Case No. B162067
(L.A.S.C. Case No. BC 245144, consolidated with Case No. BC 251718)

IN THE COURT OF APPEAL
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FOUR

WATTS INDUSTRIES, INC., and JAMES JONES COMPANY,
Plaintiffs and Respondents,

v.

ZURICH AMERICAN INSURANCE COMPANY,
Defendant and Appellant.

Appeal from the Superior Court of the State of California
for the County of Los Angeles
Honorable Peter D. Lichtman, Judge Presiding

MOTION FOR LEAVE TO APPEAR AND BRIEF OF *AMICUS CURIAE* UNITED POLICYHOLDERS AND SCOTT C. TURNER IN SUPPORT OF RESPONDENTS

Scott C. Turner (SBN 83115)
Law Offices of Scott C. Turner
1870 Jackson Street, Suite 304
San Francisco, CA 94109
Tel: (415) 359-1155
Fax: (415) 359-1151

Amy Bach (SBN 142029)
Law Offices of Amy Bach
42 Miller Ave.
Mill Valley, CA 94941
Tel: (415) 381-7627
Fax: (415) 381-5572

Attorneys for Amicus Curiae and Amicus Curiae
UNITED POLICYHOLDERS
SCOTT C. TURNER

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Pursuant to California rules of Court, Appellant Rule 13(c), United Policyholders and Scott C. Turner ("Turner") respectfully request leave to appear as *amicus curiae* and file their accompanying joint brief in support of respondents Watts Industries, Inc. and James Jones Company.

United Policyholders is a non-profit organization dedicated to (a) educating the public on insurance issues and consumer rights and (b) protecting the interests and presenting the positions of policyholders through *amicus curiae* participation in insurance coverage cases. United Policyholder's growing reputation as a source of useful information for appellate courts was confirmed when its *amicus* brief was cited in the U.S. Supreme Court's opinion in Humana v. Forsyth, 525 U.S. 299 (1999). United Policyholders has filed *amicus* briefs on behalf of policyholders in over one hundred and twenty cases throughout the United States.

Scott C. Turner is the author of over 1,022 page legal treatise Insurance Coverage of Construction Disputes (West Group 2nd ed.2003), is the immediate past Co-Chairperson of the American Bar Association's Construction Insurance Coverage Subcommittee of the Insurance Coverage Committee of the Section of Litigation, and is perhaps the only California attorney practicing full-time in the specialty area that is the subject of this appeal. He occasionally submits briefs as *amicus curiae* in appellate cases when his expertise might be of some use to the court.

Coverage analysis provided in an *amicus curiae* brief submitted by United Policyholders and Turner was adopted by the California Supreme Court in its landmark decision in Vandenberg v. Sup. Ct. (1999) 21 Cal.4th 815.

This case concerns the scope of coverage of the Products-Completed Operations feature in CGL insurance policies in regard to manufacturers of products used in construction. However, its outcome will likely have a broad impact on the coverage of defects in products and services of all kinds. As such, it is an issue worth billions of dollars. This Court should permit United Policyholders and Turner to participate as *amicus curiae* because of the importance of these issues. Their appearance as *amicus curiae* herein will assist the Court, because they can provide the Court with their broader perspective on, and expertise in, the substantive issues before the Court.

For the foregoing reasons, United Policyholders and Turner respectfully request that the Court grant this application for leave to appear as *amicus curiae* and file the accompanying brief in support of respondents Watts Industries, Inc. and James Jones Company.

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Date: Aug. 19, 2003 Respectfully submitted,

LAW OFFICES OF SCOTT C. TURNER

Scott C. Turner
Attorney for United Policyholders
and on his own behalf

Of Counsel: Amy Bach
LAW OFFICES OF AMY BACH

INTEREST OF AMICUS CURIAE

United Policyholders was founded in 1991 as a non-profit organization dedicated to educating the public on insurance issues and consumer rights. The organization is tax-exempt under Internal Revenue Code §501(c)(3). It is funded by donations and grants from individuals, businesses, and foundations.

In addition to serving as a resource on insurance claims for disaster victims and commercial insureds, United Policyholders actively monitors legal and marketplace developments affecting the interests of all policyholders. United Policyholders receives frequent invitations to testify at legislative and other public hearings, and to participate in regulatory proceedings on rate and policy issues.

