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Aug. 19, 2008

Honorable Ronald M. George, Chief Justice
and the Associate Justices
CALIFORNIA SUPREME COURT
350 McAllister Street
San Francisco, CA 94102

RE: Intra-American Foundation & Drilling Co. v. Evanston Ins. Co.
California Supreme Court No. S164752

Dear Chief Justice George and Associate Justices:

This letter in support of a petition to review is submitted pursuant to Rule 8.500(g) of the California Rules of Court by the national American Subcontractors Association and its California affiliate, the American Subcontractors Association of California , (collectively, the "ASA"), as well as the undersigned individually acting on his own behalf.

The Applicant ASA's Interest. Founded in 1966, the ASA is a non-profit trade association that leads and amplifies the voice of trade contractors to improve the business environment in the construction industry and to serve as stewards for the community. ASA is dedicated to improving the business environment in the construction industry. The ideals and beliefs of ASA are ethical and equitable business practices, quality construction, membership diversity, integrity, and a safe and healthy work environment. ASA has 5,000 members nationwide, including more than 400 members from five Chapters in the State of California.

In this case, the Court of Appeal decision held that a subcontractor's CGL insurer was not required to defend against a both general contractor's (1) allegations that alleged property damage caused by the subcontractor's defective performance of its work, and (2) claims extrinsic to the pleading asserting particular instances of such property damage.

The ASA's membership is dramatically affected by these issues—as are most other commercial entities in all industries. The construction industry can be a highly litigious one, as building involves the complex orchestration of often as many as sixty separate subcontractors on a given project, using and installing the products of myriad manufacturers, and dependent upon the successful and timely performance of one another's work. Every project is also, to some extent, a prototype, such that there are

many unforeseen factors that can, and often do, go wrong, resulting in disputes between the parties over the resulting costs.

Not surprisingly, then, multiple claims between multiple parties are an inevitable part of most construction projects. Many of these end in big, complex, expensive litigation. Insurance is therefore extremely important to this industry. Coverage often means the life or death of one of our member companies. Studies have shown that defense coverage represents about half of the overall economic benefits to CGL insureds in complex, commercial litigation like this. Hence, our great concern over the defense coverage issues here. But, then, all other businesses that run the risk of complex commercial litigation share our concerns.

Our member subcontractors are generally required to indemnify and defend the other parties on a construction project (the general contractor, owner, and design professionals) for any liability arising out of the subcontractor's work. Hence, our concern over CGL coverage of indemnity obligations.

We are hardly unique in this regard. The risks involved in every commercial contractual relationship are allocated by way of either contractual indemnity or non-contractual common law and statutory rules of indemnification. So, not only do we speak for our own substantial sector of the California and national economies, namely the construction industry, but we can also fairly claim to represent all commercial enterprises involved with indemnity law, which is to say virtually all commercial enterprises.

Finally, most commercial activity everywhere is undertaken under contract of one sort or another. Therefore, not only our membership but also most other commercial enterprises everywhere are concerned over the protection of CGL coverage for liabilities in contract.

The Applicant Scott Turner's Interest. I am one of the handful of attorneys in California, and in the nation as a whole, specializing exclusively in insurance coverage of the construction-related liabilities, a specialty I have practiced now for twenty years. I am the author of Insurance Coverage of Construction Disputes (West Group 2nd ed. 2008), a two-volume, 1,500 page legal treatise and numerous articles in ABA and other legal, construction industry, and insurance industry publications. I was the 2000-2001 chairperson of the ABA Construction Insurance Coverage Subcommittee of the Insurance Coverage Committee of the Section of Litigation.

My intensive, long-term involvement with both the substantive and procedural law in this area has, of course, given me insights into its most serious problems.

