No. S278481

IN THE SUPREME COURT OF CALIFORNIA

JOHN'S GRILL, INC. et al.,
Plaintiffs and Appellants,

v.

THE HARTFORD FINANCIAL SERVICES GROUP, INC. et al.,
Defendants and Respondents.

AFTER A DECISION BY THE COURT OF APPEAL
FIRST APPELLATE DISTRICT, DIVISION FOUR
CASE NO. A162709

ANSWER BRIEF TO AMICUS CURIAE BRIEF OF AMERICAN PROPERTY CASUALTY INSURANCE ASSOCIATION

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Introduction

Pursuant to California Rule of Court 8.520(f)(7), plaintiffs and appellants John's Grill, Inc. and its owner John Konstin (collectively, "John's Grill") file this response to the Amicus Curiae Brief of American Property Casualty Insurance Association in Support of The Hartford Financial Services Group, Inc. ("APCIA Amicus Brief") filed on December 21, 2023. The arguments of APCIA largely rehash the arguments of defendants and respondents The Hartford Financial Services Group, Inc., and its subsidiary Sentinel Insurance Company, Ltd. (collectively, "Hartford"), but in less detail and sometimes with no supporting legal authority.

This answer brief responds to APCIA's three principal arguments. APCIA's first two arguments are that the illusory coverage doctrine does not apply to coverage conditions, and that the doctrine applies "only when a broader reading of a policy exclusion would eliminate all coverage" under the entire policy at issue. *Id.* at 12. APCIA's third argument is that the unanimous three-justice panel below (Streeter, J., Pollak, P.J., Goldman, J.) failed to fully appreciate that insurance policies issued to small businesses in the United States are not individually negotiated but are based on standard form policies and standard add-on coverages, and that this misunderstanding led the Court of Appeal to adopt an unworkable standard for adjudicating illusory coverage disputes that somehow threatens to

"upend the California insurance market, increase premiums, and potentially reduce available insurance options, to the detriment of California policyholders." *Id.* at 9.

APCIA's arguments fail because they lack legal authority and misread the decision in the Court of Appeal, which demonstrates a thorough understanding of standard insurance policies and endorsements purchased by small businesses, including by using language with which APCIA and Hartford appear to take issue, but that is remarkably similar to language that Hartford itself uses to describe how small businesses can select add-on coverages to "customize" and "tailor" their policies to their specific line of business. In sum, APCIA's amicus brief adds nothing new to Hartford's arguments and only reinforces that the Court of Appeal decision was correctly decided and should be affirmed.

Argument

I. APCIA cites no supporting legal authority for its argument that the illusory coverage doctrine does not apply when insurers use policy conditions to eliminate promised coverage.

APCIA makes a sweeping assertion that "the illusory coverage doctrine does not apply to clear conditions of coverage," but it cites no supporting legal authority. *Id.* at 11. APCIA similarly argues that the Court of Appeal's contrary ruling is "out of line with California law," but fails to specify the California law to which it refers. *Id.* At the same time, APCIA

does not even mention, much less address, the contrary arguments and cited authorities in John's Grill's Answering Brief on the Merits ("Answering Brief") that the illusory coverage doctrine is widely applied not just to exclusions, but also to any policy provision that serves the same function as an exclusion: defining the scope of coverage. *See* Answering Br. at 31-32.

To cite a few specific examples, APCIA ignores case law from numerous state supreme courts indicating that the illusory coverage doctrine applies not just to exclusions, but more broadly to any policy "definition" (Idaho and Rhode Island),[1] "term" (Kentucky),[2] "provision" (Montana),[3] or other "policy language [that] defines coverage" (Wisconsin).[4] Among the many kinds of policy provisions that define

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[1] *Pena v. Viking Ins. Co. of Wisconsin* (Idaho 2022) 169 Idaho 730, 737-38 (illusory coverage doctrine applies "when the declarations page of the policy contains language and words of coverage, then by definition and exclusion takes away the coverage"); *Pressman* v. *Aetna Cas. & Surety Co.* (R.I. 1990) 574 A.2d 757, 759 (holding policy's narrow definition of term was unenforceable because it rendered coverage illusory).

[2] *Thomas v. State Farm Fire & Cas. Co.* (Ky. 2021) 626 S.W.3d 504, 506 (illusory coverage doctrine applies "when an insurer's interpretation of a contract term would deny the insured 'most if not all of a promised benefit'").

[3] *Kenneth & Kari Cross v. Warren* (Mont. 2019) 395 Mont. 62, 76 (concurring op.) (illusory coverage doctrine applies "if a provision defeats coverage for the which insurer received valuable consideration"); *see also U.S. Specialty Ins. Co. v. Estate of Ward* (Mont. 2019) 395 Mont. 199, 206 (any policy interpretation under which "the insurer would hardly, if ever, provide the insured with the amount of coverage she thought she had purchased").

