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Client Alert

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California Supreme Court Broadens Availability of Insurance Coverage to Adjudicative Administrative Proceedings

"The *Ameron* decision is likely to have broad and favorable implications for California policyholders confronted with claims brought by state and federal agencies empowered to pursue relief in either traditional lawsuits or quasi-judicial administrative forums."

On November 18, 2010, the California Supreme Court issued an important decision for companies insured under comprehensive general liability (CGL) policies providing for defense coverage against "suits."[1] Marking a sea-change in the interpretation of standard CGL policy language, the high court's decision in *Ameron* broadens the scope of coverage available to policyholders responding to administrative orders by holding that quasi-judicial administrative proceedings qualify as "suits" that insurers must defend under CGL policies.

This decision may have significant ramifications for California businesses subjected to claims by administrative agencies empowered with the authority to conduct adversarial adjudicative proceedings outside of court. In order to assess fully the potential insurance benefits that may flow to policyholders facing significant liabilities from claims brought in quasi-judicial forums by environmental or other administrative agencies, businesses that have been insured by standard CGL policies should promptly evaluate their historic coverage portfolios with experienced coverage counsel.

Ameron Extends Coverage to "Quasi-Judicial" Administrative Proceedings that are Functionally Equivalent to "Suits" in Court

Before *Ameron* changed course in policyholders' favor, the California Supreme Court had taken a much narrower view of the types of proceedings that constitute "suits" that must be defended under standard CGL policies. In 1998, a divided court ruled 4-3 to apply a "literal meaning" to the term, holding that "suit" refers only to "actual court proceedings initiated by the filing of a complaint."[2] As a consequence, the court ruled that the operator of a pesticide and fertilizer business was not entitled to a defense from its CGL insurers against an order issued by the California Department of Toxic Substances Control requiring the performance of various environmental-remediation tasks.

Three years after *Foster-Gardner*, the Supreme Court extended its "literal meaning" approach to CGL insurers' duty to indemnify. In *Powerine I*, the Court applied the "*Foster-Gardner*

syllogism" — the duty to indemnify is no broader than the duty to defend — to conclude that the obligation to indemnify "all sums that the insured[s] [became] legally obligated to pay as damages" was "limited to money ordered by a court" in a "suit."[3] Therefore, the standard CGL policy did not provide policyholders with insurance coverage for costs incurred to respond to a federal agency's environmental-remediation order. Although the reach of *Powerine I* was subsequently limited by the Supreme Court's decision in *Powerine Oil Co., Inc. v. Super. Ct.*, 37 Cal. 4th 377 (2005) (*Powerine II*), the court did not re-visit the holding of *Foster-Gardner* until this year.

In *Ameron*, the California Supreme Court was faced with an issue testing the limits of *Foster-Gardner*'s "literal meaning" interpretation of the term "suit." Ameron was hired to manufacture concrete piping to be installed pursuant to a contract with the United States Department of the Interior's Bureau of Reclamation (Bureau). In 1990, the Bureau discovered that the piping was defective, ultimately finding Ameron responsible for $40 million in damages allegedly caused by the defects.

Ameron challenged the Bureau's decision in a proceeding before the US Department of Interior Board of Contract Appeals (IBCA), filing a complaint that provided "simple, concise, and direct statements of each claim."[4] Pursuant to its statutory authority to "conduct trials, determine liability, and award money damages," the IBCA conducted an adversarial administrative hearing that, over the course of 22 days, involved the taking of witness testimony and resolution of contested factual issues.[5]

After Ameron provided timely notice to its insurers, who denied any obligation to defend or indemnify against the IBCA proceedings, Ameron brought a declaratory relief claim in Superior Court. Relying on *Foster-Gardner*, the trial court granted the insurers' demurrer and dismissed Ameron's complaint, concluding that the IBCA proceedings did not constitute a "suit." The Court of Appeal affirmed the trial court's ruling as it applied to the traditional CGL policies which did not define the term "suit."[6]

The Supreme Court unanimously reversed, holding that a "quasi-judicial adjudicative proceeding, employed to resolve government demands against insured parties" is a "suit" under policies that do not otherwise define that term.[7] Contrasting the clean-up order at issue in *Foster-Gardner* which provided insurers "insufficient notice of the parameters of the action against the insured," the court found that the IBCA pleadings "inform[ed] the insurer of the nature of the dispute" and provided "fair notice" of the claims against its insured, thereby fulfilling the purpose of a complaint filed in court.[8] Consequently, a reasonable policyholder "would recognize such [administrative] proceedings as a suit and would expect to be defended and, if necessary, indemnified by its insurer."[9]

