No. S278481

IN THE SUPREME COURT OF THE STATE 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 Published Decision by the Court of Appeal First Appellate District, Division Four, Case No. A162709, Partially Affirming and Partially Reversing a Judgment Entered by the Superior Court for the County of San Francisco, Case No. CGC20584184, The Honorable Ethan P. Schulman, Presiding.

REPLY IN SUPPORT OF PETITION FOR REVIEW

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes and Rules

Other Authorities

INTRODUCTION

Sentinel filed a petition urging this Court to review the First District's decision because it "is both wrong and pernicious." Pet. at 14. Wrong, because it misreads the Policy and misapplies the illusory-coverage doctrine. Pernicious, because, while the First District insisted it was addressing only "[t]he particular policy language in this case," Op. at 26, it did so by radically altering the illusory-coverage doctrine in ways that will cause confusion in other insurance-coverage and contract cases and that could disrupt the California insurance market.

In the weeks since the petition was filed, the need for this Court's review has only intensified. The Ninth Circuit Court of Appeals, in a case involving a similar policy with a similar "Limited Coverage" provision, declined to follow the First District's decision and instead certified a question concerning the application of the illusory-coverage doctrine to this Court. *See French Laundry Partners, LP. v. Hartford Fire Ins. Co.* (9th Cir. 2023) 58 F.4th 1305.[1] The Fourth District, in another case against Sentinel, ordered supplemental

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[1] The Ninth Circuit has stayed at least two other appeals, waiting for this Court to rule on the issues addressed in the First District's decision. *See Kevin Barry Fine Arts Ent't, LLC v. Sentinel Ins. Co.* (9th Cir. Feb. 15, 2023) No. 21-15240, Dkt. 71; *Mostre Exhibits, LLC v. Sentinel Ins. Co., Ltd.* (9th Cir. Feb. 9, 2023) No. 22-55191, Dkt. 59.

briefing on whether the First District's decision is correct. *See Showa Hosp., LLC v. Sentinel Ins. Co., Ltd.* (Cal. App. Feb. 10, 2023) No. D080008. Meanwhile, a federal district court in California cited the First District's discussion of the illusory-coverage doctrine in interpreting a completely different exclusion in another insurance company's policy. *See C.J. Segerstrom & Sons v. Lexington Ins. Co.* (C.D. Cal. Feb. 27, 2023) No. 22-cv-466, Dkt. 52 at 15.

What these developments show is that the First District's decision has already had—and will continue to have—an outsized impact on the interpretation of insurance policies (and contracts more generally) in California, and that other courts and litigants need this Court to address the First District's reasoning. In short, Plaintiffs' prediction that the decision will have limited impact is already wrong.

This case offers the Court an excellent vehicle for clarifying the scope and application of the illusory-coverage doctrine in California. Indeed, even Plaintiffs have now urged the Court to grant review in this case if it concludes that clarification is necessary. In their letter to this Court concerning the Ninth Circuit's certification request in *French Laundry*, Plaintiffs ask the Court, if it opts to grant the request, to also "grant the pending Petition for Review in *John's Grill* so that all affected parties could have the opportunity to be heard . . . ." Plaintiffs' Rule 8.548(e) Letter

Responding to Order Certifying Question at 2 (Feb. 27, 2023). Sentinel agrees.[2] It is clear that guidance is needed on the questions arising in this case and this petition provides the Court with the best vehicle for providing that guidance.

ARGUMENT

I. The First District's decision, if unreviewed, will cause continued confusion over California law.

Plaintiffs try to downplay the potential impact of the First District's decision by arguing that the Limited Coverage, itself, is "unique in the industry." *See* Ans. at 19–25. But that misses the point. The most significant problem with the decision (from the perspective of California law as a whole) is not the particular result it reaches with respect to the Limited Coverage, but its radical and ill-considered reimagining of the illusory-coverage doctrine. *See* Pet. at 11–14, 24–38; *see also* Req. for Depublication at 5–7.