An Overview of Why You Should Grant Review. By granting review, you can rid California of three very troublesome issues with one stone:

(1) Most importantly, you can for the first time guide insureds, insurers, and the courts as to the specific analytical steps to take in assessing the potential of coverage in

establishing the duty to defend. This would address, and mostly eliminate, a bear trap that frequently ensnares both insureds and the Court of Appeals;

(2) You can protect and reaffirm the critically important principle that the duty to defend is determined by the facts alleged against the insured, not by the legal theory asserted. This is an issue on which our courts and the courts of other states still regularly stumble; and

(3) You can establish the proper interpretation and role of this troublesome new Breach of Contract Exclusion within the context of this court's landmark decision in *Vandenberg v. Superior Court* (1999) 21 Cal.4th 815, 840-41 ("*Vandenberg*") in which established that the standard CGL policy does not on its own preclude coverage of liabilities in contract.

Given this court's leadership role nationally, particularly in regard to insurance law, and great national confusion over these same issues, you guidance here is all the more urgently needed. These are enormously important issues with billions of dollars and the economic lives of millions at stake, both within the construction industry and in most other commercial enterprises.

We agree with petitioner and the issues it has raised in its petition. However, we see these issues somewhat differently. Therefore, we submit the following discussion.

I. THE NEED TO SPECIFICALLY DESCRIBE THE PROPER ANALYTICALSTEPS IN ASSESSING AN INSURER'S DUTY TO DEFEND

All recent Court of Appeal decisions recognize that the starting point for determining an insurer's duty to defend is, in the words of the decision in this case, "whether the factual allegations of the [claimant's pleading against the insured] and the extrinsic evidence available to [the insured] revealed the potential that any claim of the [claimant] was covered by the insurance policy . . ." *Intra-American Foundation & Drilling Co., Inc. v. Evanston Ins. Co.* (2008) 2008 WL 2123852 at *11 ("*Intra-American*"). That much is clear.

The problem with the case law—and *Intra-American* in particular—is in exactly *how* one determines that potential.

In this case, the Court of Appeal first sought to apply the foregoing principle by restating it in a form intended to fit the facts of this case: ". . . i.e., whether any potential *non-contractual* claim for property damage existed." *Id.* (We disagree with the logic and appropriateness of this statement in III. below, but for the time-being we focus on the following steps taken by the court, as these involve even more important issues.)

Next, the Court of Appeal properly recognized that the test for defense coverage is a two-stepped examination of alternatives: Defense coverage is triggered if either the pleading in question or the facts extrinsic to that pleading show a potential of coverage.

A. The Pleading Test for Potential of Coverage

Turning to the first alternative, the pertinent allegations of the general contractor claimant against the insured subcontractor in the words of the Court of Appeal's *Intra-American* decision are as follows:

> The cross-complaint's first cause of action, for breach of contract, alleged, inter alia, [the insured subcontractor] failed . . . . "[t]o . . . perform [its] obligations in a manner that is consistent with . . . the duty of due care. . . . and as a result of these "acts of breach," the general contractor was "damaged in extra charges for property damages . . . and other disbursements and liabilities . . . ." The second cause of action, for express indemnity, alleged the subcontract provided for [the subcontractor] . . . to indemnify the general contractor from . . . losses and damages incurred by the General contractor.
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> *Id.*,at *4.

But the pleading against the insured need not allege a covered cause of action to trigger the insurer's duty to defend. It need only allege facts sufficient to raise the potential of coverage:

- "The duty to defend arises when the facts alleged in the underlying complaint give rise to a potentially covered claim regardless of the technical legal cause of action pleaded by the third party." *Barnett v. Fireman's Fund Ins. Co.* (2001) 90 Cal.App.4th 500, 510 ("*Barnett*").

- "It makes no difference that for strategic adversarial reasons this cause of action was labeled 'antitrust';... it is not the form or title of a cause of action that determines the carrier's duty to defend, but the potential liability suggested by the facts alleged or otherwise available to the insurer." *CNA Cas. of Calif. v Seaboard Surety Co.* (1986) 176 Cal App 3d 548, 609 ("*Seaboard Surety*").

