

Golden Gate University School of Law

Professor Joseph Lavitt

Insurance Law - Course No. 845

Final Examination

Saturday, May 6, 2006

Time Allowed: 3 Hours

Insurance Law

Open Book

2:00 p.m. to 5:00 p.m.

Spring 2006

1. This examination is **open book**. You may refer to any materials you brought with you to the examination, but you may not, during the examination, *contact or consult with anyone or refer to anything else*, by phone, internet connection, or otherwise. With the exception of approved laptop computers which are not connected to any external source, including the internet, electronic devices are prohibited.
2. Write your exam number # at the top of this page, each page of questions, and each blue book or typewritten page of your responses. Do not use your name or Social Security Number on any exam materials. At the conclusion of the exam, return all exam materials to the proctor. Students who do not return all exam materials at the end of the exam may not be graded.
3. **WRITERS:** On the cover of all bluebooks, please place your exam label or clearly print your exam number, the course name and number, the professor's name, the semester, and number your bluebooks to indicate their order, stating the total number of bluebooks that you are submitting (i.e., 1 of 4, 2 of 4, etc.) Please write clearly and on every other page.
4. You will need your textbook to complete the examination. As used in this examination, textbook means *Insurance Law and Regulation, Fourth Edition* (Abraham, Foundation Press).
5. You will be allowed **three (3) hours** to complete the examination. You may allocate your time as you wish. There are three hypotheticals, each two pages in length. It is recommended that you spend about one hour on each hypothetical, *and it is recommended that you answer the hypotheticals in the order presented*. Each hypothetical is of equal importance and point value.
6. There is no need to quote policy language in full and verbatim. You may instead support any reference to the terms of a policy by citing to the policy language by section and paragraph, e.g., Commercial General Liability (CGL) Policy, Section I, Coverage A, Para. 2.e.(1). You may, of course, quote the actual policy language as you see fit and as time permits.
7. Answer each question as directly as possible and do not answer questions not asked. Each hypothetical raises numerous issues. Respond *as fully as possible* within the time allowed, but be mindful of your time to make sure you will have an opportunity to respond to *all three* hypotheticals.
8. Explain fully the grounds that support an answer. An answer which is unsupported by a thorough discussion justifying the answer will not receive full credit.

9. Read, think and analyze before you begin to write. Be as clear and concise as possible. Points will not be earned for rhetorical flourishes or fancy language.

ALL EXAMINATION QUESTIONS MUST BE TURNED IN AT THE END OF THE EXAMINATION

GOOD LUCK!

Hypothetical One

Mr. and Ms. Honest Insured, husband and wife, are the joint owners of a single-family, wood-framed residence located in San Francisco, California (the Insured Home). The Insured Home was constructed in 1999. The Insureds bought the Insured Home on December 31, 2003.

In February, 2006, the Insureds bought a new washing machine. The installer of the new washing machine noticed staining on the surface of the wall below the window in the laundry room of the Insured Home, behind the old washing machine being replaced. The installer told Ms. Insured about his observation, and recommended retaining an expert to evaluate the extent of the damage.

Insureds thereupon hired Water Pros, an engineering firm specializing in water damage, to assess the extent of the damage. Water Pros removed a section of the exterior wall in the laundry room below the window, and observed extensive damage to the wood framing thereby exposed. Water Pros reported that the window in the laundry room was improperly constructed, allowing rain water penetration around and below the window. Extensive wet rotting of the wood framing inside the wall resulted from this water intrusion. Water Pros advised the Insureds to retain a general contractor to: a.) remove the exterior siding of the Insured Home to expose the wood framing, b.) repair and replace the rotted wood framing around and below the leaking laundry room window, and c.) upon completion, replace the exterior siding of the Insured Home.

Insured submitted a claim to three insurance companies to cover the cost of performing this recommended work. Really Old Reliable Insurance Company issued an insurance policy to the Insureds, effective from December 31, 2003 until December 31, 2004. Old Reliable Insurance Company issued an insurance policy to the Insureds, effective from December 31, 2004 until December 31, 2005. Newcomer Insurance Company issued an insurance policy to the Insureds, effective from December 31, 2005 until December 31, 2006. All of these insurance policies are identical in form and content to the insurance policy in your textbook at pp. 174-196. Each of the policies identifies the Insureds as the named insureds, properly describes the Insured Home, and provides the Insureds with all of the coverages set forth by the policy, subject to all of the applicable terms of the policy with respect thereto. The policy limits are sufficient, and there are no deductibles.

