SUPREME COURT
FILED

NOV 01 2017

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Deputy

S239510

IN THE SUPREME COURT OF CALIFORNIA

PITZER COLLEGE,
Petitioner,

vs.

INDIAN HARBOR INSURANCE COMPANY,
Respondent

QUESTIONS CERTIFIED BY THE NINTH CIRCUIT COURT OF APPEALS
CASE NO. 14-56017

RESPONDENT INDIAN HARBOR INSURANCE COMPANY'S ANSWER TO AMICUS CURIAE BRIEF OF UNITED POLICYHOLDERS

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INTRODUCTION

The submission by United Policyholders ("UP") offers no new or persuasive basis to change long-standing California law in a way that would allow Pitzer to avoid its contractual obligations and recover almost $2 million in remediation costs it spent on its own, months before notifying Indian Harbor of its discovery of soil contamination. UP's arguments fail for the same reasons that Pitzer's do.

To override this State's strong public policy in favor of choice of law provisions, a competing public policy must be "fundamental." UP ignores that this Court in the *Gantt* case held that "fundamental" policies are "delineated in constitutional or statutory provisions." UP also disregards the fact that *Nedlloyd* carried this standard forward in the context of analyzing choice-of-law provisions, and this Court later broadened the standard to include unconscionable contractual provisions. With only one exception (a federal trial court case that is irreconcilable with *Nedlloyd*), this standard has been uniformly applied by California courts, and the cases cited by UP all demonstrate this. Because it is undisputed that the notice-prejudice rule does not fall into these categories, the public policy basis for the rule is not "fundamental."

While UP addresses what it believes the standard for "fundamental" is not, UP has not articulated what it believes the standard is. UP jumps to the conclusion that the notice-prejudice rule is a "fundamental" policy because California courts have expressed an interest in protecting policyholders. But one does not flow from the other. California's interest in adding an element to the proof required for the late notice coverage defense does not compel the conclusion that a policy's choice of law clause should not be enforced. California's public policy in favor of enforcing such clauses is at least as strong a policy as the notice-prejudice rule. UP's position also ignores that the dispute here is not one that should require

such protection: the contract here was entered into by two sophisticated parties that both had insurance experts representing their interests.

UP also has not come forward with any compelling reason the consent provision should not apply on its face, as it has been by numerous California courts (including this one) for decades. UP's argument that the Indian Harbor policy is a first-party policy is both untrue and irrelevant. UP's contention is based on its description of the Indian Harbor policy as providing "indemnification for direct losses," but the Indian Harbor policy provides coverage for Pitzer's *liability*, not losses, a key distinction between third-party and first-party policies. Regardless of the classification of Indian Harbor's policy, there is no basis to ignore the consent provision. Indian Harbor had the right to be involved with the remediation in order to ensure the efficient and effective resolution of Pitzer's liability for pollution, and it was deprived that right. The well-established policy justifications for enforcing the consent provision without a showing of prejudice therefore apply here.

UP's ambiguity argument is inappropriate and incorrect, and it should be rejected by this Court. Specifically, the issue of any alleged ambiguity in the policy is not before this Court, and Pitzer has conceded the point by admitting that, if New York law applies, it loses. If that were not the case, review of the questions certified to this Court would not be necessary. This Court should not consider an argument not before it and raised for the first time in the more than four years of this litigation by an amicus curiae. Further, the argument has no merit. The policy is not ambiguous and requires both prompt notice and Indian Harbor's prior consent before commencing remediation and incurring costs. Pitzer, a party to the contract, has never contended that it did not understand what these provisions meant, and the record establishes that it and its broker understood the provisions in the exact same way as Indian Harbor did. Any

argument for a new interpretation raised by a non-party to the contract is without merit and should not be entertained at this point in the litigation.

For these reasons and those set forth in Indian Harbor's Answering Brief, Indian Harbor respectfully requests that the Court answer both certified questions in the negative.

