**S239510**

# IN THE SUPREME COURT OF CALIFORNIA

**EN BANC**

SUPREME COURT
FILED

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Deputy

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**PITZER COLLEGE,**
*Petitioner,*

*vs.*

**INDIAN HARBOR INSURANCE COMPANY,**
*Respondent.*

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QUESTIONS CERTIFIED BY THE NINTH CIRCUIT COURT OF APPEALS
CASE NO. 14-56017

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## PETITIONER'S OPENING BRIEF

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**PITZER COLLEGE,**
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**PETITIONER'S OPENING BRIEF**

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## CERTIFIED QUESTIONS

Pursuant to its order dated March 22, 2017, this Court certified two questions for review in connection with this case:

1) Is California's common law notice-prejudice rule a fundamental public policy for the purpose of choice-of-law analysis?

2) If the notice-prejudice rule is a fundamental public policy for the purpose of choice-of-law analysis, can the notice-prejudice rule apply to the consent provision in this case?

## INTRODUCTION

Though this Court certified two questions for review, this case presents only one basic question, which this Court has answered before: does California law permit insurance companies to achieve a technical forfeiture of coverage as a result of a non-prejudicial breach of an immaterial term of the insurance contract? This Court's answer to that question has always been a resounding no, regardless of the artifice employed by insurers attempting to engineer a contrary result. The Court should honor its well-established jurisprudence on this theme and should reject Indian Harbor's effort to sidestep this basic principle of California's insurance law.

Indian Harbor's first tactic is to employ a New York choice of law provision to achieve a strict application of its notice provision. Such a strict application would be contrary to more than fifty years of California's "settled law," which instead would apply the "notice-prejudice rule" and require a showing of prejudice by Indian Harbor to enforce the notice provision. Indian Harbor's tactic has a particularly ironic and inequitable twist: New York's state legislature enacted the notice-prejudice rule, but limited it to insurance policies "issued or delivered" within the state of New York (thus protecting only New York insureds), and New York's high court recognized the notice-prejudice rule by judicial decision, but only for reinsurance contracts (thus protecting insurers). As a result, under New

York law, Pitzer's status as a disfavored California insured deprives Pitzer of the protection of the notice-prejudice rule, creating a technical forfeiture of coverage.

California's choice of law rules should prevent this inequitable result. When a "fundamental public policy" of the state of California would be violated by application of another state's law, California courts will refuse to enforce a choice of law provision as to that issue. This Court should hold that California's well-established notice-prejudice rule is a fundamental public policy of the state of California.

Indian Harbor's second tactic is to employ third-party coverage case law regarding consent provisions to a first-party coverage situation, i.e., outside of the appropriate context. In third-party policies, consent provisions secure a crucial right for insurers: the right to control defense and settlement of the third party's claim. In deference to this right, California courts have treated consent provisions in third-party policies differently from notice and cooperation provisions, applying consent provisions strictly, without requiring a showing of prejudice.

But under this policy, in the absence of the insurer's right to control defense and settlement of a third-party claim, a consent provision secures no crucial rights for the insurer, and should be treated the same way as similar conditions precedent, namely the notice and cooperation provisions.

As such, this Court should apply the notice-prejudice rule to the consent provision at issue in this case.

## STATEMENT OF JURISDICTION

The California Supreme Court has jurisdiction over the present case as a result of its March 22, 2017 order granting a request for certification of questions by the United States Court of Appeals for the Ninth Circuit pursuant to California Rule of Court 8.548.

## STATEMENT OF THE CASE

### I. PROCEDURAL HISTORY

Pitzer College ("Pitzer") sued Indian Harbor Insurance Company ("Indian Harbor") in California state court in 2013, alleging that Indian Harbor had breached its insurance contract with Pitzer. Indian Harbor removed the case to federal court on the basis of diversity, then, in 2014, brought a motion for summary judgment based upon Pitzer's delay in notifying Indian Harbor of Pitzer's claim under the policy, and upon the resulting failure to secure Indian Harbor's consent before incurring costs. The District Court granted the motion on May 22, 2014, and judgment was entered on June 3, 2014. Pitzer timely appealed from that judgment to the Ninth Circuit Court of Appeals. Pitzer's appeal was argued before a three-judge panel of the Ninth Circuit on October 5, 2016 (Judges Harry Pregerson, Richard A. Paez, and John T. Noonan Jr.). After oral argument,

on December 12, 2016, Judge Noonan was replaced on the panel by Judge Andrew D. Hurwitz.