Each of these insurers hired an engineer to inspect the claimed damage, to evaluate its cause and determine when it occurred.

Newcomer's retained engineer, Mr. I.C. Everything, issued a report indicating that damage to the wood framing of the Insured Home likely happened shortly after it was built, when rain water penetration began because of defects in both the installation and design of the windows throughout the entire structure. According to the Everything Report, by the end of the year 2000, rain water intrusion had likely occurred around nearly every one of the windows of the Insured Home, which started the process of wet rotting the entire wood frame of the structure (once started, such wet rot spreads and grows.) In Mr. Everything's opinion, because the wet rot likely spread throughout the wood framing, the cost to repair and replace all of the rotted framing would approach or exceed the cost to tear down and rebuild the Insured Home.

The expert retained by Old Reliable, Mr. B. Diligent, issued a report opining that, but for rain, there would have been no damage to the wood framing of the Insured Home. Mr. Diligent did not identify rain as the sole cause of the damage to the framing of the Insured Home, and he also noted that the Insured Home had construction defects. According to the Diligent Report: If there were no construction defects and the water penetrated anyway, then technically it got in somehow and rain caused the damage. Asked by Old Reliable to explain this statement further, Mr. Diligent stated: In the Sahara Desert, where it almost never rains, a building built as the Insured Home was built would not suffer rain water penetration, and thus, no wet rot.

Really Old Reliable also hired a professional engineering expert, Mr. Y. Paynow. Mr. Paynow reviewed the reports by Messrs. Everything and Diligent, and thereupon opined that damage to the framing of the Insured Home was caused by defective construction. According to Mr. Paynow, Windows intended to keep out the rain will do so if not defectively designed and installed.

All three insurers obtained an Examination Under Oath of the Insureds. Upon insistent examination, Ms. Insured conceded that she noticed staining on the wall below the window in the laundry room in February 2004, but, she testified, she believed the staining was caused by the washing machine leaking. Mr. Insured corroborated Ms. Insured's testimony, and stated that the washing machine was in fact leaking, and that's the reason it was being replaced. Moreover, Mr. Insured stated, in February 2005, he noticed an inordinate amount of cold air blowing into the Insured Home from around the window frames during rain storms, and he knew, at that time, that something was wrong with the window frames, although he had no idea the framing inside the walls below the windows was rotten or rotting.

You have been retained by the Insureds. They have asked you to describe the full scope of insurance benefits, if any, owed to Insureds by the insurers pursuant to the terms of their homeowner's insurance policies, and to discuss the relevant policy terms, facts and law pertinent to your answer. Be sure to advise the Insureds about defenses to coverage which each of these insurers might assert. Note: Insureds will want to know your view about the merit of any anticipated coverage defenses.

END OF HYPOTHETICAL ONE

Hypothetical Two

John Jones, Inc., a licensed general contractor, is a California corporation (Jones). On April 17, 2006, Mr. and Ms. Honest Insured, husband and wife and joint owners of a single-family residence located in San Francisco, California (the Insured Home) retained Jones, pursuant to a written Construction Agreement (the Contract), to: a.) remove the exterior siding of the Insured Home to expose the wood framing, b.) replace all of the windows and repair and replace all rotted wood framing throughout the Insured Home, and then, c.) upon completion, replace the exterior siding of the Insured Home.

Jones hired a crew, comprised entirely of independent contractors, to perform the work at the Insured Home required by the Contract. Mr. N. Gligent Frammer was retained by Jones to remove the exterior siding and repair/replace the rotted wood framing. Mr. L. Eaky (Eaky) was retained by Jones to install the new windows.

On April 19, 2006, Frammer commenced work at the Insured Home, ripping the exterior siding from the Insured Home, and throwing the debris to the ground in front of the residence in the process. As the exterior siding was removed, Eaky began removing the old windows to make way for the new windows to be installed. In so doing, Frammer and Eaky created a huge pile of debris in front of the Insured Home. While they worked on April 19, 2006, Frammer and Eaky drank beer and chain-smoked cigarettes, nonchalantly tossing the empty beer cans and cigarette butts onto the ground around the Insured Home.