ARGUMENT

I. THE NOTICE PREJUDICE RULE IS NOT A FUNDAMENTAL POLICY OF CALIFORNIA FOR CHOICE OF LAW PURPOSES

A. UP Incorrectly Describes the Standard for What Qualifies as a "Fundamental" Policy

UP does not dispute that, to negate the parties' choice of law in a contract, the California policy must be "fundamental." (*Nedlloyd Lines B.V. v. Superior Court* (1992) 3 Cal.4th 459, 466 (the last step of the analysis is "whether the chosen state's law is contrary to a *fundamental* policy of California"); Restatement (Second) of Conflict of Laws § 187(2)(b) (". . . application of the law of the chosen state would be contrary to a fundamental policy of a state . . .").) This "fundamental" standard has significance and means that the policy must be more than merely "strong," as discussed in Indian Harbor's answering brief (pp. 22-25).

UP (and Pitzer in its reply brief) ignores this Court's prior pronouncement of what makes a policy "fundamental" such that it can override another, competing, policy. In *Gantt v. Sentry Insurance* (1992) 1 Cal.4th 1083 (decided six months before *Nedlloyd*), this Court held that an employee, to override the public policy behind the at-will employment rule,[1] must show that the interests they seek to protect are "carefully

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[1] "The California Supreme Court has held that the presumption of at-will employment exists because of public policy considerations." (*Haycock v.*

tethered to fundamental policies *that are delineated in constitutional or statutory provisions.*" (*Id.* at 1095 (emphasis added).)

Nedlloyd reiterated this test by describing the required showing to avoid a choice of law clause as follows: a "*government regulatory policy* designed to restrict freedom of contract" and a "*California statute or constitutional provision* designed to preclude freedom of contract." (*Nedlloyd*, 3 Cal.4th at 468, 471 (emphasis added).) UP offers no explanation of what this Court meant in these statements if not that the requisite policy must arise from statute or a constitution, just as held in *Gantt.* In the choice of law context, the requisite test has been expanded to include situations where a contractual clause is so unfair as to be unconscionable. (*Discover Bank v. Superior Court* (2005) 36 Cal.4th 148.) This makes sense, because by statute an unconscionable provision may be unenforceable. (*See*, *e.g.*, Cal. Civ. Code, § 1670.5(a) ("If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.").) And the standard for unconscionability is so high (e.g., a provision "shock[s] the conscience" (*Sonic-Calabasas A, Inc. v. Moreno* (2013) 57 Cal.4th 1109, 1145)) that this additional exception does not swallow the rule in favor of enforcing choice of law clauses.

Nedlloyd made no mention of a "fundamental" policy arising from ordinary common law. And, as set forth in Indian Harbor's answering

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Hughes Aircraft Co. (1994) 22 Cal.App.4th 1473, 1488, *as modified on denial of reh'g* (Feb. 28, 1994).)

brief, California courts have, for decades (and with only one exception), applied the "fundamental" policy in the way described by Indian Harbor: limited to what has been expressed in a statute, constitution, or rule of unconscionability. (*See* Answering Brief, pp. 29-31.) Indian Harbor continues to assert that the outlier case of *Tri-Union Seafoods, LLC v. Starr Surplus Lines Ins. Co.* (S.D. Cal. 2015) 88 F.Supp.3d 1156 is contrary to *Nedlloyd*, was incorrectly decided, and should not be relied on to change California law. (See Answering Brief discussion at pp. 31-32.)

UP's sole argument with respect to *Tri-Union* is that it is not contrary to *Nedlloyd* because: "The elements of adhesion and public interest – which are implicated in insurance policies – were not at issue with the contract analyzed in *Nedlloyd*." (UP Brief, at p. 19.) However, the relationship in *Nedlloyd* was a *more* protected one than the insurer-insured relationship – a fiduciary's duty to its principal. (*See, e.g., Vu v. Prudential Prop. & Cas. Ins. Co.* (2001) 26 Cal.4th 1142, 1150-1151 (holding that the insured-insurer relationship does not rise to the level of a fiduciary relationship).) Moreover, this Court has made clear that the *Nedlloyd* rule and test applies just as strongly to contracts of adhesion as any other contract. (*See, e.g., Washington Mutual Bank, FA v. Superior Court* (2001) 24 Cal.4th 906, 917-918 (holding that the *Nedlloyd* analysis applies "in the context of consumer adhesion contracts").) The type of reasoning employed by *Tri-Union* does not comport with precedent and would undermine parties' ability to accurately predict the enforceability of their choice of law clauses. The better answer is that *Tri-Union* cannot be reconciled with *Nedlloyd* and thus should be disregarded.

