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IN THE SUPREME COURT OF CALIFORNIA

PITZER COLLEGE,
Petitioner,

vs.

INDIAN HARBOR INSURANCE COMPANY,
Respondent

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

RESPONDENT'S ANSWERING BRIEF

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INTRODUCTION

To avoid the financial consequences of its disregard of its insurance policy's enforceable requirements, Pitzer asks this Court to create new law. Pitzer, a sophisticated entity, bought a specialized claims-made pollution liability insurance policy with a New York choice of law clause, and with requirements of prompt notice of pollution and of obtaining consent prior to commencing remediation and incurring costs. However, upon discovering soil contamination, Pitzer provided its insurer no notice and conducted a $2 million remediation without ever seeking insurer consent. Under New York law, even Pitzer agrees that those policy requirements bar Pitzer's claim. Its risk manager and broker understood right away that Pitzer's claim would be denied. Pitzer nevertheless brought its lawsuit in the hope of having the courts create new law to relieve it of those requirements. The trial court correctly refused to do this and properly granted summary judgment in favor of Indian Harbor. On appeal, the Ninth Circuit has asked, via certified questions, whether this Court will create such new law, which this Court has recast as follows:

(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?

Pitzer's Opening Brief seeks to further recast these questions as a generalized issue of consumer protection under California insurance law. But this is a transparent effort to draw attention away from the fact that answering "yes" to either question would constitute an unprecedented change in the prior decisions of this Court, *Nedlloyd Lines B.V. v. Superior Court* (1992) 3 Cal.4th 459 (enforcing choice of law provision to bar common law tort claims) and *Gribaldo, Jacobs, Jones & Associates v.*

Agrippina Versicherunges A. (1970) 3 Cal.3d 434 (enforcing consent requirement regardless of prejudice), and the way in which these decisions have since been applied by California courts for decades. The sound policy reasons expressed in this precedent militate the conclusion that the common law notice-prejudice rule is not a "fundamental" policy of California and that the notice-prejudice rule does not apply to consent provisions in insurance policies. Accordingly, this Court should answer "no" to each certified question.

In *Nedlloyd*, this Court directed that California courts shall follow the Restatement approach enforcing choice of law provisions, reflecting California's "strong" policy favoring the enforcement of freely negotiated choice of law clauses. In adopting the Restatement, *Nedlloyd* held that this policy is so important that only a "*fundamental*" policy can override it. And, in *Nedlloyd*, this Court adopted the approach that the "fundamental" policy required to ignore this important contract provision must be a limitation on the freedom of contract that is so vital to California that it is set forth in its written laws (constitution or statute); subsequently, it has also recognized contractual unconscionability as a "fundamental" policy.

Since *Nedlloyd*, no California appellate court has found any common law cause of action or limitation on a defense to be so fundamental as to prevent the enforcement of a contractual choice of law. Pitzer, however, seeks to undo the strict approach of *Nedlloyd* such that any judicially recognized common law policy could be found to trump the parties' choice of law. However, this is not what this Court said in *Nedlloyd*, is contrary to how courts have applied *Nedlloyd*, is inconsistent with this Court's pronouncement of what constitutes a "fundamental" policy in other contexts, and is not good policy.

California's common law notice-prejudice rule applicable to occurrence policies is a creation of the judiciary and so does not meet the

Nedlloyd test. In addition, the common law rule adding the element of prejudice to proving a late notice defense is, as a matter of policy, less significant than the very existence of the common law torts of breach of fiduciary duty and bad faith, which *Nedlloyd* found not to be "fundamental." The notice-prejudice rule has never been found to be a "fundamental" policy and cannot be considered one, as it is a rule of limited application that is subject to numerous exceptions recognized by California courts. In fact, the notice-prejudice rule has never been applied in the context of a claims-made-and-reported policy between sophisticated parties and should not be. The enforcement of these parties' agreement to New York law comports with their reasonable expectations and so does not impinge on any "fundamental" policy.

Pitzer also seeks to create new law by creating a "first-party insurance" exception to a rule that has been recognized for decades since this Court's decision in *Gribaldo*: enforcement of insurer consent requirements before costs are incurred does not require a showing of prejudice. The differences between notice and consent provisions, and the irrelevance of prejudice to breach of consent requirements, have been recognized by California courts for many years.

