HINSHAW

Alerts

Court Correctly Applied Subjective Test to Determine Whether Coverage Was Barred as Nonaccidental

July 5, 2012
Insurance Coverage Alert

Brief Summary

California's Second District Court of Appeal recently considered whether defendant, a wife who co-owned rental property with her co-defendant husband, was entitled to indemnity coverage for a judgment awarded to the couple's tenants based on her argument that she was an "innocent co-insured." The wife argued that, unlike her husband, who had been sued in a criminal action related to the maintenance of their jointly owned apartments, she was not aware of the actual conditions at the apartments and could not have expected that the tenants would be injured by the conditions. She asserted that as she did not expect that the tenants would be injured by the conditions at the apartments, their injuries should be construed as "accidents," entitling her to coverage as an "innocent" insured, notwithstanding her husband's knowledge of the conditions at the apartments.

The appellate court found that the trial court had correctly applied the correct subjective standard to determine that neither the wife's nor the husband's liability for bodily injury and property damage had resulted from an "accident" and that it was "expected" by both co-owners.

Complete Summary

Plaintiff insurer was awarded more than $2 million as reimbursement of indemnity monies it had paid to settle habitational-deficiency claims against its insureds by their tenants. The insureds were a married couple who owned apartments in Southern California. They were sued "as co-owners and co-managers" by their tenants, who alleged cockroach infestation, inoperable heating and cooling systems, water leaks, mold and electrical deficiencies and that common areas were maintained in unsafe and unsanitary conditions. The tenants alleged that they made repeated requests for correction of the deficiencies, but that the insureds failed to take proper action. The tenants sought compensatory damages in excess of $10 million. The insurer defended under a reservation of rights, and contributed $2,162,500 to settle the tenants' claims. The insurer then sued the insureds to recover its defense costs and its settlement contribution—together about $2.42 million.

The court of appeal agreed with the trial court that coverage was not owed for the indemnity payments, and that the insurer was entitled to reimbursement because there is no coverage for the "intended, deliberate, and anticipated consequences of acts are not included within the policy coverage for the consequences of accidents." (Ins.Code, § 533 [excludes coverage for willful acts]). The court relied on precedent holding that "[W]hether injury or damage is 'expected or intended' under an insurance policy is determined by reference to the insured's subjective mental state," citing *Hassan v. Mercy American River Hospital*, 31 Cal. 4th 709, 720 (2003).

Both the trial and appellate courts agreed that the wife was not unaware of the conditions at the apartments and that she was not an "innocent co-insured" because she "was in a position to learn, and did learn, sufficient information about the management style and apartment conditions to establish that she should be charged with knowledge of the management methods and decisions that were in use."

A former property manager testified that during the time he had worked for the couple the apartments were in a terrible, unsafe and unsanitary condition and that the owners' decisions were guided only by costs and not by proper management principles. He testified that the husband told him that his "business model was to get new, illegal immigrants from Central America as tenants because they were not aware of their rights and could be threatened with deportation if they complained about conditions." He also testified that he had spoken with the wife about management issues between 25 and 50 times and that he ultimately quit because he was not allowed to perform maintenance or make needed repairs.

Both courts rejected the wife's testimony that, although she and her husband had worked together "full-time with the property management and purchasing properties," she played a somewhat limited role in the management and oversight of the apartments, and that she was not aware of criminal proceedings and code violation notices that had arisen out of the ownership of the rental properties. The trial court found that the wife was more than a ministerial bill payer and rejected the husband's testimony that he had turned the management of the properties over to a property manager and that he also was an uninformed and innocent absentee owner. The evidence established that the husband was an involved and informed owner who insisted on managing his property in a manner that led to poor living conditions for his tenants.

The insurer was not awarded reimbursement of its defense costs because it did not meet its burden under *Buss v. Superior Court*, 16 Cal. 4th 35, 39–40, 50 (1997), to allocate defense costs incurred for the defense of claims that were never potentially covered for those incurred for claims that were potentially covered.

Significance of the Opinion

This opinion is noteworthy as well-reasoned and current discussion of the appropriate application of the subjective standard to determine whether there has been an "occurrence."

Axis Surplus Ins. Co. v. Reinoso, ___ Cal. App. 4th ___, 2012 WL 2389324 (Cal. App. 2 Dist. 2012)

For further information, please contact your regular Hinshaw attorney.

This alert has been prepared by Hinshaw & Culbertson LLP to provide information on recent legal developments of interest to our readers. It is not intended to provide legal advice for a specific situation or to create an attorney-client relationship.