United Policyholders submits *amicus curiae* briefs in cases involving important insurance principles that are likely to impact large segments of the public. Because a diverse range of policyholders throughout the United States communicate on a regular basis with United Policyholders, it provides current information on insurance matters to courts throughout the country.

United Policyholder's growing reputation as a source of useful information for appellate courts was confirmed when our *amicus* brief was cited in the U.S. Supreme Court's opinion in Humana v. Forsyth, 525 U.S.

299 (1999), and our arguments were adopted by the California Supreme Court in Vandenberg v. Sup. Ct. (1999) 21 Cal.4th 815. United Policyholders has filed *amicus* briefs on behalf of policyholders in over one hundred and twenty cases throughout the United States. More information about United Policyholders can be accessed at www.unitedpolicyholders.org.

Scott C. Turner is the author of Insurance Coverage of Construction Disputes (West Group 2nd ed. 2003), a 1,022 page legal treatise, in addition to numerous articles and other publications on the subject of liability insurance coverage issues, particularly as they relate to the construction industry. This subject has been the exclusive focus of his legal practice since 1988. He is the immediate past chairperson of the American Bar Association's Construction Insurance Coverage Subcommittee of the Insurance Coverage Committee of the Section of Litigation and frequently lectures on the subject.

STATEMENT OF FACTS[1]

On November 3, 1998 Nora Armenta filed an action, as a Qui Tam plaintiff, on behalf of various cities and municipalities in Southern California against Jones, Watts Industries, Inc. ("Watts") and others, seeking, "damages" and civil penalties for violation of the California False

Claims Act. The suit alleges that Jones has been in the business of manufacturing and selling water works parts to municipal water systems. (Clerk's Transcript "CT" at 433.) Jones made valves which control the flow of water from the main water line to a residence; and the components of those valves. (CT 436.) The core of the complaint is that Jones produced and sold defective water works parts that have exposed the customers of public water to increased levels of lead:

> Real Parties and their water customers have been further damaged because Jones' parts made of 81 metal - installed at hundreds of thousands of California households - contain 40% more dangerous lead than permitted by AWWA specifications. (CT 461.)

On November 18, 1998 the Los Angeles Department of Water and several cities filed a complaint-in-intervention, alleging causes of action for breach of contract, fraud, negligent misrepresentation and unjust enrichment (CT 424), asserting that "intervenor may become obligated to replace approximately 300,000 parts in order to protect the water supply and therefore the health and welfare of the citizens of Los Angeles" (CT 429).

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[1] United Policyholders and Turner hereby adopt and incorporate section A. of the Statement of Facts provided in appellant James Jones Company's opening brief. It is reproduced here for the convenience of the Court.

The City of San Francisco, East Bay Municipal Utility District, and City of Santa Monica ("Cities") also filed complaints in intervention, which expanded upon these allegations. The Cities alleged causes of action for false claims, intentional misrepresentation, negligent misrepresentation, breach of contract and unjust enrichment. They sought damages for "the cost of replacing [Jones' parts] in order to protect the water supply and health and welfare of [their] citizens." (CT 542; 545; 621; 590.) They alleged that "Jones' parts made of 81 metal ...contain 40 % more dangerous lead than permitted by AWWA [American Water Works Association] standards." (CT 541; 618.)

The Qui Tam Plaintiffs filed answers to interrogatories on Nov 24, 1999 stating that "the nature of the damage is [that] the potable water has been contaminated by excessive lead leaching from the defective or substandard parts." (CT 627:6-8.)

Plaintiffs stated that they seek damages for "1) the cost of excavating and replacing each defective part with appropriate replacement parts; 2) the cost of metallurgy testing; 3) the cost of potable water monitoring and testing; and 4) treble damages and civil penalties under the False Claims Act." (CT 628:7-9; 668.)

The City of Burbank filed answers to interrogatories on August 11, 2000 stating that "the City contends that the additional lead leaching caused by Jones' use of substandard parts may pose a health risk. At present, the

City anticipates that it will support this contention at trial with expert opinions...." (CT 650.)