- "Predicating coverage upon an injured party's choice of remedy or the form of action sought is not the law of this state . . . . '[W]hether a particular claim falls within the coverage afforded by a liability policy is not affected by the form of the legal proceeding. Accordingly, the legal theory asserted by the claimant is immaterial to the determination of whether the risk is covered.' " *Vandenberg,* 21 Cal.4th at 840-41.

The California Supreme Court has explained the rationale behind this rule as follows: "This is so because current pleading rues liberally allow amendment; the third party plaintiff cannot be the arbiter of coverage." *Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal 4th 287, 296. Thus, in our case, the fact that the general contractor's allegations against the insured subcontractor appear in a cause of action denominated "breach of contract" cannot preclude defense coverage.

There are four independent reasons why these factual allegations raised the potential of coverage, any one of which triggered the insurer's duty to defend.

First, the factual allegation in this case that the insured's "breach" of its "duty of care" resulted in "property damage" certainly raises the potential of a claim of negligence which is *not* simultaneously a breach of contract. That would both (a) avoid the effect of the policy's Breach of Contract Exclusion and (b) fall well within the usual coverage parameters of the CGL policy—an accident or occurrence causing property damage. That is, the acts causing the third party property damage may not have breached the terms of the subcontract, but they nevertheless negligently caused property damage to third party neighbors. The vicariously liable project owner city paid those claims. The owner then backcharged that payment against the general contractor, who in turn attempted to pass-through that backcharge to the insured subcontractor. The general contractor's claim could easily be based on non-contractual theories of implied or equitable indemnity. Here, there is no breach of contract at any level.

Second, the factual allegation in this case that the insured's "breach" of its "duty of care" resulted in "property damage" raises the potential of a claim of negligence which *is* a breach of contract, but a breach of contract that both (a) avoids the effect of the policy's Breach of Contract Exclusion and (b) falls well within the usual coverage parameters of the CGL policy—an accident or occurrence causing property damage. That is, the acts causing the third party property damage may have breached the terms of the subcontract but also negligently caused property damage to third party neighbors for which the vicariously liable project owner city paid. The owner then back-charged that payment against the general contractor, who in turn attempted to pass-through that backcharge to the insured subcontractor. The general contractor's claim could easily have been based on non-contractual theories of implied or equitable indemnity, not breach of contract. Here, there is a breach of contract that is a concurrent cause of the property damage, but the actual claim against the insured is not for breach of contract.

Third, the allegations that the general contractor was "damaged in extra charges for property damages" raises the possibility that the project itself suffered property damage. This is because the term "extra charges" within the context of the construction industry refers to those contract adjustments a general contractor makes with a subcontractor when that subcontractor's scope of work at the project increases beyond that originally envisioned at the time of contracting. This strongly raises the possibility that the insured subcontractor damaged property at the project in a way that required

another subcontractor to perform work beyond its original scope of work to repair. The general contractor was contractually bound to pay that second subcontractor for these "extra charges." Such property damage is usually accidental and tortious in nature. Having suffered these "extra charges" because of that property damage, the general contractor sought recovery from the insured subcontractor who caused the problem. (As we will see in the discussion at B. below, this is not merely a possibility under the pleadings. The extrinsic facts support such an interpretation, too.)

Fourth, the very fact and enforceability of the subcontract was in contention in the underlying case. As such, there was the potential that there was no enforceable contract between the contractor and the subcontractor, which by definition would leave the general contractor with only non-contractual claims against the insured, such as for implied or equitable indemnity.