[4] *Marks v. Houston Cas. Co.* (Wis. 2016) 369 Wis.2d 547, 583 (illusory coverage doctrine applies when "policy language defines coverage in a manner that coverage will never actually be triggered").

coverage would certainly be a "condition[] for an exception to an exclusion," which is how APCIA characterizes the specified-cause-of-loss condition at issue here. Amicus Br. at 14.

As John's Grill has previously argued, to adopt Hartford's (and now APCIA's) view that the illusory coverage doctrine applies to only one kind of policy provision that defines the scope of coverage (i.e., exclusions) and not to others "makes no sense analytically" and "improperly elevates form over substance." Answering Br. at 31-32 (citing Cal. Civ. Code § 3528 and related case law). The argument should be rejected.

II. APCIA invites insurer abuses by arguing that the illusory coverage doctrine does not apply if most of a policy's promised coverages are virtually illusory, so long as some coverage remains available under some aspect of the policy.

APCIA also echoes Hartford's argument that illusory coverage issues must be analyzed only at the level of the entire policy or (in a less extreme alternative version of the argument) at the level of the entire endorsement, and not at the level of individual perils for which a policy or an endorsement purports to provide coverage. Amicus Br. at 12. Thus, according to APCIA, there is no illusory coverage problem here both because the specified-cause-of-loss provision about which John's Grill complains does not eviscerate all coverage under the entire Spectrum Business Owner Policy at issue, and because the "Limited Fungi, Bacteria of Virus Coverage" endorsement containing the provision provides non-

illusory coverage with respect to some of the endorsement's named perils other than virus (e.g., fungi). *Id.* at 12.

In so arguing, APCIA ignores the Court of Appeal's sound reasons for rejecting this argument as contrary to foundational principles of contract interpretation, including because it requires rewriting the endorsement to delete the word "virus" from the limited coverage provisions. *See John's Grill, Inc. v. The Hartford Fin. Serv. Grp., Inc.* (2022) 86 Cal.App.5th 1195, 1222 (citing *Energy Ins. Mut. Ltd. v. Ace Am. Ins. Co.* (2017) 14 Cal.App.5th 281, 306, which rejected the insurer's attempt to rewrite the liability policy at issue by interpreting an "*illegal* act" exclusion as excluding losses for liability from *negligent* acts); *see also Palmer v. Truck Ins. Exch.* (1999) 21 Cal.4th 1109, 1115 ("While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply.").

The Court of Appeal's reasoning is also supported by other basic principles of contract interpretation, including that "[w]here a contract admits of two constructions, the court ought to adopt that which is most equitable and which will not give an unconscionable advantage to one party over the other," *Brawner v. Wilson* (1954) 126 Cal.App.2d 381, 384-85, and that contract interpretation "must be fair and reasonable, not leading to absurd conclusions," *Eucasia Schools Worldwide, Inc. v. DW August Co.* (2013) 218 Cal.App.4th 176, 182, *review denied* (Oct. 16, 2013). *See also*

Safeco Ins. Co. of Am. v. Robert S. (2001) 26 Cal.4th 758, 765, citing Cal. Civ. Code §§ 1650, 1652, 1653 (contract "[l]anguage involving an absurdity is rejected, and so is any phrase or clause which is inconsistent with the object and intention of the parties"); *Ins. Co. of N. Am. v. Elec. Purification Co.* (1967) 67 Cal.2d 679, 691 (warning insurers with convoluted policies that "build[] … one condition or exception upon another in the shape a linguistic Tower of Babel," instead of drafting policies with "clarity and simplicity," that they run the risk of courts refusing to uphold their denials of coverage based on that language). APCIA's amicus brief simply ignores all these basic principles of contract law, which the Court of Appeal persuasively found must be considered in the legal analysis.

III. The Court of Appeal understood that insurance policies issued to small businesses (including the Policy here) are based on standard form policies and standard add-on coverages, and it structured its decision around that reality.

APCIA argues that the Court of Appeal's decision ignores, or somehow fails to fully understand or appreciate, the reality that small businesses like John's Grill "typically purchase the insurance they need by choosing among the available coverages contained in an insurer's standardized policy forms" as supplemented by "add-on coverages that might pertain specifically to their business," and that small businesses "typically do[] not separately negotiate the terms of a policy form or add-on

coverage in an endorsement." Amicus Br. at 14-15. Nothing in the Court of Appeal's opinion indicates the unanimous panel was ignorant of this reality, which is common knowledge among attorneys generally and certainly would have been understood by the three highly experienced jurists on the First District Court of Appeal. Indeed, the decision below, authored by Justice Streeter, consistently demonstrates great facility with the structure and components of the Policy at issue, as one would expect from any Court of Appeal decision certified for publication.[5]