Plaintiffs filed a brief in September, 2000 on the expert testimony they intended to present at trial ("Plaintiffs' Memorandum In Opposition to Defendants' Motion for 'Cottle' Process and in Support of Bifurcation"), in which they emphasized the dangers caused by excessive leaching of lead from Jones' parts:

> The 81 metal parts that Defendants provided contained 40% more lead (nominally) than allowed for parts that come in contact with drinking water. Lead in such parts unquestionably `leaches' over time into drinking water. Studies performed by the California Department of Health Services and two public universities show that products similar to Defendants' leach enough lead to cause a 6% reduction in reading scores for thousands of California children. Plaintiffs maintain that in light of the foregoing facts, they are entitled to remove Defendants' parts where practicable, and to replace them with parts that meet governing industry standards. (CT 681.)

The Plaintiffs emphasized that the toxic effects of lead in drinking water "establish a *prima facie* case that Defendants' products create an increased risk to Plaintiffs' customers", justifying the removal of those parts

from the water distribution system. (CT 691.) The Plaintiffs added that they "expect to prove at trial that the additional lead leached by Defendants' parts creates a potential health risk warranting the removal and replacement of those parts...." (CT 693.)

The Attorney General of California made specific reference to the public health risks created by the allegation of lead contamination of public water supplies:

> We believe that the underlying case involves critically important issues of public health, namely the introduction of excess lead into public drinking water supplies.
>
> The violation alleged in this case is that parts sold by defendants to the plaintiff municipalities contained lead in excess of explicit lead specifications. Use of excess lead in parts that came into direct contact with public drinking water, where tests show that some of the lead leaches into the drinking water may present public health risks.
>
> ***
>
> Because of the toxicity of lead and the very low exposure at which toxicity occurs, the leaching of lead into drinking water is of extreme concern to us. The case in which the instant writ has been brought alleges sale of valves for use in drinking water systems that contain excess lead.

(CT 699).

SUMMARY OF ARGUMENT AND INTRODUCTION

Zurich clearly had the duty to defend the insured in the underlying action. The allegations against the insureds there certainly include at least the possibility of the claimants recovering damages because of property damage that is unaffected by either the "Your Product" or "Impaired Property" exclusions. That is, there is at least the possibility of the claims being based on "property damage" to the water running through the insureds' valves by contamination from lead in the valves. Therefore, any damages awarded to the claimants for the cost to remove and replace the valves easily qualify as damages "because of" that property damage. Likewise, any damages for investigation costs, monitoring, etc. would be damages "because of" the contamination of the water. The "Your Product" exclusion cannot apply, as it only excludes property damage to the valves themselves, not property damage to the water. The "Impaired Property" exclusion cannot apply for any of several reasons. Chiefly, it only comes into play in circumstances that do not involve a physical injury to property, and contamination of water is such a physical injury.

The CGL is by far the primary policy form used for covering business liabilities as its generic names, "Commercial General Liability Policy" and "Comprehensive General Liability Policy", suggest. The

actual use of specialty liability policies for particular business risks or particular classes of business insureds is extremely limited. Overwhelmingly, a business risk is either insurable under the CGL policy form or not insured at all. As such, the CGL is designed with the enormous range and complexity of business liabilities very much in mind – including new, emergent liabilities. It is most certainly not limited to classic "wham-bam" accidents, such as slip-and-fall injuries, contrary to what many outsiders might initially think. The CGL can, and often does, cover business liabilities of virtually every type.

Unlike any other industry, liability insurers are in the litigation business, both on the defense side and on the coverage claims side. Their only product is litigations services: defense and indemnity. Not surprisingly, then, insurers are astoundingly sophisticated at managing litigation, particularly where the stakes are large. The rest of the business is prosaic, so the best thinking goes into litigation strategy. However, when large claims arise insurers find it to their strategic advantage to "play dumb," arguing a very simplified paradigm of coverage. This proffered version on coverage is tailored to fit the necessarily basic and historic preconceptions jurists initially have as to what a CGL policy is and does. Zurich and CICLA pursue just such an approach here. This approach ignores or downplays the policy language itself. And, of course, it ignores what the insurers themselves understand the policy language to mean.

Insurers also find it advantageous to portray insureds as grasping to reach coverage beyond what was ever intended or paid for -- as seeking something for nothing. To the contrary, it is more often the insurer who seeks an unearned windfall. Profit margins are extremely tight in the insurance industry. It is a mature industry with many companies and almost nothing to differentiate one company's product from another. But, if an insurer – or the whole industry – can successfully charge premiums for risks that it or they later avoid by skillful argument before the courts, profits jump dramatically. Can there be any doubt, then, where planning, skill, intelligence, and creativity are brought to bear in the industry? Thus, if Zurich and the rest of the industry can sell a costly CGL-based Products-Completed Operations Hazard coverage feature to American manufacturers and then succeed in convincing the courts to drastically reduce the scope of their obligations for that coverage, the resulting windfall is in the billions of dollars – if not tens of billions of dollars! The California campaign in that stratagem is before you now.