In contrast to the foregoing, the Court of Appeal's analysis (in fact, the totality of its brief discussion on point) is as follows:

> We turn first to the general contractor's cross-complaint. The lone reference to "property damage" appears in the breach of contract cause of action, where the general contractor [claimant] contends that as a result of [the insured] plaintiff's "acts of breach," the general contractor was damaged "in extra charges for property damages." (Italics added.) Thus, the general contractor claimed to have suffered extra charges for property damage as a result of plaintiff's breach of the subcontract, i.e., a contractual claim. In the absence of the breach of contract exclusion endorsement, this allegation would have triggered a duty to defend, but under the plain language of the endorsement, defendant had no such duty.
>
> *Id.*

So, the trial court saw the clear potential of coverage raised by the allegations quoted above. Yet, somehow the Court of Appeal missed the multiple reasons these allegations triggered the duty to defend. Why? How?

The short answer is that apparently this Court of Appeal panel was unaware that a subcontractor's negligence in performing the subcontract work could coexist with a breach of contract claim or *actually avoid being in breach of that contract while at the same time causing property damage* to either third parties or the general contractor itself In both cases, such property damage would be actionable in tort — yet at the same time result in either: (1) a setoff charge for settling the neighbors' claims passed down from the owner to the general contactor and on down to the subcontractor; or (2) a property damage claim from the general contractor for damage done to the project itself resulting in "extra charges" to the general contractor for which it sought implied indemnity from the subcontractor.

For longer, more meaningful answer, let's consider step-by-step the extreme difficulty of the analytical task before the Court of Appeal in these cases. Construction disputes usually involve multiple, separate claims, each arising out of separate, unrelated facts, e.g., problems with the construction of the roof as opposed to problems with the heating/ventilation/air-conditioning system, problems with neighbors over dust control, delay in the completion of the project, etc. etc. Ten or twenty or more separate claims are not unusual. For purposes of this discussion, let's say there are only 10 claims.

Given the number of parties at a commercial construction project site, the factual complexity of the processes performed there, and the complexity of the adverse effects that occur when something goes wrong, each of these claims usually involves its own universe of factual complexity. Again, let's be conservative and say that each of these claims involves only 10 factual issues. Construction law then overlays upon this a considerable body of legal issues, such as alternative legal theories of liability. I'll estimate conservatively that there are 50 such legal issues. Among other things, the construction contracts on a commercial project are usually long and intricate, and use a specialized nomenclature. Each of these legal issues potentially applies to each of the factual issues.

Thus, analytically speaking, there are 5,000 different scenarios that should be considered at this point. Then, insurance law and the complexity of CGL polices further multiplies the potential issues to be considered. There are over 50 policy provisions potentially at play in a given construction-related coverage dispute, and most of these are provisions involve numerous sub-issues of maddening complexity. The analysis of these issues in my two-volume legal treatise, Insurance Coverage of Construction Disputes (2 ed. Thomson West 2008)[1] runs over 800 pages. Yet, I consider its treatment of only middling detail. Multiplying through, that now totals 250,000 scenarios to consider.

Now, to the foregoing we must layer on the fact that it is defense coverage we are considering here. Because of the great complexity of the facts involved, it is customary for the allegations in construction cases to be pleaded in a very general and summary way. That results in very broad, unspecified factual allegations. When this occurs, the courts must consider all of the remote factual possibilities that might fit within each such broad allegations. *Horace Mann Ins. Co. v. Barbara B.* (1993) 4 Cal.4th 1076, 1083 (although lacking in specificity, the complaint evinced a possibility that the insured teacher would be held liable for damages within the coverage of the policy stemming from the insured's negligent nonsexual conduct in his public relationship with his student, as opposed to non-covered acts of intentional molestation). In the context of construction disputes, the different categories of factual possibilities here number in the thousands. Let's conservatively estimate this layer at only 1,000 possibilities. Multiplying that with

[1] If the court would like to peruse it, the Westlaw Database identifier is "ICCDS". Alternatively, its Table of Contents can be found at: http://web2.westlaw.com/TOC/default.wl?rs=WLW7.02&scdb=ICCDS&fn=_top&sv=Split&tc=29&scrlt=CLID_DB173518293&abbr=ICCDS&tf=2004&utid=%7b7340A328-4EEC-11D5-A99D-000102463493%7d&vr=2.0&rp=%2ftoc%2fdefault.wl&mt=Insurance&FLV=true&Action=JumpTree

the other layers results in 250,000,000 different, possible scenarios to analyze for defense coverage purposes if one did a properly thorough job of it.