The court also recognized that the IBCA proceedings were created as an alternative to traditional lawsuits brought in the Federal Court of Claims. However, the court held that the delegation of Article III judicial powers to a "quasi-judicial" administrative agency was not functionally different from assigning the same powers to a court. Since it would "exalt form over substance to find such a complaint before the IBCA insufficient simply because the IBCA is not a court of law," the court rejected the insurers' attempt to escape their coverage responsibilities by applying such a narrow definition to the term "suit."[10]

Despite its seeming rejection of the "literal meaning" approach employed in *Foster-Gardner* and adoption of a "functional" approach similar to that followed in many other states, the majority of the court opted not to overrule *Foster-Gardner* directly:

> Here, the court limits *Foster-Gardner*'s "bright-line rule" by holding that it does not apply to administrative agency adjudicative proceedings. The court reaches this result by concluding that the word "suit," when used in a CGL policy that does not define that word, is sufficiently ambiguous that it should be construed to protect the insured's reasonable expectation of coverage. In so doing, the court implicitly rejects *Foster-Gardner*'s reasoning that "suit" unambiguously refers only to court proceedings. Although I would prefer that *Foster-Gardner* be overruled, the decision here is at least a step in the right direction.[11]

Instead, the court provided a guidepost for future coverage disputes, distinguishing mere "'threat[s]' to take legal action" like those embodied in certain environmental remediation orders from "administrative adjudicative" actions that "dictate[] [a] departure from *Foster-Gardner*."[12]

Implications for Insurance Coverage of Administrative Proceedings

The *Ameron* decision is likely to have broad and favorable implications for California policyholders confronted with claims brought by state and federal agencies empowered to pursue relief in either traditional lawsuits or quasi-judicial administrative forums. Rather than allowing CGL insurers to deny coverage reflexively for any claim asserted outside a traditional lawsuit, *Ameron* dictates that insurers carefully analyze the formal and adversarial nature of administrative claims to determine whether they are "quasi-judicial" in nature and therefore trigger the policyholder's right to a defense. Because "California courts have been consistently solicitous of insureds' expectations" with respect to their "desire to secure the right to call on the insurer's superior resources for the defense of third party claims," insurers cognizant of their duty of good faith and fair dealing should be more likely to provide defenses against adjudicative administrative proceedings.[13]

The number of decisions issued by the California Supreme Court concerning these issues confirms that *Ameron* is a crucial next step in an evolving area of law of critical importance to policyholders facing administrative agency claims. Going forward, the impact of *Ameron*'s holding on the continuing viability of *Foster-Gardner* may be of particular focus in the context of defining an insurer's duties with regard to environmental remediation proceedings such as those conducted by a Regional Water Quality Control Board, where administrative hearings and discovery are conducted to develop a record that is ultimately relied upon by the Board in issuing its final order.

* * *

Although California policyholders have begun to right the ship, gaining much greater leverage in disputes with their insurers than existed in the pre-*Ameron* world, it will be imperative for policyholders responding to administrative agency demands to consult experienced coverage counsel to evaluate the potential insurance implications of this latest development fully.

Latham & Watkins' "EPIC" Practice Group (Environmental, Products Liability, Insurance Coverage and Class Actions Litigation) has a unique capacity to deal with insurance coverage matters, particularly those arising in environmental contexts. The firm's Insurance Litigation Group, which has been for years recognized as one of the top policyholder practices by Chambers and other publications, is well-positioned to assess insurance policies and advise clients regarding strategies for maximizing coverage to protect policyholders against claims asserted by all types of administrative agencies.

Endnotes

[1] *Ameron Int'l Corp. v. Ins. Co. of the State of Penn.*, 50 Cal. 4th 1370, 1375 (2010) (*Ameron*).

[2] *Foster-Gardner Inc. v. National Union Fire Insurance Co. of Pittsburgh*, 18 Cal. 4th 857, 878-879 (1998).

[3] *Certain Underwriters at Lloyd's of London v. Superior Court*, 24 Cal. 4th 945, 951(2001) (*Powerine I*).

[4] *Ameron*, 50 Cal. 4th at 1382-1383; *see* 43 C.F.R. § 4.107(a).

[5] *Ameron*, 50 Cal. 4th at 1376, 1386.

[6] *Ameron Internat. Corp. v. Ins. Co. of State of Penn.*, 150 Cal. App. 4th 1050 (2007).

[7] *Ameron*, 50 Cal. 4th at 1374-1375.

[8] *Id.* at 1383-1384.

[9] *Id.* at 1386.

[10] *Id.* at 1385.

[11] *Id.* at 1388 (Kennard, J., concurring).

[12] *Id.* at 1386-1387.

[13] *See Montrose v. Super. Ct.*, 6 Cal. 4th 287, 295-96 (1994).

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