For an example of a very similar past attempt, see *Maryland Cas. Co. v. Reeder* (1990) 221 Cal. App. 3d 961, where the same "playing dumb" approach was used in an attempt to nullify the CGL's Products-Completed Operations Coverage for general contractors. In that decision, insurance industry publications were used by the court to reveal the industry's own understanding of, and full intent to confer, expanded

coverage for the subject risks through a very subtle change in policy wording. Though unsuccessful in California and in the majority of jurisdictions to consider the point, that stratagem succeeded in enough other jurisdictions to handsomely reward the effort. *E.g., Alaska Pac. Assur. Co. v Collins* (Alaska 1990) 794 P.2d 936, 944; *Vari Builders, Inc v United States Fid. & Guar. Co.* (Del. Super. Ct. 1986) 523 A.2d 549, 552; *Tucker Const. Co. v Michigan Mut. Ins. Co.* (Fla. App. 1982) 423 So.2d 525, 528-529; *Indiana Ins. Co. v. DeZutti* (Ind. Super. 1980) 408 N.E.2d 1275; *Knutson Const. Co v St. Paul Fire & Marine Ins. Co.* (Minn. 1986) 396 N.W.2d 229, 234-238; *J.G.A. Const. Corp. v Charter Oak Fire Ins. Co.* (1979) 414 N.Y.S.2d 385; *Ryan Homes, Inc v Home Indem Co.* (Pa. Super. 1995) 647 A.2d 939; *Blaylock & Brown Const., Inc. v AIU Ins. Co.* (Tenn. App. 1979) 796 S.W.2d 146, 149-154.

Finally, Zurich and CICLA try to make something of a seeming incongruity in CGL policy coverage for product liability related risks: As noted, the "Your Product" exclusion generally bars coverage for product liability claims involving property damage to the insured's own product itself but makes no attempt to bar coverage for the costs of removing and replacing a product that is defective in another way. Despite any superficial appearances to the contrary, this distinction is fully intended, and manufacturers pay enormous sums for, and rely upon, this important coverage when disasters of this sort strike – as it has occurred for Jones and

Watts. Zurich promised to be there for them when this happened, but now it cannot remember that promise.

ARGUMENT

I. THE ACTUAL LANGUAGE OF THE POLICY – NOT "GENERAL RULES" – MUST BE USED TO DETERMINE COVERAGE

Myths reduce complex, nearly indecipherable phenomena into simple, easy to grasp explanations. The appeal is in their simplicity. Appellant Zurich and CICLA repeatedly offer myths as to what is and is not covered by CGL policies as a substitute for the harder work of applying California's rules of construction to the policy language itself. Frequently, they support their statements with a snippet from a case or secondary authority made in regard to completely different policy language.

Such myths must be rejected. California insurance law requires that coverage be construed according to the specific language of the policy in question, not according to what the California courts charitably refer to as "general rules":

> In questions of insurance coverage the court's initial focus must be upon the language of the policy itself, not upon "general" rules of coverage that are not responsive to the policy language.

American Cyanamid Co. v. American Home Assur. Co. (1994) 30 Cal. App.4th 969, 978. *See also Garriott Crop Dusting Co. v. Superior Court* (1990) 221 Cal. App.3d 783, 790.

CGL insurance policies are not simple, uniform, monolithic, and immutable. As such, general rules cannot be stated. True, there is a degree of standardization to CGL policies. For purposes of employing actuarial principles, an insurance industry service organization, Insurance Services Office, Inc. ("ISO"), drafts standard policy forms for use by subscribing insurance companies. However, even the standardized, ISO-drafted body to the CGL policy comes in numerous alternative forms. And, from there, the policy can be altered by attaching any of a myriad of standardized endorsements that amend its terms in innumerable different ways. Further, individual insurers can, and regularly do, depart from the standard ISO-drafted language for any number of reasons. Insurers are not constrained to adhere to the ISO-drafted language. Thus, one CGL policy may clearly cover a particular business risk while another just as clearly does not.