The decision is "aggressive and unprecedented," Ans. at 21 (quoting Pet. at 13), not because it misreads a particular coverage provision in a particular insurance policy, but because it completely reformulates well-settled law on illusory promises in contracts. And it "could wreak havoc on

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[2] Sentinel agrees that this case presents the cleanest vehicle for review of the illusory-coverage issue. It also agrees with the Ninth Circuit that there may be "efficiencies" gained by granting review of this question alongside the "viral presence" issue that his certified in *Another Planet Ent't v. Vigilant Insurance Co.*, No. S277893.

the California insurance market," *id.* (quoting Pet. at 13), not because Sentinel must "rewrite the endorsement for future use," *id.* at 25, but because as a practical matter the decision would require *all* insurers in California to comb through their policies to ensure that each aspect of each coverage provision will foreseeably provide coverage for each individual policyholder.[3] That is not how the modern insurance market works.

A. The decision will have consequences beyond this case.

As Sentinel explained in its petition, the First District misapplied the illusory-coverage doctrine in three related ways. *First*, it applied the doctrine to a *condition* of coverage, as opposed to an exclusion or limitation, even though there is no suggestion that Sentinel controls whether the condition can be satisfied (it doesn't) or knows that the condition is impossible to satisfy (it isn't). Pet. at 28–31. *Second*, the decision applied the illusory-coverage doctrine even though it is undisputed that the condition in question does not eliminate all or virtually all coverage. *See id.* at 31–36. And *third*, it insisted on applying the doctrine on a policyholder-specific level, rather than considering whether the condition

[3] The American Property and Casualty Insurance Association plans to file an amicus brief supporting review in this case.

eliminated coverage as a general matter for all policyholders. *See id.* at 37–38.

None of these defects in the First District's reasoning is case- or policy-specific. If the decision is not overruled, the First District and other courts can and will continue to make the same mistakes in reading other insurance policies. Indeed, a federal district court has already cited *John's Grill*'s discussion of the illusory-coverage doctrine in the course of interpreting a completely different exclusion in another insurance company's policy. *See C.J. Segerstrom*, *supra*, No. 22-cv-466, Dkt. 52 at 15. And, because the illusory-coverage doctrine is simply an insurance-specific variation of a more general principle of contract law, the First District's revision of the doctrine could well have implications beyond the insurance context.

B. The decision has already caused confusion and concern in other courts.

As the Ninth Circuit's certification order in *French Laundry* shows, the First District's decision here has already caused both confusion and concern among federal courts applying California law.

French Laundry involves a similar policy underwritten by another Hartford affiliate. Appealing the federal district court's dismissal of their coverage claims, the plaintiffs there argued, like Plaintiffs here, that the limited-coverage provision in their policy should pay for some of their losses

and that the specified-cause-of-loss condition, if applied according to its plain meaning, would render the coverage illusory. After the case was fully briefed, the Ninth Circuit decided to submit it for decision without oral argument, commonly a sign that it plans to affirm.

But then the First District issued its decision here, diverging from the unanimous view of other courts that the Limited Coverage is not illusory. *See* Pet. at 35 n.7 (citing 23 other decisions addressing illusory-coverage argument). The plaintiffs in *French Laundry* filed a letter urging the Ninth Circuit to follow *John's Grill*. *See* Rule 28(j) Letter, *French Laundry Partners, LP. v. Hartford Fire Ins. Co.* (9th Cir. Jan. 3, 2023) No. 21-15927, Dkt. 59-1 at 2. Instead, the Ninth Circuit issued an order requesting guidance from this Court. *See French Laundry*, *supra*, 58 F.4th 1305.