To make matters worse, that last step requires an understanding of the factual possibilities well beyond the legal experience and factual knowledge of the average jurist. For example, what are all the possible causes and ill effects that may occur when a concrete foundation is poured, and it does not harden within the usual time? Does a general contractor have a property interest in its half-completed construction project under California law? Could the general contractor still state a covered claim for property damage to the project if it does not have an interest in the property?

Obviously, 250,000,000 different, possible scenarios is too impossibly large a number for a court to methodically and rationally work through each one. That would be on par with the Human Genome Project. To do anything like a reasonable job, a very experienced attorney specializing in both construction law and insurance law must use something like the intuition chess champions use to discern the right moves out of the millions of options.

As jurists are unlikely to be intimately familiar with either construction law or insurance law from their pre-bench careers—and certainly not both areas of law—it is very easy for them to be blind to covered factual possibilities that are clear to experienced counsel. It takes years of experience to begin to get a feel for all the myriad things that can go wrong at a construction project, the many types of property damage that can result, all the different economic damages that can flow from these, the various legal theories and doctrines that apply to such liabilities, all the types of damages that can be sought, and how all of these interface with the insurance policy provisions and insurance law.

So, it is not really surprising if the Court of Appeal did not realize that a subcontractor could negligently cause property damage at or to a construction project without it necessarily being in breach of its subcontract, that a general contractor can have a right to non-contractual indemnity for this, that property damage to the project itself can result in "extra charges" to the general contractor, that the general contractor can make a covered claim to recover these from the subcontractor that caused them, etc. etc.

Lastly, to make a bad situation even worse, one of the attorneys in the coverage action usually wants to keep jurists blind to all these possibilities and has seriously studied the arguments that have the most gut level appeal in that regard. Faced with layer on layer of impossible complexity, and encouraged by counsel, desperate courts are often eager to embrace grossly simplifying—but erroneous—rules of thumb such as "CGL policies never cover liabilities in contract" when offered by counsel. For instance, that particular example was accepted by the Court of Appeal and the Federal courts applying what they thought was California law for 20 years resulting in a dozen published decisions, which the Supreme Court only overruled in its decision in *Vandenberg* in 1999.

Contemplate for a moment all of the unpublished Court of Appeal decisions, the trial court cases, and pre-litigation claims that must have followed that erroneous case law during those twenty years—and the utter enormity of the injustice that resulted! During this period, I personally had clients that lost their thriving companies, family businesses that had taken one or more lifetimes to build from scratch, because of that bad case law.

The good news is that there is a means by which this problem can be mostly solved. The problem stems from the fact that neither the case law nor the commentaries actually explain *how* an insured might best prove the potential of coverage that arises from the pleading against it. The usual way, as it was done in this case, is to quote the pertinent language from the pleading, simply assert that it raises the potential of coverage, and leave it to the court to figure it out. And, again, jurists often cannot see the significance, because they do not have the experience needed to intuitively navigate the near infinite number of issues involved.

The practical solution is for the insured's counsel to offer up one or more specific, possible, factual scenarios that both fit within the allegations and fit within all the terms of the policy in contention. Then, all that is required of the court is to confirm that this analysis is in fact true.

For instance, in this case as I have done above, the insured's attorney could have edited the allegations to highlight the part leading to the envisioned coverage. He would then describe a specific factual scenario. Lastly, he would explain how that scenario: (1) fit as a possibility within those allegations; (2) at least potentially satisfied the requirements of the Insuring Clause of the policy (e.g., explaining how the claim sought "damages" because of "property damage" caused by an "occurrence" during the policy period); and (3) avoided falling within the scope of any policy exclusions the insurer was asserting as a defense to coverage.

