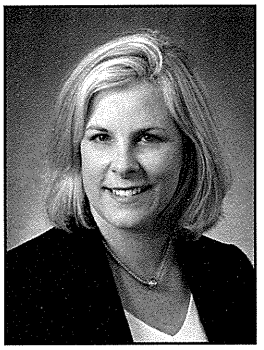
Insurance Law Committee Annual Report on Developments in California Insurance Law

Kimberley Dellinger-Dunn and H. Thomas Watson



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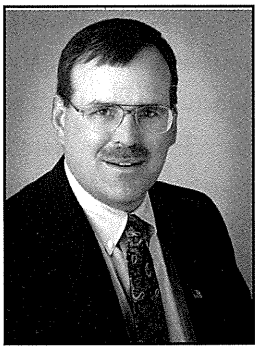
Kimberley Dellinger-Dunn serves as General Counsel for the Personal Insurance Federation of California (PIFC), a nonprofit insurance trade association whose members are insurers specializing in personal lines of insurance. She represents those companies before the Legislature and the Department of Insurance on legislative and regulatory issues, and manages general legal matters for the association.



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Mr. Watson is a partner at Horvitz & Levy, LLP, and a California State Bar Certified Appellate Specialist. Mr. Watson has extensive appellate experience in insurance and healthcare law. He has authored articles on insurance, healthcare law and punitive damages issues, and is a frequent lecturer on these topics.

This article reviews significant developments in three areas of California insurance law: published case law, legislation, and new regulations promulgated by the California Department of Insurance ("CDI").

I. CASE REVIEW

A. CALIFORNIA SUPREME COURT

In 2011, the California Supreme Court published the following insurance law decisions:

1. Harris v. Superior Court (Liberty Mutual Ins. Co.) 2011 WL 6823963 (Dec. 29, 2011)

Claims adjusters employed by two insurance companies filed consolidated class action lawsuits against their employers alleging that the insurers had erroneously classified them as exempt "administrative" employees and seeking damages based on unpaid overtime work. The claims adjusters moved for summary adjudication of the insurers' affirmative defense that they were exempt from the overtime compensation requirements under the California Industrial Welfare Commission's ("IWC") Wage Order No. 4-2001, which applies to professional, technical, clerical, mechanical, and similar occupations. The trial court denied the motion but the court of appeal directed the trial court to vacate its decision and grant the motion, holding that the claims adjusters could not be considered exempt employees.

The California Supreme Court reversed, holding that the court of appeal had improperly analyzed whether the adjusters were exempt employees. Under Labor Code section 515, subdivision (a), employees are exempt from overtime compensation if their work is "administrative." In turn, IWC Wage Order No. 4-2001, subdivision 1(A)(2)(a)(1), provides that persons are employed in an administrative capacity if their duties and responsibilities involve office or non-manual work "*directly related to management policies or general business operations of [their] employer or [the] employer's customers.*" (Emphasis added.) The court held that, pursuant to a federal regulation incorporated into Wage Order No. 4-2001, work qualifies as "directly related" if it satisfies two components. "First, it must be *qualitatively* administrative. Second, *quantitatively*, it must be of substantial importance to the management or operations of the business." With respect to the qualitative requirement that the work must be administrative in nature, this regulation explains that administrative operations include work done by " white collar" employees engaged in servicing a business. According to the regulation, such servicing may include advising management, planning, negotiating, and representing the company.

The California Supreme Court limited its discussion to the qualitative component because the court of appeal had improperly applied the "administrative/production worker dichotomy." That dichotomy draws a distinction between workers who are primarily engaged in "administering the business affairs of the enterprise" and production–level employees whose " primary duty is producing the commodity or commodities, whether goods or services, that the enterprise exists to produce and market." The appellate court had held that under this test, "only work performed at the level of *policy* or *general* operations" can qualify as "directly related to management policies or general business operations." In contrast, work that merely carries out the particular day-to-day operations of the business is production, not administrative, work. The California Supreme Court disagreed, holding that in light of Wage Order No. 4-2001, the administrative/production worker dichotomy is not a dispositive test and that a court instead should consider the particular facts of the case before it and apply the language of the relevant statutes and wage orders at issue to decide whether employees are exempt. The

Court said that "[o]nly if those sources fail to provide adequate guidance . . . is it appropriate to reach out to other sources." Accordingly, whether work is part of the "administrative operations" of a business may depend, in part, on whether those operations involve advising management, planning, negotiating, and representing the company—and activities such as interviewing witnesses, making recommendations regarding coverage and value of claims, determining fault and negotiating settlements may satisfy that test.