Ordinarily, the Ninth Circuit will follow the decision of a state's intermediate appellate court on a question of state law, "unless [it] finds convincing evidence that the state's supreme court likely would not follow it." *Ryman v. Sears, Roebuck & Co.* (9th Cir. 2007) 505 F.3d 993, 994. Here, the First District is the only California intermediate appellate court to address the application of the illusory-coverage doctrine to the Limited Coverage. But the Ninth Circuit declined to follow the First District and issued a certification

order in *French Laundry* instead, suggesting that it believes this Court may disagree with the First District.

While the Ninth Circuit's decision to certify in *French Laundry* rather than follow *John's Grill* seemingly reflects doubt about the First District's ruling, the wording of the certification order also reflects confusion. The order asks whether "the *virus exclusion* in French Laundry's insurance policy" is "unenforceable because enforcing it would render illusory a limited coverage provision." *French Laundry*, *supra*, 58 F.4th at 1307. But no one has ever argued that the Virus Exclusion renders the Limited Coverage illusory, because the exclusion expressly "does not apply" to the extent the Limited Coverage does. *See* Hartford's Rule 8.548(e)(1) Letter at 6 (Feb. 27, 2023); Plaintiffs' Rule 8.548(e) Letter Responding to Order Certifying Question at 4 (Feb. 27, 2023) ("The *French Laundry* Order's understanding of what *John's Grill* held is materially different from *John's Grill*'s stated holding.").

The Ninth Circuit's mistaken formulation of the question likely reflects confusion caused by the First District's unprecedented expansion of the illusory-coverage doctrine. Traditionally, that doctrine had been applied to narrowly read *exclusions* in insurance policies, not to express conditions of coverage. After all, the very nature of insurance coverage is conditional. 2 Witkin, *Summary of California Insurance Law* § 90 (11th ed. 2022). But a *conditional* promise "is no less a

promise because there is [a] small likelihood that any duty of performance will arise, as in the case of a promise to insure against fire a thoroughly fireproof building." Restatement (Second) of Contracts § 2. Given this general understanding, it is possible that the Ninth Circuit assumed that the First District's illusory-coverage decision applied to an *exclusion*, and not (as it in fact did) to a condition on coverage.

The *French Laundry* certification order confirms that this Court's direction is needed on the scope and application of the illusory-coverage doctrine. If a federal court is confused by (and reluctant to follow) a decision of the Court of Appeal, there is ample reason for this Court to intervene, eliminate the confusion, and provide a clear statement of California law.

II. The decision is wrong and worthy of review.

A. Plaintiffs do not actually defend the First District's reasoning.

Though Plaintiffs repeatedly state that the First District's decision was "correct," they never actually defend its reasoning. *See* Ans. at 27–30. They simply restate the First District's reasoning, without explaining why it is superior to the uniform decisions of every other court to consider these questions.

Plaintiffs do not contest that coverage conditions can only render coverage illusory when: (1) the condition to coverage is within the promisor's exclusive control; and (2) the promisor knew, when making the promise, that the condition

could not occur. *See* Pet. at 30 (citing Restatement (Second) of Contracts § 76(1) & cmt. d). And Plaintiffs do not contest that Sentinel has no control over whether a virus will result from a specified cause of loss, nor that Sentinel knew the specified-cause-of-loss condition could not occur when it promised to provide coverage under the Limited Coverage. *See id.* Indeed, courts have recognized that it is possible for viruses to result from specified causes of loss. *See, e.g.*, *French Laundry Partners, LP v. Hartford Fire Ins. Co.* (N.D. Cal. 2021) 535 F.Supp.3d 897, 903–04; *Franklin EWC, Inc. v. Hartford Fin. Servs. Grp.* (N.D. Cal. 2020) 506 F.3d 854, 861. Plaintiffs therefore cannot contest that the First District's decision extended the illusory-coverage doctrine to an area where had previously not applied.

