

'Innocent Co-insureds' Gain Broader Insurance Protection

By Stephen Huchting and Douglas Wood

On Feb. 17, in *Century National Insurance Co. v. Garcia*, the state Supreme Court declared the intentional loss and the dishonesty, fraud, or criminal conduct exclusions in a homeowner's policy to be invalid as to "innocent co-insureds." In resolving this previously unsettled issue, the Court concluded that both exclusions "impermissibly reduce coverage that is statutorily mandated" by California Insurance Code Sections 2070 and 2071.

Jesus Garcia Sr. and his wife, Theodora Garcia, were named insureds under a homeowner's policy issued by Century National. On May 2, 2007, a fire that originated in the bedroom of their adult son, Jesus Garcia Jr., damaged their home. Century National investigated the origin and cause of the fire and concluded that it had been intentionally set. The son ultimately pled no contest to arson charges and was sentenced to five years in prison.

On Oct. 22, 2007, Century National filed its complaint for declaratory relief, seeking a declaration that it had no duty to pay the Garcias' claim pursuant to two policy exclusions involving intentionally caused loss. The Garcias' policy excluded coverage for "intentional loss," which was defined as "any loss arising out of any act committed by or at the direction of any insured having the intent to cause a loss." The policy also excluded coverage for losses caused by "[d]ishonesty, [f]raud, or [c]riminal [c]onduct of any insured."

The Garcias' responded with a cross-complaint, alleging breach of contract, bad faith and reformation. They contended that the policy definition of intentional loss, which used the words "any insured" rather than "the insured," violated



Insurance Code Section 2071, by restricting the minimum coverage required by the California Standard Form Fire Policy. They also argued that Insurance Code Section 533, a provision that exonerates an insurer from paying losses intentionally caused by the insured, should be considered a part of Section 2071, which otherwise did not contain an exclusion for intentionally caused losses.

The Superior Court sustained

Court of Appeal affirmed.

In declaring these exclusions invalid and unenforceable as to innocent co-insureds, the state Supreme Court first noted that Insurance Code Section 2070 requires that "[a]ll fire policies...shall be on the standard form," as set forth in Insurance Code Section 2071. While insurers are free to use other language in providing such coverage, they must ensure that "coverage with respect to the peril

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Century National's demurrer without leave to amend, finding that: the policy defined "any insured" to include the insureds' resident relatives; courts generally interpret policies which exclude coverage for criminal or intentional acts to exclude coverage for innocent co-insureds; and California's public policy, expressed in Section 533, is that coverage should be denied for willful wrongs. The 2nd District

of fire, when viewed in its entirety, is substantially equivalent to or more favorable to the insured than that contained in such standard form fire insurance policy." The question before the Supreme Court was then "whether the Century National policy provides coverage that is at least as favorable to the insureds as the coverage provided in the standard form. If application of the intentional acts exclusion

in the [Century National policy] results in coverage that is not at least substantially equivalent to the level of protection available in [the statutory standard form fire policy], the exclusion is to that extent invalid."

The Supreme Court first observed that the statutory standard form fire policy "contains no express exclusion for losses caused by intentional acts or criminal conduct." Insurance Code Section 533, however, provides that "[a]n insurer is not liable for a loss caused by the wilful act of the insured." Further, because Section 533 represents "an implied exclusionary clause which by statute is to be read into all insurance policies," the Court concluded that Section 533 should be read as being part of the statutory standard policy.

The Supreme Court then pointed to language differences between Insurance Code Section 533 and the critical exclusions in the Century National policy. While Section 533 precludes coverage "for a loss caused by the wilful act of the insured," the intentional conduct exclusions in the Century National

policy purported to bar coverage for all insureds, even innocent co-insureds, for losses resulting from the intentional wrongful conduct of "any insured." The Court noted that "unlike policy exclusions that refer to 'an' insured or 'any' insured, exclusions based on acts of 'the' insured are construed as not barring coverage for innocent co-insureds."

From there, the Supreme Court reasoned that because Section 533 precludes coverage only for the wrongful acts of "the" insured; "the standard form fire policy must be construed as including a willful acts exclusion that is protective of innocent insureds." It concluded that the "any insured" exclusion, "with respect to the peril of fire...is invalid and unenforceable as to innocent co-insureds because [S]ection 533 only precludes coverage for losses caused by "the willful act of [the] insured." The "any insured" exclusion was therefore found to be more restrictive than that permitted by Insurance Code Sections 2070 and 2071.

In an important footnote, the

Supreme Court added: "Because our analysis concerns a fire policy subject to the requirements of [S]ections 2070 and 2071, it should not be read as necessarily affecting the validity of clauses that deny coverage for the intentional acts of 'any' insured in other contexts." (Slip Opinion, fn.8, p12.) Those "other contexts" conceivably could involve not only liability coverage, but also property coverage for perils other than "fire" as defined by Insurance Code Section 102.

The *Garcia* decision does leave open other substantial legal and practical problems. For example, the issue of how to measure the "innocent co-insureds'" "share" of the recovery remains unresolved. In addition, exactly what qualifies co-insureds in future cases as "innocent" will be a contentious issue. While *Garcia* appears to settle one controversial question, insurers will continue to struggle with how to apply this decision to their practice over the coming years as more difficult problems arise.



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