The cases discussed by UP do not provide support for its argument, because all are consistent with Indian Harbor's position. UP first sets up the strawman argument that Indian Harbor has argued that a fundamental policy can only be found in a statute and then UP provides contrary

examples. However, Indian Harbor's position, set forth extensively in its answering brief, is that a fundamental policy can be found in a statute, constitution, or rule of unconscionability. Thus, UP's citation to *Klussman* does not contradict Indian Harbor's argument, but rather supports it. (*Klussman v. Cross Country Bank* (2005) 134 Cal.App.4th 1283 (class action waiver unconscionable under California law so choice of law provision not enforced).)

UP's citation to an unpublished federal trial court case (*Fundingsland v. Omh Healthedge Holdings, Inc.* (S.D. Cal. May 26, 2016) No. 15-CV-01053-BAS(WVG), 2016 WL 3022053) is unpersuasive. The court's choice-of-law discussion cited by UP was dicta: "the Court does not need to determine whether California law ultimately applies." (*Id.* at *9.) In that discussion, the court stated only that there was a "possibility" that California law applied. (*Id.*) Moreover, it appears that the issue the *Fundingsland* court was addressing – whether a litigant can waive its right to a jury trial through a pre-dispute contract – has been resolved by California courts by reference to the California Constitution and Code of Civil Procedure, and thus falls within the test for "fundamental" created by *Nedlloyd*. (*See, e.g.*, *Grafton Partners L.P. v. Superior Court* (2005) 36 Cal.4th 944.)

With a citation to a Washington case, UP argues that "protecting parties in a weaker bargaining power (like Pitzer here) is a fundamental public policy of California." (UP Brief, p. 18.) First, *McKee v. AT & T Corp.* (2008) 164 Wash.2d 372 is entirely in keeping with Indian Harbor's position: that case finds that New York law conflicts with Washington's fundamental public policy of allowing class actions, a waiver of which has been found unconscionable. (*Id.*, citing *Scott v. Cingular Wireless* (2007) 160 Wash.2d 843, 854.) Thus, *McKee* is consistent with cases relied on by Indian Harbor, such as *Discover Bank v. Superior Court* (2005) 36 Cal.4th

148, which declined to enforce a choice of law provision because a class action waiver was unconscionable under California law.

In addition, as discussed below, Pitzer did not have "weaker bargaining power" than Indian Harbor. It is a sophisticated entity with insurance experts representing it during the negotiation and underwriting of the policy. Further, the *McKee* decision does not stand for the proposition that anytime there is a party with superior bargaining power, all issues arising under the contract will be deemed "fundamental." Such a rule would not give effect to this Court's rule that enforcing choice of law clauses is a strong California public policy. (*See, e.g.*, *Nedlloyd*, *supra*, 3 Cal.4th at 464-465 (California has a "strong policy favoring enforcement" of choice of law provisions).)

UP argues that "[d]ecisional authority impacting the insurer/policyholder relationship, including the notice-prejudice rule, are a matter of substantial public interest and should be considered in a choice-of-law analysis." (UP Brief, p. 20.) UP cites no authority for this proposition. In addition, there is no "substantial public interest" here: two private entities contracted for New York law, but one seeks to avoid that law it agreed to in order to obtain reimbursement for almost $2 million it unilaterally spent several months before it bothered to notify its insurance carrier of its discovery of pollution or the work it wanted to perform. If any public interest exists here, it is that of the public's interest to rely on contractually agreed choice of law provisions.

B. The Notice Prejudice Rule is Not a "Fundamental" Policy of California

1. California's Purported Interest in Protecting Policyholders Does Not Make the Notice-Prejudice Rule a "Fundamental" Policy

UP devotes much of its brief to discussing California's purported interest in protecting policyholders. This is a red herring.

California's interest in protecting policyholders does not mean that all insurance-related issues are "fundamental" policies. This would negate choice of law provisions in all insurance policy disputes where California law favored the policyholder, which is not the law in California. After all, insurance contracts are interpreted according to typical contract rules. (*Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1264 ("While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply.").)

