentheses in original.)[7]

2. The relevant terms of L&M's liability policy

"Liberty Surplus Insurance Co. had issued L&M a commercial general liability policy ("General Policy") for the relevant time period. The General Policy between the parties provided, in pertinent part:

SECTION I—COVERAGES

COVERAGE A. BODILY INJURY AND PROPERTY DAMAGE LIABILITY

1. Insuring Agreement

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" ... to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" ... to which this insurance does not apply....

b. This insurance applies to "bodily injury" and "property damages" only if:

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[7] The appellate record shows that Doe ultimately prevailed on her claims against L&M for general negligence, negligent hiring, and negligent supervision. (1ER 3.)

(1) The "bodily injury" ... is caused by an "occurrence" that takes place in the "coverage territory";

* * *

SECTION V—DEFINITIONS

...

13. "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions. (ER 267–268, 289.) (Cert. Req., 834 F.3d at pp. 1000, 1001, ellipses in original.)

B. Procedural Summary

1. Liberty's declaratory-relief action against L&M to establish non-coverage

"Pursuant to the General Policy, and other insurance policies, both L&M and the School District tendered their defense in the Underlying Action to Liberty Surplus Insurance Corporation and Liberty Insurance Underwriters, Inc. (collectively "Liberty"). Liberty defended L&M under a reservation of rights . . . .

"Liberty commenced the current action in the United States District Court for the Central District of California, seeking a declaration that, among other things, it was under no obligation to defend or indemnify L&M or the School District in the Underlying Action. . . . (Cert. Req., 834 F.3d at p. 1001, footnote omitted.)

2. The federal district court grants summary judgment for Liberty

The district court granted summary judgment for Liberty. (*Id.* at p. 1001; 1ER 14, 15.) In general, it found that *accident* as used in the policy

referred to "unforeseen or unexpected injury *resulting from unintentional conduct.*" (1ER 14, emphasis added.) The court concluded that L&M's negligence in managing Hecht could not qualify as an "occurrence" for two reasons: (1) it did not qualify as an "accident" under *Merced* because it was deliberate conduct; and (2) it was too attenuated from the injury-causing conduct committed by Hecht to constitute an "occurrence." (1 ER 14, 15.)

3. The Ninth Circuit is unable to resolve L&M's appeal in light of the muddled state of California law, and asks this Court to answer its certified question concerning the meaning of "occurrence" in liability-insurance policies

L&M appealed the adverse judgment against it to the U.S. Court of Appeals for the Ninth Circuit. After receiving full briefing from the parties and holding oral argument, the Ninth Circuit asked this Court to answer its certified question under Rule 8.548 of the California Rules of Court. (Req., 834 F.3d at p. 1000.) This Court granted review without restating the question. (Order granting review, filed Oct. 21, 2016.)

ARGUMENT

A. This Court should hold that an employer's negligent management of its employees can constitute an "occurrence" under standard liability policies

1. An employer's negligent management of its employees fits comfortably within the rubric of "accident" already adopted by this Court

This Court has thus far decided only three third-party cases[8] that have directly presented the issue of whether the claim asserted by the insured constituted an "accident" that qualified for coverage under a

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[8] First-party coverage insures against loss or damage sustained directly by the insured, whereas third-party coverage protects the insured against liability to a third party. (*Montrose Chemical Corp. v. Admiral Ins. Co.* (1995) 10 Cal.4th 645, 663, citation omitted.)

liability policy: *Geddes & Smith, Inc. v. St. Paul-Mercury Indem. Co.* (1959) 51 Cal.2d 558; *Hogan v. Midland National Ins. Co.* (1970) 3 Cal.3d 553; and *Delgado v. Interinsurance Exchange of Automobile Club of Southern California* (2009) 47 Cal.4th 302. Of this trio, *Geddes* and *Hogan* are particularly relevant, because they involve claims against a business for harm caused by the negligent conduct of its operations.

Geddes

In *Geddes,* the insured (Aluminum Products) supplied the plaintiff, a building contractor (Geddes), with 760 aluminum doors, which Geddes installed in 76 houses. All of the doors were defective. After they had been installed they sagged, went out of shape, and fell apart. (*Id.*, 51 Cal.2d at pp. 560, 564.) Aluminum Products attempted to supply replacement doors, but most of these proved defective too. (*Id.* at p. 561.) Eventually, Aluminum Products shipped a total of 2,604 doors before enough suitable doors were obtained, and Geddes "was engaged in handling, storing, repairing, removing, and installing doors for over a year." (*Id.*)

Geddes sued Aluminum Products for breach of warranty and negligence. (*Id.*) Aluminum Products tendered the defense to its liability insurer, which refused to defend, claiming that the damage did not arise from an accident as the policy required. (*Id.* at p. 562.) After obtaining a judgment against Aluminum Products, Geddes sued its insurer to recover on the policy as a judgment creditor. (*Id.*) Geddes lost in the trial court. In this Court the insurer defended that result, arguing that there had been no property damage "caused by accident." (*Id.*, 51 Cal.2d at p. 563.) This Court held otherwise.