Because of this enormous variability among CGL policies, no general rule of what is and is not covered by CGL policies can possibly be made. The actual language of the policy must control. For this reason, *Harbor Ins. Co. v. Central National Ins. Co.* (1985) 165 Cal. App.3d 1029, 1034-1035, lambastes the use of such general rules:

The issue before the trial court and now this court is whether [the insurers'] policies provided for [the insured's]

liability and defense in [the liability action] for malicious prosecution. The trial court resolved the question in the negative by applying a blanket ruling that the "occurrence" of malicious prosecution, for insurance purposes, transpires upon favorable termination of the malicious action. In so determining the matter, the court unnecessarily and overbroadly fashioned a general . . . rule of coverage, rather than focusing, as it should have, upon the particular language of the policies involved. [Footnote omitted.] Depending upon the wording of the particular policy, the significance and meaning of an "occurrence" as regards the scope of policy coverage may vary widely . . . . Accordingly, rather than continue the unproductive pursuit of a rule governing all cases, we consider instead the language of the policies themselves.

Id., at 1034-1035. (Emphasis added.) *See also American Cyanamid Co. v. American Home Assur. Co., supra*, at 30 Cal. App. 978 ("the trial court mistakenly presumed that all the policies are similarly worded").

Of particular concern for this appeal is the fact that even those standard ISO forms that provide the body for CGL policies have changed dramatically from year to year. Since the release of the first standardized policies in 1940, major revisions have been made in 1943, 1955, 1966, 1973, 1986, 1988, 1993, 1997, 1999, and 2002. Thus, what a court or

commentator states about coverage under a particular ISO form can be true in the year it is made but untrue in regard the same form issued a year later. This is even true of risks that actuarial principles once regarded as uninsurable. The lure of profit from pent-up market demand can and regularly does entice insurers into covering risks they refused to cover ten years before.

Overlooking this last point has resulted in some spectacularly embarrassing moments in California jurisprudence. For example, in *Vandenberg v. Superior Court* (1999) 21 Cal.4th 815, 88 Cal. Rptr.2d 366, the Supreme Court overturned a line of at least five published Court of Appeal decisions dating back twenty years, because the first of those cases applied the holding from an earlier case involving an earlier form of the policy without considering the changes that had been made in that form's language in the intervening years. Each of the subsequent Court of Appeal decisions applied that same holding without considering whether the new policy language supported it.

Meanwhile, the insurance industry knew all along what changes it had made to its own policy forms and why. Policy form changes are events of seismic proportion within the insurance industry. For claims people in that industry, they are what amendments to the U.S. Constitution are to constitutional lawyers. They are endlessly talked about, analyzed, and planned around – before, during, and well after the changes are made. Of

course, a thorough understanding of these changes did not, of course, stop the insurers from “playing dumb” in court.

A similar, strategic amnesia is occurring in the instant action.

II. CGL POLICIES GENERALLY DO COVER LIABILITIES FOR DEFECTS

The most egregious myth put forward by Zurich and CICLA is the proposition that CGL policies simply and categorically do not cover liabilities for defective products or defective work. Thus, Zurich’s Opening Brief, at 14, flatly states that “general liability policies do not provide coverage for inferior or defective work or products.” It would almost be a challenge to find a statement wider from the mark. To the contrary, defective products and defective work claims usually are covered by modern CGL policies under California law. These claims generally involve "property damage," satisfy all the other requirements in the policy's Insuring Agreement, and fall outside the scope of all policy exclusions. Admittedly, an occasional claim is not covered, but the frequency of coverage for defect claims, particularly for defense coverage on such claims, is very high.