On January 13, 2017, the Ninth Circuit requested that this Court certify two questions of California law for decision pursuant to California Rule of Court 8.548. On March 22, 2017, this Court granted the Ninth Circuit's request, restating the certified questions as reproduced above.

## II. FACTS

Pitzer is one of the Claremont Colleges, a collection of private colleges in southern California. The Claremont University Consortium, a separate entity, bargains and contracts on behalf of the Claremont Colleges with outside entities for certain services commonly needed by all the member colleges (including insurance). (E.R. 68.)[1] The Claremont University Consortium entered an agreement with Indian Harbor on behalf of its members, including Pitzer, whereby Indian Harbor would provide insurance coverage for payment of remediation expenses resulting from pollution on property belonging to the colleges (the "Policy"). (E.R. 61, 67-68.) The Policy was issued in Pennsylvania and delivered to the Claremont Colleges' broker in Arizona. (E.R. 211.) It contains a choice-of-law provision, selecting New York law. (E.R. 65.) Indian Harbor is a

[1] All record citations herein are to the Excerpts of Record prepared pursuant to the Ninth Circuit's procedure.

Delaware corporation, with its principal place of business in Connecticut. (E.R. 78.)

In January 2011, Pitzer was beginning construction of a new dormitory on its campus when, during excavation, construction workers discovered discolored soils present on the site, halting all activity on the project. (E.R. 61.) Pitzer quickly determined that the discolored soil was contaminated with lead. (E.R. 61, 72, 200.) With the costs of construction delays mounting (thousands of dollars per day), Pitzer's employees retained environmental consultants and an attorney specializing in environmental law to determine, as quickly as possible, the best way forward. (E.R. 79-81.) Pitzer feared that any further delay would jeopardize the completion of the dormitory in time for the 2012-2013 academic year, which would have forced Pitzer to incur the enormous cost of securing off-campus housing for its students. (E.R. 81.)

Pitzer's environmental consultants presented Pitzer with a range of alternatives. (E.R. 79, 96.) The least expensive and fastest option, which also carried the lowest risk of future liability, was the use of a transportable treatment unit ("TTU") to treat the lead-contaminated soil onsite. (E.R. 79.) By a fortunate coincidence, one of only two TTUs licensed for this purpose in southern California happened to be immediately available. (E.R. 80.) These TTUs are normally reserved for use far in advance. (E.R. 80.) Pitzer immediately retained the available unit and commenced

remediation. (E.R. 80-81.) Believing it was solely responsible for the cost of the remediation, Pitzer spent approximately $2 million and completed the cleanup on April 12, 2011, just over three months after the first discovery of discolored soil on the project. (E.R. 65, 70, 79, 81) The construction of the dormitory was ultimately completed with only a few days to spare before students were to move into the new dormitory. (E.R. 81.) Had Pitzer delayed, or been prevented from immediately retaining the TTU, Pitzer would have incurred not only further construction delay costs, but also the off-campus housing costs for its displaced students. (E.R. 81, 83.)

After the discovery of the discolored soil and during the remediation, Pitzer's employees were focused on the immediate resolution of the problem, and on getting the project back on course. (E.R. 79-82.) During the period in which the remediation took place, Pitzer's Vice President and Treasurer, Yuet Lee, was unaware that the Indian Harbor Policy covered the remediation. (E.R. 81.) Approximately two months after completion of the remediation, during an insurance renewal meeting with the Claremont University Consortium, Mr. Lee mentioned the remediation to an employee of the Claremont University Consortium, and asked whether insurance coverage might be available. (E.R. 82, 161-162.) After confirming that the Policy covered the remediation, Pitzer tendered its claim to Indian Harbor on July 11, 2011. (E.R. 82.) Indian Harbor acknowledged the claim on

August 10, 2011, and denied the claim on March 16, 2012, citing the notice and consent provisions of the Policy. (E.R. 75-76.)

The notice[2] and consent provisions of the Policy, upon which Indian Harbor relied to deny Pitzer's claim, are reproduced below:

The notice provision:

> 1. The INSURED shall forward to the Company or to any of its authorized agents every demand, notice, summons, order or other process received by the INSURED or the INSURED's representative as soon as practicable; and
>
> 2. The INSURED shall provide to the Company, whether orally or in writing, notice of the particulars with respect to the time, place and circumstances thereof, along with the names and addresses of the injured and of available witnesses. In the event of oral notice, the INSURED agrees to furnish to the Company a written report as soon as practicable. (E.R. 63-64.)