Justice Traynor's opinion for the Court initially observed that, "No all-inclusive definition of the word 'accident' can be given." (*Id.*) It cited

varying definitions of *accident* from a number of earlier cases. But the definition that the Court relied on to resolve the case was drawn from the Minnesota Supreme Court's decision in *Hauenstein v. Saint Paul-Mercury Indem. Co.*(1954) 242 Minn. 354, 358-359, 65 N.W.2d 122, 126: "Accident, as a source and cause of damage to property, within the terms of an accident policy, is an unexpected, unforeseen, or undesigned happening or consequence from either a known or an unknown cause." (*Geddes*, 51 Cal.2d at p. 564.)

Using this definition the Court held that the harm to Geddes from the door failures was "accidently caused" because the door failures were unexpected, undesigned, and unforeseen. (*Id.*)[9]

Hogan

Hogan, like *Geddes*, involved a product-defect claim. The insured, Diehl Machines, Inc. ("Diehl"), manufactured wood-processing machinery. It sold a saw to Kaufman for his lumber business, which Kaufman put into service in September 1961. (*Id.*, 3 Cal.3d at pp. 557, 558.) Kaufman immediately experienced problems with the saw's performance, which he tried over several months to remedy with Diehl's assistance. (*Id.*, 3 Cal.3d at p. 558.)

As the opinion explains, "From the beginning there were problems with the size of the lumber that came through the saw, the widths cut being

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[9] Ultimately, the Court held that the cost of the doors themselves was barred by a policy exclusion and that the damage to Geddes's business and goodwill was not recoverable because it did not constitute property damage. But Geddes was permitted to recover under the policy for the costs of removing and replacing the doors, the costs of handling the defective doors and their replacements, and for the loss of use of the houses. (*Geddes*, 51 Cal.2d at p. 564.)

too narrow. However, these deficiencies were not sufficiently serious to cause customers to reject the lumber until the spring of 1962." (*Id.*) Beginning in April 1962, some of Kaufman's customers began rejecting lumber shipments because the lumber was too narrow. As a result, after April 24, 1962, Kaufman began to deliberately cut lumber wider than specified to avoid further complaints. (*Id.*, 3 Cal.3d at p. 559.) No customers rejected orders because of the overcutting. (*Id.*)

Kaufman sued Diehl for the losses he claimed to have sustained as a result of the saw's defects. Diehl's liability insurer refused to defend Diehl against the lawsuit. (*Id.* at p. 558.) Diehl defended at its own expense, was held liable, and then assigned its claim against its insurer to Hogan, who filed the coverage action against the insurer, Midland. (*Id.*)

When the action reached this Court, Midland argued that none of the damages assessed against Diehl were covered because they were not the result of an accident. Rather, it contended that they "were not only foreseeable and expectable but were in fact foreseen since Kaufman knew from the outset that the saw was defective and would not cut lumber to the precise size desired." (*Id.* at p. 559.)

With respect to what constituted an "accident," the Court quoted its discussion of that issue in *Geddes*, but it shortened it using an ellipsis to say, "No all-inclusive definition of the word 'accident' can be given * * * as a source and cause of damage to property, within the terms of an accident policy, (accident) is an unexpected, unforeseen, or undesigned happening or consequence from either a known or unknown cause." (*Hogan*, 3 Cal.3d at p. 559, citing *Geddes*, 51 Cal.2d at pp. 563-564, internal quotation marks omitted.)

The Court held that the damage from the boards cut too narrow met the *Geddes* definition because Kaufman had been unaware of the problem when he cut the boards. (*Id.*, 3 Cal.3d at pp. 559-560.) But the Court held that Kaufman's deliberate cutting of the boards too wide failed to satisfy the *Geddes* definition of *accident* because the boards had been cut that way "by design." (*Id.* at p. 560.)

As the Court explained, "Whatever the motivation, there is no question that these boards were deliberately cut wider than necessary; the conduct being calculated and deliberate, no accident occurred within the *Geddes I* definition." (*Id.*)

Delgado

The insurance claim in *Delgado* arose from an assault and battery by the insured (Reid) against Delgado. Delgado sued Reid, alleging that he had "physically struck, battered and kicked Delgado" without provocation or justification, causing serious and permanent injuries. (*Id.*, 47 Cal.4th at p. 306.) He also alleged that Reid had "negligently and unreasonably believed" that he was engaging in self-defense when he repeatedly struck and kicked Delgado. (*Id.*)

Delgado obtained a judgment against Reid, together with an assignment of Reid's claim against his insurer. Delgado then filed suit against the insurer seeking to establish that Reid's policy provided coverage for Delgado's judgment. Two aspects of the *Delgado* opinion are particularly relevant here:

(1) The Court decided that the same definition of *accident* that it applied in *Geddes* and *Hogan* would henceforth become the common-law definition of *accident* that applies to all liability policies in California. (*Id.*, 47 Cal.4th at p. 308.); and

(2) The Court made clear that the determination of what constitutes an "accident" under a liability policy must be made from the perspective of the insured, not a third party. (*Delgado*, 47 Cal.4th at p. 310.) Hence, "the word *accident* in the coverage clause of a liability policy refers to the conduct of the insured for which liability is sought to be imposed on the insured." (*Id.* at p. 311.)