Significantly, the California Supreme Court distinguished *Bell v. Farmers Ins. Exchange*, 87 Cal. App. 4th 805 (2001), and *Bell v. Farmers Ins. Exchange*, 115 Cal. App. 4th 715 (2004) relied on by the court of appeal and which applies the administrative/production worker dichotomy to hold that claims adjusters were nonexempt "production workers" on the grounds that those decisions were carefully limited to their facts, including the insurer's stipulation that the adjusters' work in those cases was "routine and unimportant," and because the *Bell* courts did not have the benefit of Wage Order No. 4-2001 and the federal regulations incorporated into that wage order, which set out detailed guidance on the scope of the administrative exemption.

2. Century-National Ins. Co. v. Garcia, 51 Cal. 4th 564 (2011).

In *Century-National Insurance Co. v. Garcia*, the California Supreme Court issued a unanimous opinion holding that a policy provision excluding coverage for fire losses caused by the intentional act of "any" insured cannot be enforced to deny coverage to an innocent coinsured, i.e., a coinsured who neither directed nor participated in setting the fire.

The court explained that Insurance Code sections 2070 and 2071 prescribe a standard form of fire policy for use in California. Insurers may vary the form only if their policies provide fire coverage that is substantially equivalent to or more favorable to the insured than the fire coverage afforded by the form policy.

The form policy incorporates a statutory exclusion for losses resulting from a willful act by "the" insured (CAL. INS. CODE § 533), but that exclusion is not triggered by the willful act of "any" insured. Other exclusionary provisions in the form policy likewise are tied to "the" insured rather than "any" insured. The statutory form thus reflects "the Legislature's intent to ensure coverage on a several basis and protect the ability of innocent insureds to recover for their fire losses despite neglectful or intentional acts of a coinsured." As a result, "an insurance clause purporting to exclude coverage for an innocent insured based on the intentional acts of a coinsured impermissibly reduces statutorily mandated coverage and is unenforceable to that extent."

The California Supreme Court noted that because its decision involved a fire policy subject to sections 2070 and 2071, the decision "should not be read as necessarily affecting the validity of clauses that deny coverage for the intentional acts of 'any' insured in other contexts."

B. California Court of Appeal

The California courts of appeal published numerous insurance law decisions in 2011; the following are among the most significant:

1. *Janopaul + Block Cos., LLC v. Superior Court* (*St. Paul Fire and Marine Ins. Co.*), 200 Cal. App. 4th 1239 (2011).

   When an insured sues its insurer for breach of contract and bad faith based on the insurer's delay in agreeing to pay for *Cumis* counsel, the court must adjudicate the breach and bad faith issues before the court may compel the parties to arbitrate a *Cumis* fee dispute under Civil Code section 2860, subdivision (c).

2. *The Oglio Entertainment Group, Inc. v. The Hartford Casualty Ins. Co.*, 200 Cal. App. 4th 573 (2011).

   There is no potential for coverage under an advertising injury provision for a lawsuit alleging that the insured copied its client's product and then sold a competing product that injured its customer's sales and professional reputation, since the complaint did not allege the misuse of any advertisement.

3. *Western Heritage Ins. Co. v. Superior Court* (*Parks*), 199 Cal. App. 4th 1196 (2011).

   After an insured defaults by failing to comply with discovery, an insurer defending the insured under a reservation of its right to later deny coverage may intervene and contest both liability and damages.

4. *Martin v. PacifiCare of California*, 198 Cal. App. 4th 1390 (2011).

   Health and Safety Code section 1371.25 immunizes a healthcare service plan from insurance bad faith liability based on its alleged vicarious liability for errors by healthcare provider to whom it had delegated the task of utilization review (i.e., determining the medical necessity of proposed treatment).

5. *Mission Viejo Emergency Medical Associates v. Beta Healthcare Group,* 197 Cal. App. 4th 1146 (2011).

   Clear and conspicuous arbitration clauses in insurance policies are enforceable regardless of whether the insured was advised of the arbitration provision when applying for insurance or knew of its existence prior to enforcement of the provision.

6. *Behnke v. State Farm General Ins. Co.*, 196 Cal. App. 4th 1443 (2011).

   Insurer's genuine dispute regarding the amount of fees billed by insured's independent counsel, which was resolved by arbitration under Civil Code section 2860, cannot support insured's follow-on lawsuit seeking damages for fraud, breach of contract, and insurance bad faith.