The consent provision:

> No costs, charges or expenses shall be incurred, nor payments made, obligations assumed or remediation commenced without the Company's written consent which shall not be unreasonably withheld. This provision does not apply to costs incurred by the INSURED on an emergency basis, where any delay on the part of the INSURED would cause injury to persons or damage to property, or increase significantly the cost of responding to any POLLUTION CONDITION. If such emergency occurs, the INSURED shall notify the Company immediately thereafter. (E.R. 64-65.)

[2] In the Ninth Circuit's Order requesting certification of questions to this Court, the Ninth Circuit inadvertently referred to the "policy period" provision, rather than the separate "notice" provision, which is reproduced herein, and upon which Indian Harbor relies. The parties do not dispute that the claim was tendered within the applicable policy period.

The Policy contains the following choice-of-law provision, designating New York law:

> Choice of Law – All matters arising hereunder including questions related to the validity, interpretation, performance and enforcement of this Policy shall be determined in accordance with the law and practice of the State of New York (notwithstanding New York's conflicts of law rules). (E.R. 65.)

## ARGUMENT

### I. THE NOTICE-PREJUDICE RULE IS A FUNDAMENTAL PUBLIC POLICY OF THE STATE OF CALIFORNIA

#### A. Origins of the Conflict of Law at Issue

As this Court held more than fifty years ago in *Campbell v. Allstate Ins. Co.* (1963) 60 Cal.2d 303, in order to validly deny coverage based upon an insured's delay in providing notice, an insurer must prove that it suffered substantial prejudice from the delay. (*Shell Oil Co. v. Winterthur Swiss Ins. Co.* (1993) 12 Cal.App.4th 715, 760-761.) This principle has been recognized as "settled law" in California, and other jurisdictions have recognized that the rule is a "strong public policy" and a "strong and abiding policy" of the state of California. (See *Shell Oil Co.*, *supra* at 760 ("settled law"); *National Union Fire Ins. Co. of Pittsburg, PA v. General Star Indem. Co.* (3d Cir. 2007) 216 Fed.Appx. 273, 280 ("strong public policy"); *National Semiconductor Corp. v. Allendale Mut. Ins. Co.* (D.Conn. 1982) 549 F.Supp. 1195, 1200 ("strong and abiding policy").) Indian Harbor seeks to overcome this bedrock California insurance law

principle by application of New York law through the choice-of-law provision in its policy.

New York's law on the notice-prejudice rule is tortured and Kafkaesque. The baseline, common law rule in New York is the strict notice rule, which applies a blanket bar to coverage for even short delays in providing notice, regardless of prejudice. (*Indian Harbor Ins. Co. v. City of San Diego* (S.D.N.Y. 2013) 972 F.Supp.2d 634, 643, *aff'd* 2014 WL 4922143 (2d Cir.).)[3] However, this rule has two notable exceptions: a statutory exception applying the notice prejudice rule to policies "issued or delivered" within the state of New York (see New York Insurance Law § 3420(a)), and an exception for reinsurance contracts (where the insured is itself an insurance company). (See *Unigard Sec. Ins. Co. v. North River Ins. Co.* (N.Y. 1992) 594 N.E.2d 571.) The former exception is relatively new and, according to the bill sponsor's memorandum, was driven by the fact that "[c]urrent law . . . leads to an inequitable outcome with insurers collecting billions of dollars in premiums annually, and disclaiming coverage over an inconsequential technicality." (Bill Sponsor's Memorandum, 2008 New York Session Law 388.) In practical effect, New York law requires an insurer to show prejudice to deny coverage only when

[3] The courts in *Indian Harbor* and in other cases have sometimes used the term "no-prejudice rule" to describe this rule. Because of the possible confusion between the "no-prejudice rule" and the "notice-prejudice rule," this brief uses the term "strict notice rule."

the insured is either (1) an insurance company, or (2) located in New York.[4] All other insureds who delay in providing notice face an automatic forfeiture of coverage.

Since neither exception would apply here, there is a conflict between California and New York law. California law would require Indian Harbor to show prejudice to obtain summary judgment, while New York law would not. The determination of which state's law to apply to the notice provision is dispositive, as the trial court noted: "If prejudice is required, Defendant would not be able to prevail at summary judgment by relying on the Notice Provision." (E.R. 11.)