In addition, UP's argument ignores that, despite any interest in protecting policyholders, California regularly upholds insurance provisions that limit or preclude coverage to policyholders, including other types of timed notice requirements and other conditions of the policy, without a requirement of prejudice. (*See, e.g.*, *Venoco, Inc. v. Gulf Underwriters Ins. Co.* (2009) 175 Cal.App.4th 750, 760 (requirement of notice within 60 days of an accident upheld in pollution buy-back clause); *Pacific Employers Ins. Co. v. Superior Court* (1990) 221 Cal.App.3d 1348, 1357 (holding that the notice-prejudice rule does not apply to claims-made policies); *Insua v. Scottsdale Ins. Co.* (2002) 104 Cal.App.4th 737, 746 (consent provision enforced); *State Farm Fire & Cas. Co. v. Sup. Ct.* (1989) 210 Cal.App.3d 604, 612 (upholding failure to comply with first-party policy's contractual time limitation to bring a lawsuit against an insured).) California's interest in protecting policyholders does not mean that coverage will always be

found or that no time limits or conditions will be enforced without a showing of prejudice.

The cases cited by UP – *Egan v. Mut. of Omaha Ins. Co.* (1979) 24 Cal.3d 809 and *20th Century Ins. Co. v. Superior Court* (2001) 90 Cal.App.4th 1247 – address different issues than those under consideration here. In both *Egan* and *20th Century*, the courts were pointing to the "quasi-public" nature of the insured-insurer relationship as a reason for the existence of a tort remedy (e.g., bad faith) against an insurer – there is no tort remedy sought or bad faith alleged here.[2] In addition, *Egan* involved the payment of disability benefits to an individual and *20th Century* involved a homeowners' insurance policy, where the alleged "quasi-public" nature of an insurer's obligations and alleged unequal bargaining power may be more of a concern. Here, there is no proof that there was unequal bargaining power or that Pitzer was the type of policyholder that required protection "against the oppressive use of superior bargaining power": the policy is a contract entered into by two sophisticated parties, and Pitzer had others (including insurance professionals) negotiating and buying specialized insurance on its behalf.

Similarly, whether this is a contract of adhesion does not bear on the question of the enforceability of either the notice requirement or the choice of law clause in the policy. (*See, e.g., Gribaldo, Jacobs, Jones & Associates v. Agrippina Versicherunges A.* (1970) 3 Cal.3d 434 (enforcing consent requirement regardless of prejudice); *Washington Mutual Bank, FA, supra*, 24 Cal.4th at 917-918 ("California . . . has no public policy against the enforcement of choice-of-law provisions contained in contracts of adhesion where they are otherwise appropriate.").)

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[2] UP has misattributed its leading quotation to *Egan*, when it actually appeared in *20th Century*.

As part of its "quasi-public" discussion, *20th Century* pointed to the fact that the insurance industry is highly regulated. This is true. And to the extent California public policies are set forth in statute or regulations, they may qualify as a "fundamental" policy sufficient to overcome the parties' choice of law. However, when the legislature has not spoken – and California is not a state in which there is statutory adoption of the notice-prejudice rule generally or a statutory bar against choice of law clauses in insurance policies – then it has not deemed the policy sufficiently important to be treated as a fundamental policy. Therefore, Indian Harbor's position on what policies rise to the level of abrogating choice of law provisions is consistent with the scope of insurance regulations.

In addition, California courts have never applied the notice-prejudice rule in the context of a claims-made-and-reported policy between two sophisticated parties, and this Court should find that the rule does not apply in this context.

2. The Notice-Prejudice Rule is Not a "Fundamental" Policy and Should Not Apply Here in Any Event

Because the notice-prejudice rule is not found in a statute, constitution, or rule of unconscionability, it is not a fundamental policy that overrides the parties' agreement that New York law applies. In keeping with this standard, the notice-prejudice rule has never been held to be a "fundamental" policy of California.