A. The California Cases Confirming Coverage for Defective Work or Products

Liabilities because of an insured's defective construction work or product were found to be covered in *Geddes & Smith, Inc. v. St. Paul-Mercury Indem. Co.* (1959) 51 Cal. 2d 558 (home builder); *Pardee Const. Co. v. Insurance Co. of the West* (2000) 77 Cal. App. 4th 1340 (home builder); *Armstrong World Industries, Inc. v. Aetna Cas. & Sur. Co.* (1996) 45 Cal. App. 4th 1 (building materials manufacturer); *Maryland Cas. Co. v. Nationwide Ins. Co.* (1998) 65 Cal. App. 4th 81(home builder); *Chu v. Canadian Indem. Co.* (1990) 224 Cal. App. 3d 86 (home builder); *Maryland Cas. Co. v. Reeder* (1990) 221 Cal. App. 3d 961 (general contractor); *Economy Lumber Co. v. Insurance Company of North America*, (1984) 157 Cal. App. 3d 641 (building materials manufacturer); *Burke Concrete Accessories, Inc. v. Tolson* (1972) 27 Cal. App. 3d 237 (building materials manufacturer); *Blackfield v. Underwriters at Lloyd's, London* (1966) 245 Cal. App. 2d 271 (home builder); *Eichler Homes, Inc. v. Underwriters at Lloyd's, London* (1965) 238 Cal. App. 2d 532 (home builder); and *Gogerty v. General Accident Fire & Life Assurance Corp.* (1964) 238 Cal. App. 2d 574 (construction manager). Federal cases applying California law include *Pershing Park Villas Homeowners Ass'n' v. United Pacific Ins. Co.* (9th Cir. 2000) 219 F.3d 895 (home builder); *New Hampshire Ins. Co. v. Vieira* (9th Cir. 1991) 930 F.2d 696 (defense coverage for drywall contractor); and *St. Paul Fire & Marine Ins. Co. v. Sears, Roebuck & Co.* (9th Cir. 1979) 603 F.2d 780 (roofing contractor).

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B. The Insurance Industry's Own Publications and Actions Confirm Coverage

The insurance industry's own publications readily acknowledge the intent to cover most construction defect claims under CGL Policies:

> The majority of construction risks, even those transferred pursuant to an indemnification agreement, are usually supported by insurance. This ultimately transfers potentially huge risks to a third party, an insurer, who is more financially capable of bearing and spreading the risk.
>
> The major source of insurance protection for third-party claims for any insured business -- including owners, developers, contractors, and subcontractors -- is the commercial general liability (CGL) insurance policy.
>
> Patrick J. Wielinski, Insurance Coverage for Defective Construction 1 (International Risk Management Institute 2000) (Emphasis added.) [A copy of the pertinent part of this publication is attached at the end of this brief.]

Fully understanding this point, insurers themselves regularly pursue insurance coverage claims against one another in defect cases. See, e.g., *Maryland Cas. Co. v. Nationwide Mut. Ins. Co.*, *supra,* 65 Cal. App. 4th 81

(insurer who did not contest coverage of home builder successfully sues another insurer for coverage of that same insured).

In a national publication for members of the Defense Research Institute, the professional organization of attorneys hired by insurers to defend their insureds against covered claims, two Southern California defense attorneys specializing in defect cases advise as follows:

> One of the most overlooked areas in construction defect litigation is the potential for additional insurance coverage for your client. This coverage can lead to significantly lower costs for [your] carrier.
>
> . . . . You should seek to identify and obtain all coverage information from the date the insured began working on the project through the present time, as all may be under a duty to defend and indemnify the insured. [Citation.]
>
> Next, the attorney should coordinate with the carrier the game plan for getting other carriers, if any, on board. Most importantly, if given authority, you should immediately send letters to the other carriers placing them on notice of the insured's request that they share in the insured's defense and indemnity. This will allow for later recoupment of costs/fees back to the date of the tender letter if the other carriers voluntarily agree to participate in the defense, or are forced to participate through a declaratory relief

action. One of the primary complaints repeatedly made by [insurer] claims handlers is the failure of their [defense] counsel to properly tender the insureds' defense to all carriers potentially on the risk. Such failure can result in insufficient coverage for the insured, and increased costs for the defending carriers ...

Kevin D. Smith & Daniel A. Berman, *Effective Management of Construction Defect Litigation*, in For the Defense, Aug. 1997, at 30, 31. (Emphasis added.) [A copy of the pertinent part of this publication is attached at the end of this brief. The quotation appears at p. 3 of this print-out. The quoted language is highlighted for further ease of reference.]

C. Distinguishing Zurich's Authority

Zurich supports its no coverage for defects myth, at pp. 15-16 of its Opening Brief, with a quote from *Maryland Cas. Co. v. Reeder,, supra,* 221 Cal. App.3d at 967-68. Note, however, that the language quoted is dicta. The *Reeder* court simply makes a side observation about the policy drafters' probable purpose in including certain exclusions in the CGL policy. The very next paragraph after the quoted portion starts: "In actually articulating the risks which will be covered . . . ." *Id.,* at 968. In fact, the *Reeder* court proceeds on to uphold coverage in that defect case, based on a close reading of the actual language of the policy provision at issue and informed with interpretative materials from insurance industry publications' acknowledging the intent to cover the risk involved.