Synthesis of the third-party decisions

The definition of *accident* that this Court adopted in *Delgado* extends by its terms to both "happenings" and "consequences" from either a known or unknown cause, as long as that happening or consequence is "unexpected, unforeseen, or undesigned." (*See Delgado*, 47 Cal.4th at p. 308.) A *consequence* is "a result that follows as an effect of something that came before." (*Black's Law Dictionary* (10th Ed., 2014.)

Hogan and *Geddes* illustrate the application of this definition in practice. Both cases show that harm that is an unintended or unforeseen consequence of deliberate conduct — such as negligently selling defective doors or negligently sawing lumber to the wrong dimension — can constitute an accident. (*Geddes,* 51 Cal.2d at pp. 563-564; *Hogan*, 7 Cal.3d at p. 560.)

This rule plainly does not extend to *all* consequences from *all* acts that insured might commit. *Hogan* shows that the consequences that the insured expects to result from its conduct—such as deliberately cutting boards wider than specified —do not qualify as an accident. (*Id.*, 3 Cal.3d at p. 560.) And *Delgado* shows that the consequences of "acts done with intent to cause injury" are likewise not the product of an "accident," as a matter of law. (*Id.*, 47 Cal.4th at pp. 311-312.)

But as long as the resulting harm from the employer's deliberate (but negligent) conduct was unexpected or unforeseen, it would qualify as an "accident" under a liability policy, just as it did in *Geddes* and *Hogan.* This is because the harm to the third party would be an undesigned consequence of the employer's negligent conduct in managing the employee. Liberty has directly *admitted* that L&M's negligence in hiring and supervising Hecht was "accidental in nature."[10]

Delgado also makes it clear that the relevant inquiry focuses on the employer's negligent conduct, and not whether that conduct may facilitate the intention of an intentional tort by an employee. In that event *the employee's* conduct would not be an "accident," because intentional wrongful conduct is not accidental. (*Id.*, 47 Cal.4th at pp. 311-312 ["an injury-producing event is not an 'accident' within the policy's coverage language when all of the acts, the manner in which they were done, and the objective accomplished occurred as intended by the actor"].)

But the conduct at issue for the purposes of determining the availability of liability coverage is the conduct of *the insured*, "for which liability is sought to be imposed on the insured."[11] (*Delgado*, 47 Cal.4th at

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[10] 3ER 371. This statement is contained in a letter from Liberty's counsel to L&M's counsel attempting to explain why Liberty was denying coverage *even though* L&M's conduct was accidental.

[11] This principle does not appear to have been applied in *Hogan.* There, the insured was Diehl, and its conduct was selling a defective saw to Kaufman and thereafter servicing the saw. The accident found to create coverage under Diehl's policy, however, was Kaufman's conduct in using the defective saw. Under *Delgado*, Diehl's coverage for the claims asserted against it by Kaufman would have to be evaluated based on the harm resulting from Diehl's conduct, not Kaufman's conduct. But under *Geddes*, Diehl's sale of a defective saw that caused unintended damage to a customer qualified as an accident.

p. 311.) And the insured employer's conduct is not the employee's intentional tort; it is the employer's negligence in managing the employee in a way that allowed the intentional tort to occur.

This point is illustrated in *Minkler v. Safeco Ins. Co. of America* (2010) 49 Cal.4th 315, 325. There, the insured (Betty) was being sued by a third party (Scott), who alleged that Betty's son (David) had sexually molested him in Betty's home. Scott sued Betty for her negligence in failing to prevent the molestation. The Court explained that this claim was independent of Scott's claim against David:

> Safeco suggests Betty could not reasonably expect coverage for 'parasitic' claims against her arising from David's intentional acts. But this is not a situation where the only tort was the intentional act of one insured, and where the liability of a second insured, who claims coverage, is merely *vicarious* or *derivative*. On the contrary, Scott's claim against Betty clearly depends upon allegations that she herself committed an *independent tort* in failing to prevent acts of molestation she had reason to believe were taking place in her home. (*Minkler*, 49 Cal.4th at p. 325, emphasis in original.)

While Betty was not David's employer, that distinction is immaterial here. The nature of the claim against her is identical to a claim asserted against an employer for its negligent management of an employee who commits an intentional tort. (*See, e.g., Underwriters Ins. Co. v. Purdie* (1983) 145 Cal.App.3d 57, 67-71 [holding that employer's CGL policy provided coverage for claim against it for negligently hiring and supervising employee who shot victim during an argument].)