7. *American Modern Home Ins. Co. v. Fahmian,* 194 Cal. App. 4th 162 (2011).

   An insurer defending its insured under a reservation of rights who accepts a reasonable settlement within policy limits, after giving the insured the opportunity to take over the defense or waive a claim of bad faith based on refusal to settle, may seek reimbursement of the settlement amount from the insured if coverage is found not to exist regardless whether the insured had "sufficient" time to evaluate the settlement offer.

8. *Minich v. Allstate Ins. Co.*, 193 Cal. App. 4th 477 (2011).

   Under Insurance Code sections 2051 and 10102, an insurer may properly withhold payment of replacement cost benefits in excess of policy limits until a fire-damaged home is rebuilt.

9. *State Farm Mutual Automobile Ins. Co. v. Lee*, 193 Cal. App. 4th 34 (2011).

   Counsel for insurer in uninsured motorist arbitration proceedings may properly seek to discover evidence of insurance fraud.

II. LEGISLATION

The following are a few of the more significant insurance related bills that were signed into law in 2011 and went into effect January 1, 2012 (unless otherwise specified in the law or otherwise noted in this article).

A. Health

Assembly Bill No. 151 (2011-2012 Reg. Sess.) Medicare Supplement Coverage

Chapter 270 (Monning)

Proposes to expand guaranteed issuance rights into Medicare supplement policies for those covered under a Medicare Advantage Plan. Specifically, it allows an individual to drop Medicare Advantage ("MA") coverage and enroll in Medicare supplement coverage of the same issuer, or the issuer's parent company, if the MA issuer increases premiums. If Medicare supplement coverage is not available from the same issuer, or parent company, it allows an individual under limited circumstances to enroll in Medicare supplement coverage of an unaffiliated issuer.

Assembly Bill No. 210 (2011-2012 Reg. Sess.) Maternity Services

Chapter 508 (Hernandez R)

Requires individual and group health insurance policies to provide coverage for maternity services beginning no later than July 1, 2012, defined to include prenatal care, ambulatory care, involuntary complications, neonatal care, and inpatient hospital care (including labor, delivery, and postpartum care). The bill specifies that the definition of "maternity services" is effective until final regulations or guidance define the required scope of maternity benefits under the Patient Protection and Affordable Care Act.

Assembly Bill No. 922 (2011-2012 Reg. Sess.) Office of Patient Advocate

Chapter 552 (Monning)

Transfers the Department of Managed Health Care and the Office of the Patient Advocate to the Health and Human Services Agency. Adds duties and responsibilities for providing outreach and education about health care coverage to consumers. Authorizes the office to contract with community organization to provide these services. Requires the office to adopt standards and procedures regarding those organizations. Establishes the Office of Patient Advocate Trust Fund.

Senate Bill No. 51 (2011-2012 Reg. Sess.) Health Care Coverage

Chapter 644 (Alquist)

Relates to the federal Patient Protection and Affordable Care Act. Requires health care service plans and health insurers to comply with requirements imposed under that Act, including requirements relating to a lifetime limit prohibition, minimum medical loss ratios, and certain required rebates to each insured.

Authorizes the promulgation of emergency regulations by the Director of the Department of Managed Health Care and the Insurance Commissioner regarding medical loss ratios.

Senate Bill No. 222 (2011-2012 Reg. Sess.) Maternity Services

Chapter 509 (Evans)

Requires individual and group health insurance policies to provide coverage for maternity services beginning no later than July 1, 2012, defined to include prenatal care, ambulatory care, involuntary complications, neonatal care, and inpatient hospital care (including labor, delivery, and postpartum care). The bill specifies that the definition of "maternity services" is effective until final regulations or guidance define the required scope of maternity benefits under the Patient Protection and Affordable Care Act.

Senate Bill No. 946 (2011-2012 Reg. Sess.) Mental Illness: Pervasive Developmental Disorder

Chapter 650 (Steinberg)

Requires health care service plan contracts and health insurance policies to provide coverage for behavioral health treatment for a pervasive developmental disorder or autism. Provides that no benefits are to be provided that exceed the essential health benefits that will be required under specified federal law. Requires the convening of an autism advisory task force to provide assistance on topics related to behavioral health treatment and recommendations for education and training to secure licensure.