As set forth in Indian Harbor's answering brief, the notice-prejudice rule – which does no more than add an element to an affirmative defense of breach – is not the type of public policy that has been held to overcome parties' contractual choice of law. In addition, the limited scope of the notice-prejudice rule – it has only been held to apply to certain policies in certain situations (i.e., a prompt notice provision in an occurrence-based third-party liability insurance policy) – means that it cannot be

"fundamental" under an ordinary understanding of that term. UP repeatedly asserts that the notice-prejudice rule is a "mandatory" one. This is patently untrue. While the notice-prejudice rule is a policy in California in certain circumstances, there are many situations where the notice prejudice rule does not apply. (*See* discussion above and Answering Brief, pp. 36-37.) A common law rule that does no more than add an element to an affirmative defense, with such limited scope of application, cannot be deemed "fundamental."

Also as set forth in Indian Harbor's answering brief, no California court has addressed whether the notice-prejudice rule applies to the separate prompt notice requirement in the conditions of a claims-made policy with a reporting requirement. Indian Harbor respectfully urges this Court to expressly hold that the notice-prejudice rule does not apply at all in the context of this type of policy, where such contract is between sophisticated parties, in keeping with the New Jersey Supreme Court decision in *Templo Fuente De Vida Corp. v. National Union Fire Ins. Co. of Pittsburgh* (2016) 224 N.J. 189. UP did not address these arguments.

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For the above reasons and those set forth in Indian Harbor's answering brief, Indian Harbor respectfully requests that this Court answer the first certified question in the negative.

II. THE NOTICE-PREJUDICE RULE CANNOT AND SHOULD NOT BE APPLIED TO THE CONSENT PROVISION HERE

UP has cited no compelling reason to ignore this Court's long-standing rule that no prejudice need be shown to enforce the consent provision of an insurance policy. This policy is not a first-party policy and, even if it were, the consent provision should be enforced, consistent with well-established precedent.

A. The Indian Harbor Policy is Not a First-Party Policy

UP argues that "this case involves a first-party claim because Pitzer seeks indemnification for direct losses and there is no injured third-party." (UP Brief at p. 23-24.) It is not true that the policy indemnifies "direct losses." In fact, the policy does not cover losses at all, but rather it covers liability for remediation: Indian Harbor does not reimburse Pitzer for the value of its land but rather for the cost of cleaning it up when Pitzer is legally obligated to do so. Therefore, the distinction UP attempts to draw is based on a false premise.

UP's description also overly simplifies the difference between first-party and third-party policies. As Indian Harbor discussed extensively in its answering brief, the true distinction between these types of policies is not the technicality of who receives money under the policy; rather, the key is what the money is for: loss or liability. (*See, e.g., Montrose Chemical Corp. v. Admiral Ins. Co.* (1995) 10 Cal.4th 645.) Here, Indian Harbor did not agree to reimburse Pitzer for any "loss"; instead, it agreed to pay for legally required remediation. Moreover, the existence or non-existence of a claimant is irrelevant. That is not what distinguishes first-party and third-party policies. In any case, there is a claimant in environmental liability: the enforcement entity that can enforce the law if an adequate remediation is not performed.

This Court in *Garvey v. State Farm Fire & Casualty Co.* (1989) 48 Cal.3d 395 also discussed the difference between first- and third-party liability:

> Liability and corresponding coverage under a third-party insurance policy must be carefully distinguished from the coverage analysis applied in a first-party property contract. Property insurance, unlike liability insurance, is unconcerned with establishing negligence or otherwise assessing tort liability. . . . Property insurance . . . is an agreement, a contract,

> in which the insurer agrees to indemnify the insured in the event that the insured property suffers a covered loss . . . .

(*Id.* at 406 (quoting Bragg, *Concurrent Causation and the Art of Policy Drafting: New Perils for Property Insurers* (1985) 20 Forum 385, 386-387).) Although Pitzer's negligence may have been irrelevant (as it sometimes is under various environmental laws),[3] its liability for the pollution condition was required for there to be coverage. Thus, it is liability and not loss that gives rise to the relevant coverage under the Indian Harbor policy.