Let's pick one of these potential scenarios and do an abbreviated demonstration of what I am talking about. The insured subcontractor performs its work in accordance with the subcontract. Nevertheless, during the course of that work, the subcontractor accidentally drills through an underground cable, causing an electrical transformer to blow up, and that shuts down power to adjacent retail stores. The stores suffer economic losses as they cannot open for a period of time during the busy Christmas holiday shopping season.

The City which owns the construction project is vicariously liable for this, and properly settles the store owners' claims. Because it owes money to the general contractor for its project work —and the general contractor had from the beginning agreed to indemnify the City— the City sets off the settlement amount against what it owed the general contractor. The general contractor then brings indemnity actions against the insured subcontractor for both contractual and equitable indemnity.

Thus, the general contractor has brought an action for "damages," satisfying that requirement. Those damages are sought "because of . . . 'property damage'" to the third-party property. That property damage was caused by an "accident." That property damage also "occur[red] during the policy period". As such, all of the requirements of the policy's insuring agreement are satisfied. The only exclusion raised was the Breach of Contract Exclusion, but as there was no breach of contract, it cannot apply in this scenario. (If any of the usual Business Risk exclusions had been raised, none of the exclusions would apply, because the property damage was to the property of third parties.)

There are two problems with this solution that require the Supreme Court's help here. First, none of the California insurance law commentaries currently mention it, so it is not generally known. Second, when this approach has been tried, many courts are in such a state of confusion that they cannot appreciate why such a hypothetical has any bearing on the question. Aided by counsel for the insurer, they erroneously confuse such hypotheticals with an unrelated prohibition against "mere speculation."[2]

So, the ultimate solution is for the Supreme Court to grant review of the petition in this case and in the opinion that eventually results suggest that, practically speaking, the best means for an insured to meet its burden of proof in these situations is for it to offer the court a factual scenario that both fits as a possibility under the allegations and is covered under all the terms of the policy that have been raised for consideration, explaining how that scenario overcomes each hurdle. The Rutter Group and CEB practice guides will pick this recommendation up, broadly publicize it, and most counsel will start actually doing it once it is pointed out to them. The trial courts and the Court of Appeal will then be presented with something that they have the skills and time to properly analyze. And, not being overwhelmed with issues they cannot possibly process, the courts will be better able to resist the lure of dubious devices for over-simplifying the issues.

B. The Extrinsic Evidence Test for Potential of Coverage

Alternatively, defense coverage is triggered if known facts extrinsic to that pleading show a potential of coverage. The Supreme Court has explained this rule as follows: "This is so because current pleading rules liberally allow amendment; the third party plaintiff cannot be the arbiter of coverage." *Montrose Chem. Corp. v. Superior*

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[2] The insurer is not required to speculate that facts might be proved to bring the case within the policy's coverage when there is no factual basis for such speculation. *See, e.g., Friedman Professional Mgt. Co., Inc. v. Norcal Mut. Ins. Co.* (2004) 120 Cal.App.4th 17, 35; *Westoil Terminals Co., Inc. v. Industrial Indem. Co.* (2003) 110 Cal.App.4th 139, 153–154; *Low v. Golden Eagle Ins. Co.* (2002) 99 Cal.App.4th 109, 114; *Swain v. California Cas. Ins. Co.* (2002) 99 Cal.App.4th 1, 8–9; *Gunderson v. Fire Ins. Exch.* (1995) 37 Cal.App.4th 1106, 1114; *Hurley Const. Co. v. State Farm Fire & Cas. Co.* (1992) 10 Cal.App.4th 533, 538.

Court (1993) 6 Cal 4th 287, 296 ("Montrose"). That is, the complaint against the insured can usually be amended to allege such facts. *Gray v. Zurich Ins. Co.* (1966) 65 Cal.2d 263, 277.