Pitzer's requested change in law to extend the notice-prejudice rule to remediation liability insurance lacks merit for two reasons. To begin with, the relevant coverage here is not first-party coverage; it covers an insured's potential liability for remediation and thus is third-party coverage. Therefore, the policy reasons California courts have applied consent provisions in third-party policies according to their terms, without needing proof of prejudice, have equal applicability to the policy and coverage at issue here. Further, insurers generally should be able to contractually require and enforce consent provisions in either the first-party or third-party context, consistent with prior precedent, and it would be bad policy to

create an exception for this type of coverage to allow an insured to incur costs without insurer involvement and consent.

For these reasons, Indian Harbor respectfully urges this Court to answer the certified questions in the negative.

FACTS

I. THE POLLUTION AND REMEDIATION LEGAL LIABILITY INSURANCE POLICY

Indian Harbor Insurance Company ("Indian Harbor") issued to Pitzer College ("Pitzer") a Pollution and Remediation Legal Liability policy, in effect from July 23, 2010 to July 23, 2011, written on a claims-made-and-reported basis. (ER 219.)

The coverage that is in dispute in this case is for "Coverage B – REMEDIATION LEGAL LIABILITY," which states, in part, that Indian Harbor "will pay on behalf of" Pitzer for "REMEDIATION EXPENSE and related LEGAL EXPENSE resulting from any POLLUTION CONDITION." (ER 221.) "REMEDIATION EXPENSE" is defined as certain expenses incurred "to the extent required by" a law enacted to address a "POLLUTION CONDITION" or a "legally executed state voluntary program governing the cleanup of a POLLUTION CONDITION." (ER 224.)

As a "condition precedent" to coverage, the policy requires notice to Indian Harbor of the discovery of pollution conditions "as soon as practicable." (ER 230.) The policy also requires Indian Harbor's written consent before incurring expenses, making payments, assuming obligations or commencing remediation, which consent "shall not be unreasonably withheld." (ER 230.)

The policy also states that New York law applies to "[a]ll matters arising hereunder including questions related to the validity interpretation, performance and enforcement of this Policy."[1]
(ER 234.)

Pitzer was no stranger to this policy or its terms, as it had been insured by similar Pollution and Remediation Legal Liability policies since 1999, as an additional named insured on policies issued to Claremont University Consortium ("CUC"). (ER 211 at ¶¶ 13-14; SER 9, 13, 23, 25, 67; SER 357-358 at 22:1-23:20.) CUC, founded in 1925, is "the central coordinating and support organization for The Claremont Colleges," which is comprised of seven colleges, including Pitzer. (Website: http://www.cuc.claremont.edu/ceo-welcome/ (last visited 6/20/17).) CUC is a separate legal entity from the colleges. (SER 265 at 24:15-17.) "CUC provides 28 vital services and programs for The Claremont Colleges and operates the programs and central facilities on behalf of the member colleges." (Website: http://www.cuc.claremont.edu/ceo-welcome/ (last visited 6/20/17); SER 344 at 46:3-14.)

One of the services CUC provides for its member colleges is insurance. (ER 161-162 at ¶¶ 6-7; SER 261 at 20:22-20:25.) Like many sophisticated entities, CUC has a dedicated insurance administrator and insurance personnel that handle risk management for the member colleges. (ER 162 at ¶ 7; SER 268 at 27:1-8; SER 339 at 16:3-22.)

For all insurance issues, Pitzer "work[s] through . . . CUC. CUC provides the central services for us, as well as the other Claremont colleges,

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[1] It is not disputed that New York law bears a "substantial relationship" to the parties or transaction or that there was a "reasonable basis" for the parties' choice of law. (*Nedlloyd*, *supra*, 3 Cal.4th at 466; ER 210-211 at ¶¶ 3-12 (discussing New York contacts and reasons for choice of New York law).)

and they purchase insurances on our behalf." (SER 261 at 20:22-25; SER 262 at 21:15-16 ("The insurances are purchased as a group . . .").) Pitzer "rel[ies] on CUC" with respect to insurance issues. (SER 262 at 21:23-25.) CUC provides centralized purchase of insurance for the colleges (SER 265 at 24:17-22), and the insurance premium charged to CUC is distributed back to the colleges (SER 267 at 26:13-14). Therefore, CUC is Pitzer's agent for purposes of insurance purchasing and for claims. (SER 339, at 16:3-22; SER 344 at 46:3-14.)