Plaintiffs also offer no response to Sentinel's argument that the First District erred by erasing the specified-cause-of-loss condition from the policy even after recognizing that it did not make the Limited Coverage completely illusory. *See* Pet. at 31. The First District acknowledged that the Limited Coverage affords more than "some material coverage," 2 Windt, *Insurance Claims and Disputes* § 6:2 (6th ed.), because other enumerated perils (e.g., fungi, wet rot) could clearly result from a specified cause of loss, *see* Op. at 34. Under California law, the fact that the Limited Coverage provides *some* coverage means it is not illusory. *See, e.g.*, *Blackhawk*

Corp. v. Gotham Ins. Co. (1997) 54 Cal.App.4th 1090, 1097; *Barbizon Sch. of San Francisco, Inc. v. Sentinel Ins. Co. LTD* (N.D. Cal. 2021) 2021 WL 5758890, at *9; *Franklin*, *supra*, 506 F.Supp.3d at 861.

The First District focused solely on whether a *virus* can result from a specified cause of loss, but even then, it ignored the only authority actually addressing this question before the recent surge of COVID-19 coverage cases. In *Curtis O. Griess & Sons, Inc. v. Farm Bureau Insurance Company of Nebraska*, the Nebraska Supreme Court stated that a pseudorabies virus, which caused physical damage to the plaintiff's livestock, "result[ed] from" a specified cause of loss—namely, a windstorm. *Curtis O. Griess & Sons, Inc. v. Farm Burau Ins. Co. of Neb.* (Neb. 1995) 528 N.W.2d 329. Other courts have cited *Cutis O. Griess* for the proposition that a virus can result from a specified cause of loss and itself cause physical damage to living property. *See, e.g. Ets-Hokin v. Sentinel Ins. Co., Ltd.* (N.D. Cal. Aug. 27, 2021) 2021 WL 4472692, at *2 (citing; *Hair Perfect Int'l, Inc. v. Sentinel Ins. Co.* (C.D. Cal. May 20, 2021) 2021 WL 2143459, at *9 (same); *French Laundry*, *supra*, 535 F.Supp.3d at 903–04 (same); *Westside Head & Neck v. Hartford Fin. Servs. Grp., Inc.* (C.D. Cal. 2021) 526 F. Supp. 3d 727, 733;(same); *Franklin*, *supra*, 506 F.Supp.3d at 861 (same). The First District brushed *Curtis O. Griess* aside, calling it a "weird causation scenario

. . . best limited to its peculiar factual context." Op. at 36.[4] But it refused to consider the many other ways in which a virus can result from a "specified cause of loss," including by "water damage" and "vandalism." AA316.

Separately, Plaintiffs take issue with Sentinel's assertion that a virus could cause loss or damage to living property at John's Grill: for example, living shellfish or decorative plants. *See* Ans. at 30 (citing Pet. at 13 n.2, 34). But when Plaintiffs accuse Sentinel of relying on "extra-record and never-previously-raised 'facts,'" *id.*, they miss the point. Sentinel does not need to *prove* that Plaintiffs, in fact, have decorative plants in their restaurant or serve fresh oysters and lobsters. The First District asked whether it would be possible "on the actual business circumstances we are dealing with here" that a virus could cause loss or damage to Plaintiffs' property. Op. at 37. That was a question of law, not fact: can restaurants—not just, say, pet stores or farms—have losses caused by viruses that are themselves caused by a

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[4] Plaintiffs also take issue with *Curtis O. Griess*, but in so doing they mischaracterize it. *See* Ans. at 28–29. The case did not involve infected pigs being blown by a "tornado," but rather a windstorm transferring the airborne virus itself from one pen, containing infected swine, to another and thereby causing physical damage to the livestock in the second pen. 528 N.W.2d at 331. The court held that the windstorm, a specified cause of loss, was the "dominant, efficient cause" of the damaged livestock. *Id.*; *cf. Julian v. Hartford Underwriters Ins. Co.* (2005) 35 Cal. 4th 747, 754.

specified cause of loss? A restaurant having lobsters in a tank or decorative plants are ordinary hypotheticals, not "oddball scenarios," Op. at 34, showing that a virus could cause loss or damage to a restaurant's specific property.