In support of its argument that this is a first-party policy, UP cites to the definition of "RESTORATION COSTS," which provides coverage for certain "costs incurred by the INSURED."[4] (ER 224.) However, no "RESTORATION COSTS" are at issue here. In addition, "RESTORATION COSTS" are simply one type of cost under "REMEDIATION EXPENSE," which itself must be "required by" law or a "legally executed state voluntary program." (*Id.*) Moreover, the fact that the policy arguably has some element of first-party coverage does not change the overall force and effect of the policy. For example, a traditional third-party commercial general liability policy provides coverage for

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[3] Notably, there are many situations where negligence is not necessary for liability to exist, as in any strict liability imposed by law, and yet these liabilities are insured by third-party liability policies. (*See, e.g.*, *Fibreboard Corp. v. Hartford Accident & Indemnity Co.* (1993) 16 Cal.App.4th 492, 502 (finding coverage under third-party policy for strict product liability); *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 836 (finding coverage for CERCLA claims under third-party policy and noting: "CERCLA, for example, is a strict liability statute that serves essentially remedial goals, irrespective of fault.").)

[4] UP actually calls it "REMEDIATION COSTS" but there is no such term in the policy. In addition, UP incorrectly quotes the definition of "RESTORATION COSTS." (ER 224.)

"Supplementary Payments," which includes coverage for "All reasonable expenses *incurred by the insured* at our request to assist us in the investigation or defense of the claim or 'suit' . . . ." (Emphasis added.)

The difference between the definition of "RESTORATION COSTS," on the one hand (which provides some coverage for real or personal property damaged in the course of remediation required because of legal liability), and the rest of the policy, on the other hand, which provides coverage to Pitzer for its liability for certain pollution conditions, demonstrates that the policy is not a first-party policy. In addition, Pitzer incurred defense costs relating to its pollution liability and the remediation, which costs it has sought from Indian Harbor. Coverage for defense costs is one of the hallmarks of a third-party liability policy.

UP seems to suggest that because Pitzer would be the recipient of money paid under the policy, that means this is a first-party policy. However, the only reason that is the case is because Pitzer proceeded to incur the almost $2 million in remediation costs prior to notifying Indian Harbor. If Indian Harbor had been properly notified and given consent for remediation, Indian Harbor would have paid those costs itself (after Pitzer's satisfaction of the self-insured retention), directly to the companies undertaking the remediation: Indian Harbor's obligations are to "pay on behalf of" the insured for covered costs (ER 221). This is distinguishable from a first-party situation (e.g., in the property or disability context), where benefits are owed directly to the insured.

The coverage provided under the Indian Harbor policy is not for "direct losses" but for liability, so the policy is a third-party policy.

B. Regardless, a Prejudice Requirement Should Not Be Read Into the Consent Provision

UP suggests that because some courts have identified some differences between first-party and third-party insurance in certain

circumstances, that means the consent provision should not apply here. However, just because California courts have found differences in how types of policies are treated in certain other respects not implicated in this case, does not mean that a consent provision cannot and should not be enforced in both types of policies. While first- and third-party insurance is different in some respects, it is not different in all respects. The cases cited by UP for its proposition address entirely different circumstances. (*See Garvey*, *supra*, 48 Cal.3d at 399, 405 (holding that the determination of cause is different in first-party and third-party policies); *Howard v. American Nat. Fire Ins. Co.* (2010) 187 Cal.App.4th 498, 530, *as modified on denial of reh'g* (Sept. 9, 2010) ("differences in determining the scope of the implied covenant of good faith and fair dealing and the obligations the covenant imposes on an insurer"); *Shell Oil Co. v. Winterthur Swiss Ins. Co.* (1993) 12 Cal.App.4th 715, 764, *reh'g denied and opinion modified* (Feb. 22, 1993) (differences in defense obligation).)

In addition, the justifications advanced by California courts for applying the consent provision without a prejudice requirement demonstrate that the consent provision here should be enforced. For example, *Gribaldo* explained one reason behind not requiring a showing of prejudice in the consent context: because the purpose is "to prevent collusion as well as to invest the insurer with the complete control and direction of the defense or compromise of suits or claims." (*Gribaldo*, *supra*, 3 Cal.3d at 449.) Similar reasoning applies here. The insurer has a right to "complete control and direction" over the way that remediation it will pay for is conducted and to determine what form of remediation will resolve the insured's liability, prevent future liability, be most cost-effective and efficient, and will preserve rights of subrogation, among other objectives. After all, the insurance company of pollution liability is in the best position to effectuate these goals, as it has overseen remediation