Since at least 1999, CUC's Business and Financial Affairs Committee has received presentations regarding the various insurance coverages and has voted on renewals of insurance policies. (SER 8-11, 16, 18-19, 21-36, 75-79, 82-98, 100-102, 104-116; ER 160-161 at ¶ 3.) With respect to the relevant policy, CUC was represented by an insurance broker throughout this process: Wells Fargo Insurance Services of Arizona, Inc., an arm of a national commercial broker.[2] (ER 220; SER 118-155; SER 157-158.) In June 2010, the Business and Financial Affairs Committee received a presentation from CUC's Insurance Administrator and broker regarding the recommended insurance, including the insurance policy at issue in this case, and voted to renew the policy with Indian Harbor. (SER 157-158.) The policy as purchased has nine endorsements (ER 237-254), and it provides $5 million in limits for a premium of $27,535 (ER 219).

II. PITZER'S DISCOVERY OF THE POLLUTION CONDITION IN JANUARY 2011 AND CLEANUP OF SAME IN MARCH AND APRIL 2011

While the policy was in effect and during construction of a new dormitory on Pitzer's campus, Pitzer learned of lead contamination on its

---

[2] This broker tendered the claim to Indian Harbor on behalf of Pitzer, and it advocated on Pitzer's behalf during the claims-handling stage. (SER 231, 248.)

property. Specifically, on January 10, 2011, Yuet Lee (Pitzer's Vice President for Administration and Treasurer, the officer responsible for insurance) learned of the discovery of darkened/discolored soils at the site. (SER 162; SER 295-297 at 85:24-87:13; SER 308-309 at 146:21-147:9.) Test results on January 11, 2011 demonstrated that Pitzer had a "contamination situation," and, by January 21, 2011, Pitzer believed that remediation would be required. (SER 307 at 145:12-14; SER 325-326 at 28:10-29:1.) However, the contamination did not pose any emergency: the contamination was entirely on-site, no nearby dorms were evacuated, and no restrictions were placed beyond the project boundaries. (SER 327-328 at 35:24-36:3; SER 329-330 at 43:23-44:8.)

The removal of the lead contamination did not begin immediately. First, after a couple of weeks of study, Pitzer's consultants provided Pitzer a proposed Soil Management Plan on or around February 1, 2011. (SER 169; SER 312 at 150:7-12.) Then, for the next two weeks (until February 16, 2011), there were "[g]enerally no activities" at the site. (SER 332 at 49:5-19.) In the two weeks that followed, from February 16, 2011 to February 27, 2011, Pitzer commenced a "Remediation Strategy and Pricing" phase, during which time it was weighing its remediation options, ultimately deciding to conduct lead removal using an onsite treatment system called a Transportable Treatment Unit ("TTU"). (SER 162-163; SER 333 at 69:1-10.)

Actual lead removal did not begin until March, and Pitzer ultimately completed the remediation on April 9, 2011. (SER 163-164; SER 335 at 91:2-4.) Pitzer claims to have paid nearly $2 million for the remediation. (ER 65 at ¶ 8; SER 177.)

Indian Harbor's expert later opined that the way Pitzer conducted the remediation overlooked options that could have materially reduced the eventual cost and that Pitzer had conducted the remediation in a way that

waived subrogation rights against others responsible for the contaminated soil. (ER 257-261 at ¶¶ 1-22.)

Mr. Lee's after-the-fact excuse for not reporting the discovery of contamination to Indian Harbor (or to CUC or its broker), and for not consulting with Indian Harbor before incurring expenses or commencing remediation, was that he claimed he did not think about insurance during this time. (SER 299 at 93:13-19; SER 300 at 94:1-7; SER 313 at 163:3-15; SER 320 at 194:2-10.) However, if he had wanted to, he admitted that he had time and opportunity to call CUC, the broker, or Indian Harbor: "I had time to call my parents. I could have called anybody . . . I could have called my mom and said, you know, 'Hey, are you free on Saturday to have lunch?' I could have called anybody." (SER 310-311 at 148:22-149:16); "I had time to make phone calls about anything that needed to be called on topics that needed to be discussed. . . . I could have called anybody." (SER 313 at 163:16-23). While he did not contact CUC, the broker, or Indian Harbor during this time, he did notify Pitzer's President and other Pitzer administrators of the remediation efforts; Mr. Lee also took the time to contact Pitzer's attorney regarding potential sources to fund the remediation, and, on March 11, 2011, Pitzer's attorney advised Mr. Lee that "private insurance recovery" was one such source. (ER 161 at ¶ 5; SER 304-306 at 142:20-144:15; SER 314-316 at 165:12-167:24.) But Mr. Lee apparently ignored this advice for over three months.