In this case, the insured subcontractor asserted three sources of extrinsic facts: (1) the general contractor's responses to interrogatories; (2) correspondence from the general contractor asserting property damage; and (3) the terms of the eventual settlement agreement between the subcontractor and the general contractor which specified and settled the latter's claims. As to each, the general contractor had asserted property damage claims.

Once again, as we saw above, the Court of Appeal simply did not see any possible claim that the general contractor could make against the insured subcontractor that was not for breach of contract. But, just as we saw under the pleadings analysis above, the subcontractor's actions could have been negligent without breaching the subcontract, the owner could have settled those claims and charged the general contractor for them, and therefore the general contractor could have been pursuing a claim for equitable indemnity based upon that set of facts.

II. THE COURT OF APPEAL'S FAILURE TO LOOK BEYOND THE LEGAL THEORY PLEADED TO THE FACTS ALLEGED

An alternate reading of the Court of Appeal's analysis of the duty to defend in regard to the allegations pleaded against the insured subcontractor is that it disregarded the rule of *Vandenberg*, *Barnett*, and *Seaboard Surety* discussed above. That is, it saw that the cause of action alleging the property damage was for breach of contract, and rejected defense coverage on the basis of the policy's breach of contract exclusion. In doing so, it ignored that the actual facts alleged in that cause of action gave rise to a potential claim by the general contractor that would not be based on contract. That is, the general contractor could amend its complaint and assert a covered theory of recovery based on those same facts.

> [The insurer] cannot construct a formal fortress of the third party's pleadings and retreat behind its walls. The pleadings are malleable, changeable and amendable . . . the complainant in the third party action drafts his complaint in the broadest terms; he may very well stretch the action . . . In light of the likely overstatement of the complaint and of the plasticity of modern pleading, we should hardly designate the third party as the arbiter of the policy's coverage.
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> *Gray v. Zurich Ins. Co.* (1966) 65 Cal 2d at 275-277.

Therefore, review should be granted to uphold *Vandenberg*, *Barnett*, and *Seaboard Surety* and clarify that the analysis and result in this current decision is impermissible.

This point is particularly important to the ASA and its membership. To hold otherwise would allow the claimant, rather than the facts, to determine coverage under the policy. Thus, whenever a well-finance general contractor claimant wanted to use its financial strength to ruin a thinly financed subcontractor in big, complex, expensive litigation, all it would need to do is to assert its claims in causes of action for breach of contract only, thereby thwarting coverage. This is a well-known strategy and a very real threat to us. See *Dobrin v. Allstate Ins. Co.* (C.D. Cal. 1995) 897 F.Supp. 442, where this strategy was pursued though not within the context of a construction dispute.

The ASA's members are usually weaker financially than the project owners and general contractors with whom they usually litigate. As such, they are vulnerable to, and regularly face, such predatory tactics. Therefore, we are extremely interested in seeing that the rule from *Vandenberg*, *Barnett*, and *Seaboard Surety* is vigorously enforced. "The insured's desire to secure the right to call on the insurer's superior resources for the defense of third party claims is . . . typically as significant a motive for the purchase of insurance as is the wish to obtain indemnity for possible liability. As a consequence, California Courts have been consistently solicitous of the insured's expectations on this score." *Montrose,* 6 Cal 4th at 295-296. "[T]he third party plaintiff cannot be the arbiter of coverage." *Id.*, at 296.

III. A CLAIM FOR CONTRACTUAL INDEMNITY IS NOT NECESSARILY A "CLAIM FOR BREACH OF CONTRACT"

As subcontractors usually have the weakest negotiating leverage in the construction industry, owners and general contractors almost always demand that their subcontractors indemnify and defend them for any liability they may arise out of the subcontractors' work. This is a major liability exposure to ASA's subcontractor member. Fortunately, this forced assumption of liability is insured under a subcontractor's CGL policy if it otherwise falls within the terms of the policy, e.g., there is a claim for damages because of property damage caused by an accident or "occurrence" etc. and no exclusion applies. As you might imagine, this coverage is vital to ASA's members, and its removal would be catastrophic.