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III. ZURICH'S AND CICLA'S PUBLIC POLICYARGUMENT HAS BEEN SOUNDLY REJECTED IN CALIFORNIA

Zurich and CICLA argue that allowing insurance coverage for the manufacture of defective products encourages slipshod manufacturing, and therefore public policy concerns require that coverage be denied. Under such reasoning, liability insurance should be banned altogether! Everything covered by such policies involves events that society desperately wants to discourage. Why single out manufacturing? According to the proposed reasoning, the courts should deny coverage for bad driving, bad doctoring, and mistakes of any kind.

By the very nature of their position, insureds pursuing liability coverage claims have all committed some socially undesirable act. (As an aside, this also makes them vulnerable to being portrayed as undeserving and untrustworthy wrongdoers in the insurance litigation. Zurich and CICLA employ that technique here.) Nevertheless, California decided long ago that the benefits gained by allowing the sale of liability insurance -- promoting the compensation of victims and dampening the potentially devastating blow of civil liability for relatively non-culpable insureds –outweigh any social benefits of disallowing risk spreading of this kind.

Perhaps for these reasons, or perhaps out of constitutional concern for the separation of powers between the legislative and judicial branches of state government, or perhaps for both, our California Supreme Court since the 1990's has consistently rejected the sort of public policy analysis adopted in the out-of-state cases cited by Zurich and CICLA.

For example, in *Aerojet-General Corp. v. Transport Indem. Co.* (1992) 17 Cal. 4th 38, the issue before the court was the scope of coverage for an insured's defense costs in the underlying matter. That underlying case involved property damage experienced over a period of years. During those years, the insured maintained CGL insurance coverage in certain years but "self-insured" itself in other years. The insurers argued that the insured should share in a proportionate share of the defense costs. The Court of Appeal agreed, based on a public policy rationale similar to but much less severe than that urged by Zurich and CICLA here. The Supreme Court reversed, holding that the insurers must cover all of the defense costs. The Supreme Court spoke to the Court of Appeal's public policy concerns as follows:

> Beneath the Court of Appeal's concern about 'fairness' and 'justice' is, apparently, a belief that, without an approach like the one it adopted, Aerojet might get a windfall from the insurers. This is not the case. We shall assume for argument's sake that Aerojet has employed great good luck over against the insurers.

But the pertinent policies provide what they provide. Aerojet and the insurers were generally free to contract as they pleased . . . They evidently did so. They thereby established what was 'fair' and 'just' inter se. We may not rewrite what they themselves wrote . . . We must certainly resist the temptation to do so here simply in order to adjust for chance -- for the benefits it has bestowed on one party without merit and for the burdens it has laid on others without desert . . . As a general matter at least, we do not add to, take away from, or otherwise modify a contract for 'public policy considerations.' . . . We would certainly not do so here, where such considerations depend in large part on amassing and analyzing of complex and extensive empirical data which belong more appropriately to the executive and legislative branches than to the judicial.

(*Id*., at 75-76, footnotes and citations omitted, emphasis added.)

More specifically, Zurich's and CICLA's public policy arguments were all carefully examined in another CGL Products-Completed Operations case and rejected. In the now-familiar *Maryland Cas. Co. v. Reeder, supra,* 221 Cal.App.3d 961, the court concludes, "in the absence of unambiguous policy terms we are not inclined to restrict the risks for which

businesses may obtain insurance and insurers may collect premiums." *Id.,* at 974.

Thus, there can be no doubt but that the public policy approach advocated by Zurich and CICLA is not available in California.

IV. THE ALLEGATIONS AGAINST WATTS AND JONES SATISFY ALL POLICY PROVISIONS

A. The Alleged Contamination of Water Satisfies the "Property Damage" Requirement

The *Armenta* complaint alleges that "the potable water has been contaminated by excessive lead leaching from the [insureds'] parts." (CT 627). The intervenors' allegations imply the same, such as when Los Angeles alleges that it must replace the valves "in order to protect the water supply and therefore the health and welfare of the citizens of Los Angeles" (CT 429). Protect the water supply from what? Obviously, the implication is that it be protected from lead contamination.