Mr. Lee first asked CUC about coverage for the remediation by no later than June 17, 2011. (SER 218.) In response, on June 28, 2011, CUC's Insurance Administrator encouraged Mr. Lee to report the remediation to Indian Harbor, even though she understood that coverage likely would be denied:

> The pollution liability policy provides coverage for remediation and legal expenses resulting from any pollution condition at any covered location.
>
> There is an [sic] voluntary payment exclusion that states as follows: [citing Section VII.B. of policy.]
>
> Based on this exclusion, this claim will likely be denied however we should proceed to file it. If you could please provide me the date that the condition was discovered, the inspection report, the recommendation for remediation and the invoice for the cleanup. . . .

(SER 220.) On July 7, 2011, CUC's Insurance Administrator followed up with Mr. Lee by email, stating that "[d]ue to the lapse in time," the remediation claim should be submitted "as soon as possible," and Mr. Lee acknowledged this email. (SER 222, 225.) On July 8, 2011, the broker also advised that notice could be accomplished in a phone call, although "it is very unlikely we will prevail." (ER 228.)

III. PITZER'S NOTICE TO INDIAN HARBOR SIX MONTHS AFTER DISCOVERY OF THE POLLUTION CONDITION AND THREE MONTHS AFTER COMPLETING THE REMEDIATION

Pitzer did not give notice to Indian Harbor of its discovery of the pollution condition until July 11, 2011, when its broker apparently decided to act (while Pitzer continued to delay), and called an underwriter for Indian Harbor. (SER 231; SER 363-364 at 16:5-17:7; SER 365-366 at 19:22-20:4; ER 211-212 at ¶ 16.) Indian Harbor acknowledged receipt of notice to CUC, with a copy to the broker, on August 10, 2011, asking whether Pitzer sought coverage, requesting other information, and noting that pre-notice costs would not be covered under the policy. (SER 233-234.)

In an internal broker email sent that same day, one broker observed:

> I can't say I disagree with XL's position. . . . If insured wants to pursue, we should involve Bob Williams in our SF office. I have found Bob to be a great resource in these situations. He

> recently helped me negotiate a settlement with Ace on an environmental claim (we got $.50 on the loss). My client's claim also had consent issues, although not []as significant and blatant as your situation.

(ER 237.) The other broker responded that he advised CUC that "it will certainly be an uphill battle, and expectations of recovery should be low." (SER 236.)

CUC forwarded the Indian Harbor initial position letter to Pitzer on August 12, 2011, advising Pitzer of Indian Harbor's position, and recognizing the correctness of Indian Harbor's denial: "The policy is very clear on the reporting requirements. . . . Based on the above coverage opinion, it's doubtful that Pitzer will receive any recovery for this loss. Please let me know if Pitzer would like to continue to pursue this claim." (SER 240.)

After receiving no response for seven months, Indian Harbor denied coverage for the claim on March 16, 2012, based on late notice and the failure to obtain consent. (SER 244-246; SER 367 at 44:2-12.)

IV. THE LAWSUIT, SUMMARY JUDGMENT, AND APPEAL

Pitzer filed this lawsuit against Indian Harbor for Declaratory Relief and Breach of Contract in the Los Angeles Superior Court on July 8, 2013. On August 12, 2013, Indian Harbor removed the case to the Central District of California, on the basis of diversity jurisdiction. On April 24, 2014, Indian Harbor filed a motion for summary judgment. The District Court held oral argument and granted Indian Harbor's motion on May 22, 2014, based on both New York's late notice and consent law and California consent law. (ER 3.) Judgment was entered on June 3, 2014. (ER 1.) Pitzer appealed to the Ninth Circuit Court of Appeal on June 24, 2014. (ER 39.) The Ninth Circuit heard oral argument on October 5, 2016 and

certified questions to this Court on January 13, 2017. This Court granted certification on March 22, 2017.