B. Life

Assembly Bill No. 689 (2011-2012 Reg. Sess.) Insurance; Annuity Transactions

Chapter 295 (Blumenfield)

Relates to the replacement of existing life insurance policies and annuities. Requires insurers and insurance producers to comply with requirements regarding the purchase, exchange, or replacement of an annuity. Prohibits an insurance producer from selling annuities unless he or she has received approved training. Provides that sales by a financial industry regulatory authority broker-dealer that comply with certain requirements shall be deemed to satisfy these requirements.

Assembly Bill No. 793 (2011-2012 Reg. Sess.) Insurance Producers; Reverse Mortgages

Chapter 223 (Eng)

Prohibits an insurance broker or agent from participating in, being associated with, or employing any party that participates in, or is associated with, the originating of a reverse mortgage. Prohibits individuals transacting in insurance from receiving compensation, commission, or direct incentive for providing reverse mortgage brokers with a noncasualty insurance product that is connected to or a result of the reverse mortgage.

Senate Bill No. 220 (2011-2012 Reg. Sess.) Dependent Coverage

Chapter 126 (Price)

This bill gives insurers the option to offer group life dependent coverage until age 26.

Senate Bill No. 599 (2011-2012 Reg. Sess.) Life Insurance; Retained-Asset Account

Chapter 423 (Kehoe)

Requires that all life insurance benefits be paid in the form of a lump-sum to the beneficiary or by another settlement option that is clearly described in the claim form. Provides that if the beneficiary does not choose one of the available settlement options a retained-asset account on the beneficiary's behalf would be authorized only if the claim form provides for disclosure. Requires non-lump sum settlement options to conform to specified conditions. Authorizes the adoption of related regulations.

Senate Bill No. 621 (2011-2012 Reg. Sess.)(D) Insurance: Life: Disability: Discretionary Clauses

Chapter 425 (Calderon R)

Provides that if a policy or agreement that provides life or disability insurance coverage for any California resident contains a provision that reserves discretionary authority to the insurer to determine eligibility for benefits or coverage or the terms of the policy, contract, certificate, or agreement, or to provide standards of interpretation that are inconsistent with the laws of the state, that provision would be void and unenforceable. Authorizes the adoption of related regulations.

Senate Bill No. 713 (2011-2012 Reg. Sess.) Insurance; Proceeds; Disclosure

Chapter 130 (Calderon R)

Requires insurers to provide written disclosures to life insurance beneficiaries at the time a claim is made and before a retained asset account is selected or established as the payment. Requires an insurer that settles life insurance benefits through a retained asset account to provide the beneficiary with a supplemental contract that clearly discloses the rights of the

beneficiary and obligations of the insurer under the contract and to provide a related statement. Relates to violation civil penalties.

C. Workers Compensation

Senate Bill No. 684 (2011-2012 Reg. Sess.) Workers Compensation Insurance; Dispute Resolution

Chapter 566 (Corbett)

Requires an insurer that intends to use a dispute resolution or arbitration agreement to resolve disputes arising out of a workers' compensation insurance policy or endorsement to disclose to the employer that the choice of law and choice of venue or forum may be a jurisdiction other than California and that the terms are negotiable. Requires the employer to sign the disclosure as evidence of receipt, when the offer of coverage is accepted. Authorizes the negotiation of terms before a dispute arises.

D. Surplus Lines

Assembly Bill No. 315 (2011-2012 Reg. Sess.) Surplus Line Brokers

Chapter 83 (Solario)

Revises and recasts the provisions governing surplus line brokers and nonadmitted insurers to make them consistent with the federal Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. No. 111-203, 124 Stat. 1376 (2010)) (the "Act"). Includes the duties, responsibilities, and licensure of surplus line brokers, taxation of such insurance, and eligibility of nonadmitted insurers to do business in California. Requires new and renewal policies, cancellations, or endorsements, and installment premiums be classified as providing the Act's purposes.

Senate Bill No. 131 (2011-2012 Reg. Sess.) Surplus Lines Brokers: Statement of Business Transacted

Chapter 302 (T. Gaines)

Specifies that certain filing requirements apply to certain surplus line brokers. Requires that the information in a sworn statement be expanded to include certain premium information for single and multistate risks. Requires the filing to apply to a home state insured that directly procures insurance with a nonadmitted insurer. Requires that when multiple brokers are involved in placing a policy, only the one responsible for filing the report would be considered transacting business for tax purposes.

E. Auto

Assembly Bill No. 125 (2011-2012 Reg. Sess.) Guaranteed Asset Protection

Chapter 24 (Assembly Insurance Committee)

Defines guaranteed asset protection ("GAP") insurance. Expands the contractual agreements exempt from the definition of GAP insurance, and from requiring an insurance license to sell, to include the amount owed on the vehicle at the time of an unrecovered theft or total loss, after credit for money received from the purchaser's or lessee's automobile insurer or from a third-party liability insurer, and that the promise may also include a promise to waive some or all of the amount of the deductible.