The Breach of Contract Exclusion in this case eliminates coverage, including defense coverage, for "claims for breach of contract". That language seems simple and clear in the abstract, but it grafts awkwardly onto the CGL policy. As a result, it becomes ambiguous when applied in many contexts. In this regard, let's consider its application to contractual indemnity claims.

When a general contractor asserts a demand for contractual indemnity against a subcontractor, as occurred here in the general contractor's August and December 2001

letters regarding the vibratory hammer and electrical transformer events, it demands the subcontractor's contractual *performance* of its indemnity obligation. No breach of contract had yet to occur. Therefore, a Breach of Contract Exclusion cannot apply to such claims.

Had the insurer intended to exclude coverage of these indemnity claims, it should have used more expansive language that would have put its insureds on notice of that intention. If the insurer declines to immediately honor such a covered claim, the insured is not allowed to honor it itself, as the Voluntary Payments Condition in the policy prohibits it. Therefore, because the insurer's declination forces the claimant's demand for performance to mature into an actual breach of contract claim, the insurer should not then be allowed to apply the Breach of Contract Exclusion. If nothing else, this result would clearly violate the insured's reasonable expectations. Or, as its own act caused the breach, the insurer should be estopped from thereafter asserting the exclusion.

Even in those situations in which the general contractor has already incurred the liability and defense costs in question and only then files a pleading for contractual indemnification of those costs, the claim is as much one for specific performance of the contractual obligation as for breach of contract. Or, to view it another way, the general contractor could bring separate causes of action under either legal theory. The facts that support one also support the other. As one of those potential legal theories would be covered, the exclusion cannot apply. Therefore, for defense coverage purposes, where the facts alleged could support a cause of action for specific performance, the exclusion cannot apply.

In this case, the Court of Appeal wrongly frames the issue as "whether any potential *non-contractual* claim for property damage existed." *Intra-American*, at *11. That misses the mark. The question the court should have been asking was whether there was any potential claim that was not for *breach* of contract. And, the answer as we have seen is yes.

Finally, the Court of Appeal decision not only contradicts the *Vandenberg*, *Barnett*, and *Seaboard Surety* decisions, it could lead to inconsistent results *within the same construction project and parties.* Take the example of Subcontractor A and Subcontractor B, working side by side, doing the exact same work, having the exact same CGL Policy, and causing the exact same damage.

If the Court of Appeal decision here is not reversed, then insurance coverage for the resulting damage could be different for Subcontractor A and Subcontractor B. This is because such coverage would depend solely on how the injured party terms its claim, notwithstanding the otherwise identical fact patterns, damage, loss, and CGL policy.

Such a result is horrible public policy for a number of reasons. To name just a few, it would allow coverage to be defined based on actions beyond the control of the insured (and would do so in defiance of the rule this Court affirmed in *Vandenberg*). It could lead to blackmail of the insured by the injured party "unless you agree to X, I will

assert my claim as a breach of contract claim and you won't be covered." And it would undercut the insured's reasonable expectations (contradicting the rule set forth in *Montrose*).

CONCLUSION

The Court of Appeal's decision is wrong on multiple points. The case also raises several, very important issues which California's lower courts have regularly mistreated over a long period of time. This is an excellent opportunity for the Supreme Court to exercise its institutional role and provide those courts with the guidance they need. This is a particularly attractive case in this regard, because it offers the court the opportunity to "kill multiple birds with one stone."

If the petition is granted, we will apply for the privilege of briefing the foregoing issues as amici.

If the petition is not granted, we strongly oppose publication.

Very truly yours,

LAW OFFICES OF SCOTT C. TURNER

Scott C. Turner
Attorney for Amicus Curiae
American Subcontractors Association,
American Subcontractors Association of California,
and individually on his own behalf