ARGUMENT

I. THE NOTICE-PREJUDICE RULE IS NOT A FUNDAMENTAL POLICY OF CALIFORNIA FOR THE PURPOSE OF A CHOICE OF LAW ANALYSIS

A. To Override a Contractual Choice of Law Provision, the Policy Must be "Fundamental," Which Means That It Must Be Set Forth in a Statute, Constitution, or Principle of Unconscionability, and Designed to Restrict Freedom of Contract

1. Under *Nedlloyd*, the Policy Necessary to Override the Parties' Contractual Choice of Law Must Be "Fundamental," Not Just "Strong"

In *Nedlloyd Lines B.V. v. Superior Court* (1992) 3 Cal.4th 459, this Court for the first time "considered the enforceability of a contractual choice-of-law provision." (*Id.* at 464.) In that case, this Court considered whether a plaintiff could assert common law tort claims for breach of the covenant of good faith and fair dealing (bad faith) and breach of fiduciary duty, as to a shareholder agreement that specified Hong Kong law (which did not recognize such tort claims), where the courts below had applied California law and so granted leave to amend on demurrers to the claims. (*Id.* at 463, 467-71.)

In *Nedlloyd*, this Court confirmed that California has a "strong policy favoring enforcement" of choice of law provisions. (*Id.* at 464-465.) The Court viewed the plaintiff's arguments as seeking to create claims "by disregarding the law [plaintiff] voluntarily agreed to accept as binding," a result that would "undermine California's policy of respecting the choices made by parties to voluntarily negotiated agreements." (*Id.* at 471.)

After analyzing its prior decision on forum clauses and prior intermediate appellate decision on choice of law clauses, this Court decided

to adopt and direct California courts to follow the Restatement Second of Conflicts of Laws ("Restatement section 187"). In setting out the test that California courts should apply pursuant to Restatement section 187, this Court stated that in the last step of the analysis a court determines "whether the chosen state's law is contrary to a *fundamental* policy of California. If there is no such conflict, the court shall enforce the parties' choice of law." (*Id.* at 466 (emphasis in original).)

The Court ultimately reversed the leave to amend to assert the claims, finding no fundamental California policy was offended by completely depriving the plaintiff of its bad faith and fiduciary duty causes of action. (*Id.* at 468, 471.) The Court reasoned that California's bad faith law did not reflect "a government regulatory policy designed to restrict freedom of contract" and, as to fiduciary duty, there was "no California statute or constitutional provision designed to preclude freedom of contract in this context." (*Id.* at 468, 471.)

The term "fundamental" – not "strong" – is used in Restatement section 187 to describe how important a public policy must be to override a contractual choice of law. In discussing and applying the relevant portion of the test, this Court in *Nedlloyd* used the word "fundamental" twelve times, including one time where it italicized the word (*id.* at 466) and one time where it used the word in quotation marks: "We next consider whether application of the law chosen by the parties would be contrary to 'a fundamental policy' of California" (*id.* at 468). The decision never used the word "strong" to describe the required policy necessary to supersede parties' agreement to a particular state's law; in fact, it only used the word "strong" to describe California's public policy of enforcing choice of law provisions. (*Id.* at 465.) The words used in the *Nedlloyd* decision establish

that Pitzer is wrong in contending that the Court's use of the term "fundamental" was not significant.[3]

Moreover, "fundamental" and "strong" are not synonyms of one another, and their dictionary definitions are distinct. (*Compare* Merriam Webster (10th Ed.), p. 472, "fundamental" (e.g., "serving as an original or generating source" or "belonging to one's innate or ingrained characteristics") *with* Merriam Webster (10th Ed.), p. 1166, "strong" (e.g., "not mild or weak" or "well established").)

It makes sense that the modern approach as articulated in Restatement section 187 and *Nedlloyd* involves a careful choice of words in requiring a "fundamental" policy to overcome a choice of law clause. Logically, something more than a "strong" policy should be necessary to overcome California's equally "strong" public policy in favor of enforcing parties' choice of law. (*Nedlloyd, supra*, 3 Cal.4th at 465; *see also Washington Mutual Bank, FA v. Superior Court* (2001) 24 Cal.4th 906, 917.)

In arguing it should only have to offer a "strong public policy" to avoid the choice of law provision that undermines its claim, Pitzer cites to a pre-*Nedlloyd* case: *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1971) 20 Cal.App.3d 668. As noted by Justice Kennard in her *Nedlloyd* concurrence and dissent, "strong policy" was used before *Nedlloyd* adopted Restatement section 187. (*Nedlloyd, supra*, 3 Cal.4th at 479-480.) Therefore, the wording of the test as used in these pre-*Nedlloyd* cases should not be relied on in identifying the proper standard.

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[3] Justice Kennard's concurrence and dissent in *Nedlloyd* noted the existence of a distinction between the historical California "strong" articulation and the Restatement's "fundamental" standard, describing the two as only "similar." (*Nedlloyd, supra*, 3 Cal.4th at 479, 483.)