Mr. Insured came home from work at about 6:00 p.m. on April 19, 2006. When he arrived, he was appalled by the state of the work site. Finding the huge pile of debris created by Frammer and Eaky, and their cigarette butts and empty beer cans strewn around in front of the Insured Home, Mr. Insured became enraged. He confronted Frammer and said: What is wrong with you? Clean up this mess right now. In response, Frammer, by now quite intoxicated, picked up a piece of the siding debris and threw it at Mr. Insured. Seeing this, Eaky picked up beer can and threw it at Mr. Insured.

Laughing and hooting, Frammer and Eaky then began bombing Mr. Insured with exterior siding debris. Under attack, and while fleeing for his safety back to his car, Mr. Insured called 911 from his cell phone. He was rushed to the Emergency Room, where he received twenty stitches to sew up a gash in his head caused by the flying debris. (Mr. Insured is unsure whether debris thrown by Frammer or Eaky caused the bleeding gash in his head that required stitches.)

Mr. Insured promptly retained counsel, J.D. Hapless, Attorney at Law. Thereafter, Mr. Insured filed a civil action in state court styled *Insured v. John Jones, Inc., N. Gligent Frammer, L. Eaky and Does 1-10, inclusive* (the Complaint). Mr. Insured's Complaint states two causes of action against Jones: the first for bodily injury arising out of alleged negligent hiring and supervision of Frammer and Eaky, and the second for breach of contract (the contract required Jones to maintain a clean and orderly work site at all times.) The Complaint states a single cause of action against Messrs. Frammer and Eaky, for intentional and malicious conduct causing grievous bodily injury. Mr. Insured's Complaint alleges all of the facts described above in this Hypothetical Two, and, in

addition, contains the following allegation: Jones knew or should have known that Eaky had been previously convicted of assault at the time Jones hired him.

Mr. Insured's Complaint prays for compensatory damages against all Defendants, and, in addition, for punitive damages against both Frammer and Eaky.

Mr. Insured duly served the Complaint on Jones and on Frammer and Eaky after filing. On behalf of Jones, and as a courtesy to Frammer and Eaky, Jones Director of Risk Management, Mr. C. Toit Wenopay, immediately faxed a copy of the complaint to Almost Honest Insurance Company (Almost Honest), along with a handwritten comment on the fax cover sheet: Please handle as a covered loss. We require and expect an immediate response.

Almost Honest issued an insurance policy, in effect at the time of the above events (the Policy). The Policy is identical in form and content of the commercial general liability policy at pp. 442-459 of your textbook. The Policy identifies John Jones, Inc. as the named insured, with limits of \$500,000 each occurrence, a \$500,000 general aggregate limit (other than products/completed operations) and a \$500,000 products/completed operations aggregate limit. Under the Form of Business section in the Declarations, the box labeled Organization, including a corporation (but not including a partnership, joint venture or limited liability company) is checked. The Declarations were duly completed in all other respects.

You represent Almost Honest. Almost Honest has requested that you identify the issues and discuss the relevant policy terms, facts and law pertinent to your answer to each of the following questions:

1. What are Almost Honest's present obligations pursuant to the terms of the Policy with respect to the tender to it by Jones of the suit against Jones by Mr. Insured?
2. What are Almost Honest's present obligations pursuant to the terms of the Policy with respect to the tender to it by Frammer and Eaky of the suit against Frammer and Eaky by Mr. Insured?
3. How do you recommend Almost Honest respond to the tender to it by Jones and Frammer and Eaky of the suit against them by the Insureds? (Almost Honest will need to be able to determine, from your response, the proposed content of any letter(s) to be sent by it to Jones, Frammer and Eaky, individually or collectively, and the specifics of any judicial or other undertaking you may recommend.)

END OF HYPOTHETICAL TWO

Hypothetical Three

Driver was an employee of Speedy Delivery, Inc. (Speedy) on January 5, 2003. While operating her own personal automobile in San Francisco, California on that date, Driver fell asleep, and crashed her vehicle into an oncoming car, occupied by Injured

Parties. Injured Parties thereafter retained an attorney to obtain compensation for their injuries.

Injured Parties attorney contacted Driver to obtain a statement concerning the events leading to the accident. Among other things, Driver explained to Injured Parties attorney that, despite the fact that she was driving her own personal vehicle at the time of the accident, and despite the fact that the accident occurred outside of her regular work hours, she was performing the duties of her employment for Speedy when the accident occurred.