[5] To the extent that APCIA is impliedly criticizing the Court of Appeal for describing policy endorsements as "customizing" the standard provisions in policies' main property coverage forms or as "tailoring" them to policyholders' lines of business (*see, e.g.*, *John's Grill*, 86 Cal.App.5th at 1208, 1216), or arguing that this shows the Court of Appeal mistakenly believed that small businesses like John's Grill typically negotiate "bespoke" policy language, such criticism is belied by the decision below. *See id.* at 1217 ("That is what endorsements typically do. They modify the main body of an otherwise standardized form, thereby customizing it for purposes of the endorsement, which is an objective the parties to this insurance contract plainly had, given the tailored nature of several of the endorsements they agreed upon"). Moreover, the "customizing" and "tailoring" language is fully consistent with Hartford's own representations on its website that a business owner policy ("BOP"), such as the Policy here, can be "**custom**-made to fit industry specific businesses … that generally face the same risks," and that "[n]o matter what type of business you own, BOP Insurance can be expertly **tailored** to your business." The Hartford, "Business Owner's Policy," https://www.thehartford.com/business-owners-policy (last visited Jan. 22, 2024) (emphases added); *accord id.* ("Customizing your BOP Insurance is an important first step when insuring your business."); *id.* ("There are additional coverages that you can add to your Business Owner's Policy (BOP) to help tailor coverage to your specific needs."); *see also* Amicus Br. at 16 ("Policyholders may bargain for different provisions and protections they would like to incorporate into their policies and pay premiums correlated to the coverage they choose.").

Moreover, contrary to APCIA's stated concerns, nothing in the decision below can be fairly read as imposing an absurd rule that "insurers in California must ensure that every aspect of each policy provision is foreseeably beneficial to each individual policyholder" in order to protect themselves from an illusory coverage argument. Amicus Br. at 8. It is undisputed that most individual insureds like John's Grill with a more-than-200-page policy would likely find in that policy coverage for perils that are not relevant to their line of business or individual circumstances. In that circumstance, the insured has simply purchased a form policy that contains coverage against some perils that are irrelevant to the insured's line of business, much in the same way that a person buying a new car or laptop will likely discover that, among the product's hundreds of features, there are a few features that the person will never use. Such irrelevant coverages pose no risk of raising an illusory coverage issue for the simple reason that the covered peril is irrelevant to the insured's line of business, and thus will never be the basis for the policyholder to seek coverage or for the insurer to deny a claim.

On the other hand, when a policy purports to provide coverage for a peril that *is* relevant to the insured's line of business, the policy must provide non-illusory coverage with respect to that peril. Here, John's Grill is a San Francisco restaurant that purchased a Hartford "Spectrum Business Owner Policy" that purports to provide "Limited Fungi, Bacteria or Virus

Coverage" covering property damage (including "the cost of removal" of each of the named perils from the insured premises) and providing business interruption coverage. It is self-evident that each of those perils could foreseeably impact a San Francisco restaurant. Accordingly, as the Court of Appeal correctly held, the policy must provide a restaurant policyholder like John's Grill some "realistic prospect of [the restaurant] benefitting from [each aspect of the coverage] based on events the parties might reasonably have anticipated" at the time of contracting. *Id.* at 1224.

In the Court of Appeal's view, courts should not adjudicate illusory coverage arguments by asking (as APCIA and Hartford urge) whether it is possible to imagine a situation in which the challenged provision might provide coverage for any conceivable insured in any line of business in any part of the country; rather, courts should focus on the policyholder's line of business, which the Court of Appeal described as the "actual business circumstances as underwritten by the insured." *John's Grill*, 86 Cal.App.5th at 1224.

The "line of business" level of generality used by the Court of Appeal (as opposed to an "individual policyholder" or an "every conceivable policyholder" level of generality) is the correct level of analysis for adjudicating illusory coverage disputes in the context of commercial property insurance purchased by a small business. *Cf. supra* note 5 (Hartford stating that its business owner policies can be "custom-

made to fit industry specific businesses," which "generally face the same risks"). This makes clear the correctness of the Court of Appeal's holding below rejecting Hartford's (and now APCIA's) attempt to defeat John's Grill's well-pleaded illusory coverage argument by using cases involving policies insuring against risks in a different region of the country for an entirely different line of business. *See John's Grill*, 86 Cal.App.5th at 1223 (rejecting Hartford's reliance on *Curtis O. Griess & Sons v. Farm Bur. Ins.* (1995) 528 N.W.2d 329).

Conclusion

The Court of Appeal was correct in its articulation and application of California's illusory coverage doctrine, in its interpretation of the Limited Virus Coverage's express definition of loss or damage, and in its disposition of the appeal. This Court should affirm the decision below.

Respectfully submitted,

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Pursuant to California Rule of Court 8.520(c)(1), I certify that this Answer Brief to Amicus Curiae Brief of American Property Casualty Insurance Association, including footnotes, contains 2,443 words, as calculated by the Microsoft Word software used to prepare this brief.

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STATE OF CALIFORNIA
Supreme Court of California

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