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9th Circ. Set To Examine Scope Of Covering Willful Acts

By **Shane Dilworth**

Law360 (January 23, 2023, 8:27 PM EST) -- Whether an insurance company should cover a policyholder's willful misconduct will take center stage in two cases before the Ninth Circuit in the coming weeks, with legal experts eager to find out how liberally the court says a state statute can be construed.

Although the applicability of California Insurance Code Section 533 differs in the two cases before the federal appeals court, with the lower courts arriving at different conclusions, experts say insurers are turning to the statute as a way to avoid covering a policyholder's intentional conduct.

In one case, the court denied coverage to the County of Sacramento after four former police officers accused their supervisors of retaliation. In the other, a law firm accused of malicious prosecution won insurance coverage of its settlement.

Here, Law360 breaks down the statute and its role in the two cases ahead of oral arguments.

What's at Stake

G. David Rubin of the firm Litchfield Cavo LLP told Law360 that Section 533 is an important statute that reflects public policy and prohibits indemnification for willful acts.

"It's similar to an intentional acts exclusion, but not coextensive with it," Rubin said. "The overarching principle of the statute is that an insured cannot obtain indemnification for its willful acts."

From a policyholder's perspective, some courts have gone too far in finding Section 533 applicable to bar coverage, said William Um, a partner at Jassy Vick Carolan LLP's Los Angeles office.

"What I see in both of these cases is the continued bastardization of Insurance Code Section 533," Um, who represents policyholders, told Law360.

He said he's noticed that courts are weighing claims of intentional conduct against a policyholder that carriers have morphed into claims of willful, prohibitive conduct not covered under Section 533.

While Section 533 was enacted to preclude coverage for acts of intentional, willful misconduct, Um said he is concerned that courts are buying into the insurer's arguments that focus more on the alleged misconduct than the intent.

"I get the public policy concern behind the statute to not cover willful acts of misconduct," Um said. "But, in my view, it's been taken way too far by the carriers, and I'm hoping that the courts will slow down that momentum."

Employer's Liability

The Ninth Circuit will be addressing two nuanced rulings, one of which favored policyholders and another that found on the side of insurers. In the County of Sacramento's appeal of a decision in favor of excess insurer Everest National Insurance Co., the municipality is seeking reversal of U.S. Senior District Judge Morrison C. England's decision that it is not entitled to coverage for the settlement of a suit brought by officers who accused their supervisors of retaliation.

In the underlying suit, four employees of the Sacramento Police Department filed a suit alleging retaliation and harassment after complaining about discriminatory behavior. The employees accused the county of violating the California's Fair Employment and Housing Act.

Following a trial, a jury awarded the plaintiffs a total of $3.5 million in damages. The parties appealed the verdict and later reached a settlement.

The county lodged a coverage dispute against Everest, arguing that its employment practice liability policy provided coverage for claims of retaliation under anti-discrimination laws. The municipality also contended that Section 533 could not apply, arguing that it was not directly liable for the alleged wrongful conduct.

Um said that findings regarding liability in an underlying action aren't necessarily conclusive for insurance coverage purposes. In Sacramento's case, a jury found that it was directly liable for the conduct of individuals who worked in the Sheriff's Department, but were not informed about vicarious liability.

Judge England's conclusion that Section 533 was applicable based on the jury's finding on direct liability against the county intrigued Um.

"It's clear the county of Sacramento didn't do the discriminating or retaliating," said Um, who also pointed out that the county's policy provided coverage for harassment and retaliation.

Um said the case presents a situation similar to the one presented to the California Supreme Court in Liberty Surplus Ins. Corp. v. Ledesma & Meyer Constr. Co., where it said an employer could expect coverage for a claim of negligent hiring in an underlying suit over alleged sexual abuse by an employee. The Golden State high court concluded that Section 533 could not apply to bar coverage for claims involving vicarious liability.

Laura A. Foggan of Crowell & Moring LLP in Washington, D.C., told Law360 that the California Supreme Court has made it clear that Section 533 acts as an implied exclusion in every California policy and the parties to such insurance contracts may not contract otherwise. An example can be found in J.C. Penney Cas. Ins. Co. v. M.K., 804 P.2d 689, 694 n.8 (Cal. 1991) (en banc), in which the court found there is no coverage for sexual molestation.