California courts will ordinarily enforce a contractual choice of law provision, but will impose California law where a "strong" or "fundamental" public policy of the state of California would be violated by application of the contractually chosen law, and where California has a materially greater interest than the chosen state in the determination of the particular issue. (*Nedlloyd Lines B.V. v. Sup. Ct.* (1992) 3 Cal.4th 459, 466 ("fundamental policy"); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1971) 20 Cal.App.3d 668, 673 ("strong public policy").) In *Nedlloyd*, this Court articulated the standard for the determination of whether or not a

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[4] A cynical observer might conclude that New York's insurance law intentionally provides a favorable rule (the notice-prejudice rule) for favored classes of persons (New York residents and insurance companies), while derogating out-of-state insureds.

particular rule is a "fundamental policy," to be enforced despite a contractual choice of law provision specifying the law of another jurisdiction: namely, whether the rule in question is "designed to restrict freedom of contract," or "designed to preclude freedom of contract in this context." (*Nedlloyd*, *supra*, 3 Cal.4th at 468, 471.) A rule is designed to restrict freedom of contract when private parties to a contract cannot contract around the rule. (See *Brack v. Omni Loan Co., Ltd.* (2008) 164 Cal.App.4th 1312, 1323.)

### B. A Wealth of Authority Supports the Proposition that the Notice-Prejudice Rule is a Fundamental Public Policy of the State of California

California has a strong public policy in favor of the notice-prejudice rule. The United States Supreme Court, describing this Court's seminal *Campbell* decision on this point, wrote, "Announcing the notice-prejudice rule in [*Campbell*], the California Supreme Court emphasized the 'public policy of this state' in favor of compensating insureds." (*UNUM Life Ins. Co. of America v. Ward* (1999) 526 U.S. 358, 372.) In the *Ward* case, the Council of State Governments filed an *amicus* brief in which it wrote "California's notice-prejudice rule . . . is grounded in public policy concerns for the protection of policyholders against forfeiture of their insurance benefits." (Brief for Council of State Governments, et al. as *Amici Curiae* at 12, *Ward*, 526 U.S. 358.) The Supreme Court cited this portion of the *amicus* brief, stating that California's grounding of the

notice-prejudice rule in policy concerns specific to the insurance industry was "key to [their] decision." (*Ward*, *supra* at 372.)

The Ninth Circuit Court of Appeals, in rejecting an express contractual waiver of the notice-prejudice rule, has also described the notice-prejudice rule as "California's strong public policy." (*Service Management Systems, Inc. v. Steadfast Ins. Co.* (9th Cir. 2007) 216 Fed.Appx. 662, 664.)[5] The *Shell Oil* case, the leading modern case on the subject, described the notice-prejudice rule as "settled law" in California. (*Shell Oil Co.*, *supra*, 12 Cal.App.4th at 760.) The Third Circuit Court of Appeals, discussing the notice-prejudice rule, wrote, "California law is imbued with a strong public policy against technical forfeitures in the insurance context." (*National Union Fire Ins. Co. of Pittsburg, PA v. General Star Indem. Co.*, *supra*, 216 Fed.Appx. at 280.) The United States District Court for the District of Connecticut also recognized California's "strong and abiding policy [requiring] that insurers prove prejudice to escape liability under the notice provision of an insurance contract." (*National Semiconductor Corp. v. Allendale Mut. Ins. Co.*, *supra*, 549 F.Supp. at 1200.)

Even New York itself recognizes California's strong public policy in favor of the notice-prejudice rule. In *Steadfast Insurance Co. v. Casden*

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[5] Though this decision was initially issued as unpublished, the case can still be cited for its persuasive value pursuant to Ninth Circuit Rule 36-3(b) and Federal Rule of Appellate Procedure 32.1.

*Properties, Inc.* (N.Y. App. Div. 2007) 41 A.D.3d 120, 837 N.Y.S.2d 116, 121, the New York Supreme Court's Appellate Division[6] held that "California law is imbued with a strong public policy against technical forfeitures in the insurance context." In *Steadfast*, as in the *Service Management Systems* case before the Ninth Circuit, discussed above, the insurance policy in question contained an explicit waiver of the notice-prejudice rule. Citing the Ninth Circuit Court of Appeals' opinion in *Service Management Systems*, the New York court held that this explicit waiver was "void as against public policy" under California law. (*Steadfast, supra* at 121.)

