UPDATE ON CALIFORNIA LAW

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This update on California law also serves as a reminder about the far reaching developments of 1997 court decisions. In this regard, I have provided summaries of the most recent decisions effecting superior equities, the volunteer defense, inverse condemnation and recovery of defense costs. In addition, a 1998 decision concerning actual cash value is discussed.

Superior Equities

The "superior equities" doctrine means that in the absence of wrongdoing by the party to be subrogated against, a court must weigh in each case the equitable position of the insurer and defendant in determining whether "justice" permits subrogation to be pursued.

Until last year, the court decision in Fireman's Fund Insurance Co. v. Morse Signal Devices (1984) 151 Cal.App.3d 681 provided the modern standard for superior equity claims. In that case, Fireman's Fund sued various Alarm Companies for losses suffered by insureds as a result of burglaries and fires. The court rejected the subrogated negligence claim against the alarm companies, reasoning that it was within the reasonable expectation of the insured that such losses would be covered by insurance. It was unreasonable to expect Alarm companies to indemnify for such risks.

In 1997, the decision in Fireman's Fund Insurance Company v. Wilshire Film Ventures, Inc. (1997) 52 Cal.App.4th 553, provided us with an example for when your subrogation claim is superior to a defendant who is free of wrongdoing. In Wilshire Film Venture, the defendant contractually agreed to pay for any damage to property but breached that contractual duty. In contrast, the subrogated insurer made good faith payment of the claim. In effect, the insurer's decision to honor the policy was a superior position to the defendant's decision to breach the contract. However, if the defendant's breach of contract had only been a failure to obtain insurance, rather than a failure to pay, then the failure by the defendant to obtain insurance would have amounted to failing to insure the same risk as Fireman's Fund had insured. In this instance, subrogation would be barred.

The message: you must evaluate the facts and determine if another (noninsurance company) party has contractually agreed to pay your insured for the damage at issue. If so subrogation is possible.

The Volunteer Defense

The traditional notion held that if there was no coverage for a loss paid by the insurer to its insured then there is no right of subrogation. This principal served to frustrate many a subrogation case. However, in State Farm Fire and Casualty Company v. East Bay Municipal Utility District (1997) 53 Cal. App.4th 769, the court held that an insurer which paid a homeowner's claim, notwithstanding applicable policy exclusions, is entitled to pursue subrogation from the responsible third party.

In other words, if the loss occurs within the policy period and the insuring language applies then payment to the insured may be recouped in subrogation against a wrongdoer, even if you later determine that coverage is barred because of an exclusion in the policy. Such payment should be made under a reservation of rights, just in case there is no viable subrogation claim.

Inverse Condemnation

This serves as an El Nino reminder. If a public entity undertakes emergency repair measures when faced with flood level waters and those measures divert the runoff from its original flow pattern onto an insured's property, there is no inverse condemnation so long as the public entity's actions were reasonable. This was the holding in the Bunch v. Coachella Valley Water District (1997) 15 Cal.4th 432. The days of strict liability for inverse condemnation are over.

Similarly, governmental entities are immune from loss damages arising from fire protection activity and not in connection with the fire (i.e., water damage). Valley Title v. San Jose Water Co., 97 Daily Journal D.A.R 12335 (September 29, 1997).

Defense Costs

In Buss v. Superior Court (TransAmerica Ins. Co.), (1997) 16 Cal.4th 35, the California Supreme Court held that insurers can reserve their rights to reimbursement of defense costs incurred in defending uncovered claims in cases involving both covered and uncovered claims. Buss involved a commercial contract dispute that resulted in a complaint against the Los Angeles Lakers owner, Jerry Buss, which included 27 different causes of action. Only one cause of action, defamation, was potentially covered. The majority of the case centered on breach of contract claims. The California Supreme Court held that under these circumstances, insurers must defend the entire action then seek reimbursement in a separate action.

If the defense costs are substantial, the right of reimbursement may be reserved even if not expressed in the reservation of rights letter. And, if the insured defendant is solvent and potentially able to pay the amount due, then Buss provides firm basis for recovery.

Remember, in this type of case, coverage counsel, Cumis counsel, independent counsel (if required) and the insured's own counsel are potential and probable witnesses. Your subrogation counsel is ideally suited to pursue recovery of these costs. The challenge is to properly allocate costs between covered claims and non-covered claims. (The business decision of whether to pursue recovery from an insured should be addressed on a case by case basis.)

Actual Cash Value

The standard form fire policy provides for valuation of loss settlements based upon actual cash value ("ACV"). Most adjusters and appraisers determined ACV using a formula, replacement cost minus depreciation. At law, subrogation recovery is limited to fair market value (no recover for betterments and improvements). Therefore, under the traditional ACV calculation, if replacement cost less depreciation exceeded fair market value then indemnity amount could never equal recovery amount.

In Cheeks v. California Fair Plan Association, (Feb. 9, 1998) 61 Cal.App.4th 423, the Court of Appeal ruled that for purposes of setting loss values, actual cash value equals fair market value, not replacement costs minus depreciation. (Ironically, the California Supreme Court first rendered this same conclusion in 1970. Jefferson Ins. Co. v. Superior Court (1970) 3 Cal.3d 398.) Therefore, the amount recoverable in subrogation should equal the indemnity amount when standard fire policies are the basis for payment.

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