Foggan represents the Complex Insurance Claims Litigation Association, which submitted amicus curiae briefs in support of insurers in both cases. She also said several courts applying California law, including

Judge England's court, have held that retaliation is a willful act, and that it is illegal to indemnify a willful act under Section 533.

"Allowing public entities to be indemnified against judgments of damages for willful conduct would be an end run around the Legislature's determination and would thwart California's clear public policy," said Foggan, who represents carriers. "After all, to allow indemnity for willful acts would only encourage them, which is counter to the policy behind the statute and California law."

Pretrial Settlement

In the other case going before the Ninth Circuit, Aspen Specialty Insurance Co. says Miller Barondess LLP should reimburse it for a pretrial settlement to resolve claims of malicious prosecution. The carrier contends that a finding of liability is not necessary to bar coverage for the settlement.

Aspen issued a professional liability policy to Miller Barondess, which was sued by real estate investor AEW Capital Management over botched deals to purchase West Los Angeles properties. Miller Barondess represented NMS Capital Partners during the negotiations.

NMS accused AEW of cheating to acquire the properties, and AEW countered that NMS forged provisions of the agreement. AEW later sued a number of law firms, including Miller Barondess and four of its partners.

Aspen agreed to defend Miller Barondess and reserve its right to later challenge its coverage obligations. It also funded the firm's settlement with AEW.

The carrier then brought a suit in California federal court against the firm seeking reimbursement of the settlement. Aspen argued it had no duty to cover the settlement pursuant to Section 533.

Miller Barondess moved to toss the suit, arguing that Section 533 is not applicable. U.S. District Judge Andre Birotte Jr. agreed.

Aspen is asking the Ninth Circuit to rule that a finding of liability is not necessary to trigger Section 533's prohibition on coverage for claims of malicious prosecution. In its opening brief, the carrier looked to a California appeals court's ruling in Downey Venture v. LMI Insurance Co., to support its argument that Section 533 does not preclude an insurer from defending a policyholder accused of malicious prosecution.

However, Aspen says the Downey Venture ruling holds that it is not required to cover the settlement.

Crowell Moring's Foggan said that regardless of the fact that the damages were paid in a settlement, it does not make coverage permissible where it would otherwise be impermissible to indemnify a judgment.

She said that if the AEW action had proceeded to judgment, the policyholder would have had to pay the damage award without a right to indemnity.

"Where the only claim is one that cannot be indemnified, the same prohibition against indemnification for malicious prosecution claims applies to judgments and settlements," she said. "To hold otherwise would distort the insurance relationship, and motivate the insured to settle its claims solely to recoup

insurance benefits, and reward the insured with coverage for any settlement, even where the underlying misconduct was wilful in violation of Section 533."

Jassy Vick's Um said that much like liability, a settlement should not be determinative of coverage. He explained that admissions of liability rarely, if ever, occur in a settlement agreement.

"I think the carrier's position is a bit extreme to say that the mere fact of settling extinguishes coverage in this context," said Um, who said Aspen's reliance on Downey Ventures is interesting. "Aspen is trying to extend that ruling, but I don't think that's something that's binding and convincing for the Ninth Circuit."

The county declined comment. The remaining parties and their representatives did not respond to requests for comment.

The county is represented by Michael G. Colantuono and Pamela K. Graham of Colantuono Highsmith & Whatley PC.

Everest is represented by James R. Tenero and Sheryl Leichenger of Selman Breitman LLP.

Aspen is represented by Shari Klevens, Craig Giometti and David Simonton of Dentons US LLP.

Miller Barondess is represented by Justin Ehrlich of Herzog Yuhas Ehrlich & Ardell APC and by Daniel S. Miller of Miller Barondess LLP.

The cases are County of Sacramento v. Everest National Insurance Co., case number 22-15250, and Aspen Specialty Insurance Co. v. Miller Barondess LLP et al., case number 22-55032, in the U.S. Court of Appeals for the Ninth Circuit.

--Editing by Amy Rowe and Nick Petruncio.