The *Steadfast* and *Service Management Systems* cases were followed by a recent case before the Wyoming Supreme Court, *Century Surety Company v. Jim Hipner, LLC* (2016) 377 P.3d 784, in which the Wyoming Supreme Court, citing *Steadfast* and *Service Management Systems*, and answering questions certified by the Eighth Circuit Court of Appeals, held that an express waiver of the notice-prejudice rule was void as against Wyoming's public policy. The Wyoming court conducted a nationwide survey of court decisions and secondary authority considering the notice-prejudice rule, and concluded (as this Court did in 1963) that "the notice-

[6] An intermediate appellate court - the New York equivalent of California's Courts of Appeal.

prejudice rule is supported by sound public policy." (*Century Surety Company*, *supra* at 792.)

The *Steadfast*, *Service Management Systems*, and *Century Surety Company* decisions and the nature of the notice-prejudice rule itself both demonstrate that the notice-prejudice rule is "designed to restrict freedom of contract" under *Nedlloyd*, and is therefore a fundamental public policy of the state of California. As occasionally formulated, the notice-prejudice rule "creates a mandatory contract term." (*Cisneros v. UNUM Life Ins. Co. of America* (9th Cir. 1998) 134 F.3d 939, 946.) Thus, while a strict reading of the contract would void coverage when the insured fails to provide notice "as soon as practicable," the overriding public policy against technical forfeitures of insurance coverage causes a deviation from the contract's literal terms. Similarly, as the Ninth Circuit, the New York Superior Court's Appellate Division, and the Supreme Court of Wyoming have all held, an attempt by the insurer to contract around the notice-prejudice rule is void as against public policy.

Further, the *Nedlloyd* "fundamental public policy" rule itself is derived from Section 187 of the Restatement Second of Conflict of Laws. Comment (g) to that section of the Restatement includes the following highly suggestive language:

> [A] fundamental policy may be embodied in a statute which makes one or more kinds of contracts illegal or which is designed to protect a person against the oppressive use of

superior bargaining power. **Statutes involving the rights of an individual insured as against an insurance company are an example of this sort.** (emphasis added)

C. The Widely-Recognized Policy Reasons for the Notice-Prejudice Rule Also Support the Conclusion that the Rule Should Override a Choice of Contrary Law

Since the notice-prejudice rule was first recognized by this Court in 1963, many other jurisdictions have adopted the rule, typically by judicial decision. As a result, a great deal of detailed policy analysis on the question has been conducted by the highest courts of many different states. Similarly, the issue has been thoroughly examined in insurance treatises and other secondary sources of authority. The recent *Century Surety Company* decision, discussed above, surveys much of this scholarship and organizes the basic policy rationales for the notice-prejudice rule into three categories:

- "the adhesive nature of insurance contracts,"
- "the public policy objective of compensating tort victims," and
- "the inequity of the insurer receiving a windfall due to a technicality." (*Century Surety Company*, *supra*, 377 P.3d at 789.)

Each of these three rationales finds strong support in California law, and in the decisions of other courts applying the notice-prejudice rule.

1. The adhesive nature of insurance contracts supports the conclusion that the notice-prejudice rule should override a choice of contrary law.

The Pennsylvania Supreme Court, in *Brakeman v. Potomac Ins. Co.* (1977) 371 A.2d 193, 196, set forth in clear terms the rationale for treating contracts of adhesion differently from typical private contracts:

> We are of the opinion, however, that this argument, based on the view that insurance policies are private contracts in the traditional sense, is no longer persuasive. Such a position fails to recognize the true nature of the relationship between insurance companies and their insureds. An insurance contract is not a negotiated agreement; rather its conditions are by and large dictated by the insurance company to the insured.

This line of thinking, along with other policy rationales, has caused insurance contracts to be treated significantly differently from most other contracts in several respects (*Gray v. Zurich Ins. Co.* (1966) 65 Cal.2d 263, 269), including: the imposition of tort liability for bad faith (*Cates Construction Inc. v. Talbot Partners* (1999) 21 Cal.4th 28, 44), the principle that exclusions to coverage must be "conspicuous, plain and clear" (*Gray, supra* at 271), and the doctrine that courts have a "heightened responsibility to prevent marketing of policies that provide unrealistic and inadequate coverage." (*Carson v. Mercury Ins. Co.* (2012) 210 Cal.App.4th 409, 426.) One of these legal consequences, California's doctrine of tort liability for insurer bad faith, has already been held to be a "fundamental public policy" of the state of California in a recent, well-