In any event, the First District's focus on Plaintiffs' particular business and its subjective insurance needs was improper. *See* Pet. at 37–38. The Limited Coverage was not the result of a negotiation between Plaintiffs and Sentinel. It was, as Plaintiffs themselves alleged, a standard coverage appearing "in countless other policies in California and elsewhere . . . ." AA89. The First District's focus on Plaintiffs' particular business needs ignores the reality of the modern insurance market. State insurance commissions regulate the coverage provided (and excluded) in property-insurance policies. Sentinel and other carriers therefore draft generic forms and submit them for approval. The First District would instead require every policy to be specifically tailored to the needs of the individual policyholder. Needless to say, it would create an impossible administrative burden on insurance commissions to require approval of every bespoke policy. It would also radically increase the cost of insurance, since insurers would be forced to negotiate policies individually and repeatedly seek regulatory review. Plaintiffs make no effort to defend the impractical focus of the First District's decision.

B. Review is necessary under Rule 8.500(b).

Under Rule 8.500(b)(1), this Court may order review of a Court of Appeal decision "[w]hen necessary to secure uniformity of decision or to settle an important question of law." Plaintiffs assert that there is "no split in authority among the Courts of Appeal" and that "the illusory coverage doctrine rarely comes up in insurance coverage disputes." Ans. at 32. The first assertion is irrelevant, the second false.

First, Sentinel need not identify a split among the California Courts of Appeal. Rule 8.500(b) asks whether this Court's guidance is necessary "to secure uniformity of decision," broadly. Every other court to consider whether the Limited Coverage is illusory—including all 10 other decisions applying California law—have concluded that it is not. *See* Pet. at 35 n.7 (collecting cases). The First District decision stands alone as the *only* decision to reach a contrary result. Its deviation from the conclusions in multiple federal cases warrants this Court's review and authoritative response.

Second, the illusory-coverage doctrine has been raised frequently: 24 times in the context of analogous limited coverage provisions. *See id.* (collecting cases). And as the *French Laundry* order shows, federal courts also have been asked to apply California's illusory-coverage doctrine. Needless to say, if the First District's ill-considered expansion of the doctrine is left undisturbed, there will be many more lawsuits alleging illusory coverage in the future, as the

doctrine becomes a means of eliminating coverage conditions to transform limited coverage into unlimited coverage. Whether California should become the proving ground for a novel and aggressive doctrine of contract law is the type of "important question" that warrants this Court's review under Rule 8.500(b)(1).

Finally, Plaintiffs argue that "this particular case arises in an obscure corner of the illusory coverage doctrine," because "illusory coverage issues arise more commonly . . . in cases where application of an *exclusion* arguably renders the policy's promise of any coverage illusory." Ans. at 32 (emphasis in original). "As a result," Plaintiffs say, "virtually all the Court of Appeal case law relied on by Sentinel arises in the . . . scenario involving exclusions," as opposed to scenarios involving *conditions* of coverage. *Id.* Plaintiffs are right—the illusory-coverage doctrine typically isn't applied to coverage conditions. But that cuts in the opposite direction. The First District's sweeping extension of the illusory-coverage doctrine into this new territory will lead to unprecedented consequences for insurers, policyholders, and the California insurance market. This Court should review the propriety of that expansion.

CONCLUSION

For these reasons, this Court should grant this petition to review the First District's decision. At a minimum, it should depublish the decision.

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Pursuant to Rule 8.204(c) of the California Rules of Court, I hereby certify that this petition including footnotes, contains 3,209 words, as calculated by the Microsoft Word software used to prepare the brief.

/s/ *Tadhg Dooley*
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Dated: March 6, 2023.

/s/ *Tadhg Dooley*
Tadhg Dooley

STATE OF CALIFORNIA
Supreme Court of California

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