According to Driver's statement, at 2:00 a.m. on January 5, 2003, she was stirred from a sound sleep by a telephone call from the manager of Speedy's local office. The manager was very upset, and ordered Driver to drive to offices of Speedy immediately, to return a certain set of keys that Driver forgot to turn in at the end of her regular shift. Given the late hour, Driver explained, she fell asleep at the wheel of her own car on the way to the Speedy offices.

Injured Parties thereafter filed a civil action against both Driver and Speedy. Speedy and Driver were individually served with the Complaint. Speedy immediately delivered its copy of Injured Parties' Complaint to Good Faith Insurance Company (Good). Good issued a policy of automobile liability insurance to Speedy, as Named Insured, in effect at the time of the accident (the Policy.) Insofar as relevant here, the Policy provided as follows:

We will pay damages for bodily injury for which any Insured becomes legally responsible because of an auto accident. We will have the right and duty to settle or defend, as appropriate, any claim or suit seeking such damages.

As used in this Policy, the term Insured shall mean the Named Insured. Each of the following is also an Insured: An employee of the Named Insured, but only for acts within the scope of that employee's employment by the Named Insured or while performing duties related to the conduct of the Named Insured's business.

Upon tender of the Injured Parties' Complaint, Good promptly agreed to provide a defense to Speedy, and appointed the law firm Schlocky, Grumpy and Stunado (SGS) to represent Speedy. Good took no action to answer the Complaint on behalf of Driver.

Driver had no liability insurance in effect at the time of the accident, and had no idea that she might be entitled to any insurance benefits under any policy issued to Speedy. Thus, she did not tender any request to Good to provide her with a defense to the Injured Parties' Complaint. Because Driver could not afford an attorney to answer the Injured Parties' Complaint, she paid \$25.00 to a local Do It Yourself legal forms supply business, to obtain the necessary forms to answer the Complaint herself. Driver timely completed and filed the forms to avoid a default.

During the course of discovery in the Injured Parties' action, SGS obtained a copy of the statement Driver provided to Injured Parties' attorney. In January, 2004, SGS provided a copy of that statement to Good.

In January, 2005, on motion by Injured Parties, the trial court ruled that the accident occurred while Driver was acting in the course and scope of her employment by Speedy. Good then instructed SGS to undertake Driver's defense. Driver accepted the defense provided by SGS (and paid for by Good.)

In February, 2005, Good settled the action against Speedy and Driver by the Injured Parties. Good paid all of SGS's fees, and Good paid the entire amount of the settlement with Injured Parties on behalf of both Speedy and Driver.

In March, 2005, Driver filed a complaint against Good, setting forth two causes of action: (a) breach of the terms of the Policy and (b) breach of the covenant of good faith and fair dealing (bad faith.) The Driver Complaint against Good alleged, in relevant part:

- }{ Good knew that Driver was acting in the course and scope of her employment by Speedy at the time of the accident, but failed to inform the court, Driver or the Injured Parties of that fact; and
- }{ Good failed to communicate to Driver the availability of coverage under the Policy, which caused Driver years of undue and severe worry and anxiety.

Good moved for summary adjudication (judgment by the court, without jury) solely on Driver's cause of action for breach of the covenant of good faith and fair dealing (the bad faith claim.) After considering all of the facts described above, and hearing argument by the parties, the trial court entered the following Order Granting Summary Adjudication (the Order):

Driver has not produced sufficient evidence to support a common law bad faith action against Good in this case. It is undisputed that Driver did not request coverage from Good. Driver was later found to have been acting within the course and scope of her employment at the time of the accident, but we cannot find bad faith in the failure of Good to immediately realize that based on the facts before it at the outset. Further, it is uncontroverted that Good provided Driver with a defense once the court determined that she had been acting in the course and scope of her employment. Finally, payment by Good of SGS's fees, and Good's settlement of all claims against Driver by the Injured Parties, eliminated any cause of action Driver could have had against Good for bad faith.

Driver has brought an interlocutory (interim) appeal from the summary adjudication. You are a Justice of the Court of Appeal in the State of California. Draft an opinion, either reversing or affirming the Order. You may consider any issues you wish, but be sure to explain the reasons for your opinion about whether the trial court correctly held that the evidence was insufficient as a matter of law to support a common law bad faith action by Driver against Good. Be sure also to describe the damages which Driver would be allowed by law to recover if the trial court is reversed and the jury decides in her favor on the bad faith claim.

END OF HYPOTHETICAL THREE

***** END OF EXAM *****