Assembly Bill No. 1024 (2011-2012 Reg. Sess.) Low Cost Automobile Insurance; Sales

Chapter 401 (Hueso)

Authorizes a state automobile assigned risk plan certified producer to accept and process an application to purchase low-cost auto insurance policies through an Internet website. Requires the plan to coordinate with the California Department of Insurance in order to develop a system for receiving and assigning policies issued through such sites. Requires producer contracts, by way of open bidding, to develop and maintain the website. Relates to applicant disclosure requirements and notification documents.

F. Other

Senate Bill No. 596 (2011-2012 Reg. Sess.) Insurance; Disclosures

Chapter 240 (Price)

Amends an existing law that requires an insurer, upon receiving notice of a claim, to immediately provide the insured with a legible reproduction of the specified Insurance Code section detailing acts prohibited as unfair trade practices, as well as a written notice. Revises the written notice and requires that it be provided to the insured with a legible reproduction of only specified portions of the Insurance Code in at least 10-point type. Requires the insurer to provide a certain code provision when requested.

Assembly Bill No. 624 (2011-2012 Reg. Sess.) State Organized Investment Network

Chapter 436 (Perez J)

Extends the California Community Development Financial Institution ("CDFI") Tax Credit and Certification Program until

2017. The program, which began in 1997, is administered by the California Organized Investment Network ("COIN") within the California Department of Insurance.

The bill also authorizes the Insurance Commissioner to create a COIN advisory board, which will include volunteers knowledgeable in identifying sound investment opportunities for insurers wishing to assist California's low-to-moderate income communities. This board will include insurance industry specialists and others who provide recommendations on how to increase investments in community development projects.

Assembly Bill No. 1416 (2011-2012 Reg. Sess.) Omnibus

Chapter 411 (Assembly Insurance Committee)

Repeals Insurance Code provisions that are inconsistent with more recent legislative enactments, makes technical corrections, and updates the codes to be more consistent with the National Association of Insurance Commissioner's ("NAIC's") Producer Licensing Model Act ("PLMA"). This bill was sponsored by the California Department of Insurance ("CDI") to remove inconsistencies within existing laws governing the business of insurance, and to clarify and clean-up several code sections.

Assembly Bill No. 1425 (2011-2012 Reg. Sess.) Omnibus/Life Settlement Fix

Chapter 414 (Assembly Insurance Committee)

Standardizes the adoption of future regulations implementing California's life settlement law under standard, rather than emergency, APA procedures; repeals an obsolete reporting requirement by the Insurance Commissioner regarding credit insurance agents; and repeals the requirement to adopt emergency regulations in connection with implementing the low-cost automobile insurance program.

Senate Bill No. 712 (2011-2012 Reg. Sess.) Omnibus

Chapter 426 (Senate Insurance Committee)

This bill fixes technical issues from last year's SB 1408 which updated California's life and health guaranty statutes based on NAIC recommended coverage limits and administrative provisions.

III. INSURANCE REGULATIONS

Principally at-Fault Regulations (File No. REG.-2010-00011)

This regulation modifies the process for determining whether a driver was "principally at-fault" for an automobile accident. These regulations modified Title 10 of the California Code of Regulations, sections 2632.13 and 2632.13.1. The regulations were approved by Office of Administrative Law on March 16, 2011. The effective date of the regulation was delayed to allow insurers time to make necessary systems modifications. Effective Date: December 11, 2011.

Estimating Replacement Costs (File No. REG.-2010-00001)

This regulation adds and amends sections within Title 10 of the California Code of Regulations dealing with the process of estimating the replacement cost for homeowners insurance, including sections 2188.65 (Broker-Agent Training), 2190.2 (Required Records), 2190.3 (Records by File), 2695.180 (Definitions), 2695.181 (Standards for Real Estate Appraisers), 2695.182 (Documentation of Person Making Estimate), and 2695.183 (Standards for Estimates of Replacement Values). Effective June 27, 2011. *

**Two trade associations representing insurance companies selling homeowners insurance in California (Association of California Insurance Companies and the Personal Insurance Federation of California) have filed suit in Los Angeles superior court challenging the legality of the regulations based upon a lack of authority by the Insurance Commissioner and constitutional free speech.* ■