The definition of "property damage" in the CGL policy includes "physical injury to tangible property". Water is tangible property – as opposed to intangible property such as intellectual property rights. Lead contamination is certainly a "physical injury" to water.

B. The Costs to Remove and Replace the Defective Valves Are Damages "Because of" the Property Damage to the Water

It is not disputed that Armenta and the intervenors seek damages for the cost to remove and replace the defective valves. There may be various potential reasons motivating their desire to remove and replace the valves, but all that matters for defense coverage purposes is that one or more of these reasons is "because of" contamination of the water. In this regard, Armenta's alleged rationale for removal and replacement is:

> Real Parties and their water customers have been further damaged because Jones' parts made of 81 metal – installed at hundreds of thousands of California households – contain 40% more dangerous lead than permitted by AWWA specifications. (CT 461.) (Emphasis added.)

Thus, the motivation to remove and replace the valves at least potentially is because of the lead contamination of the water.

Even more clearly, intervenor Los Angeles alleges the need to "replace approximately 300,000 parts in order to protect the water supply and therefore the health and welfare of the citizens of Los Angeles". (CT 429.) The other cities allege that they seek damages for "the cost of replacing [the insureds' valves] in order to protect the water supply and health and welfare of [our] citizens." (CT 542; 545; 621; 590.) At least potentially, then, the removal and replacement damages alleged are "because of" contamination of water that had occurred and was continuing to occur owing to the high lead content of the insureds' valves.

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1. Zurich's Argument that There Is No Possibility of these Costs Being "Because of" Water Contamination Is Clearly Wrong

Zurich argues that the allegations against the insureds do not seek recovery for the past contamination of the water itself, so any damages sought for the removal and replacement of the valves cannot possibly be "because of" such property damage. However, there is no policy requirement that the claim against the insured be for the property damage itself – only that it seek "damages because of property damage." For example, in *Globe Indem. Co. v. State of California* (1974) 43 Cal.App.3d 747, the insured negligently set a fire that the State incurred costs in suppressing. Under a statute that allowed the State to recoup these costs, the State sued the insured. The State was not in any way seeking to recover for the property damage itself, as that was beyond the scope of the statute. Nevertheless, the *Globe Indemnity* court held, at 751, as follows

> We note that the policies in the present case extend coverage "to all sums which the insureds become legally obligated to pay as damages because of" property damage, and the coverage is not limited solely to damages to property

> Since liability for fire suppression costs under section 13009 of the Health and Safety Code can arise only if the fire causes damage to property belonging to others, since most, if not all of the property belonging to others damaged by the fire was tangible in character, and since all of the fire suppression costs in question were expended to prevent further damage to tangible property, it can be said that the insureds became legally obligated to pay these fire suppression costs because of damage to tangible property. Accordingly, these costs should be considered a sum recoverable under the policies.
>
> (Emphasis added.)

In *Aerojet-General Corp. v. Superior Court* (1989) 211 Cal.App.3d 216, the insured was sued by the State of California for remediation costs because of contaminating ground water, a situation highly analogous to the facts presently before this Court. Looking to the *Globe Indemnity* decision, the *Aero-Jet General* court held, at 227-228, as follows

> Under the Globe analysis, [the insureds] could reasonably expect that funds expended [by the governments] to correct third party property damage [that is, damage to parties other than the governments themselves] caused by pollution, and to mitigate the effects of that damage, are covered by their CGL policies.

In *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, the insured sought coverage for environmental response costs to cleanup water contamination, among other things, in the aftermath of state and federal governments obtaining an injunction compelling the insured to do so. The insurers argued against coverage, because the government had not sought recovery for the property damage itself. Looking to the *Aero-Jet General* case, the *AIU* court held, at 842-843, as follows:

> We . . . hold that reimbursement of response costs and the costs of injunctive relief under CERCLA and related statutes are incurred "because of" property damage . . . [T]he mere fact that the governments may seek reimbursement of response costs or injunctive relief without themselves having suffered any tangible harm to a proprietary interest does not exclude the recovery of cleanup costs from the coverage under the "damages" provision of CGL policies. For similar reasons, in plain and ordinary terms, such recovery is "because of" property damage
>
> . . . .
>
> This is true, moreover, whether the cleanup at issue in the underlying suits takes place on property owned by [the insured], the state and federal government, or third parties. The [policy] provisions at issue here do not specify that coverage hinges on the nature or location of property damage. We therefore construe

them to encompass damages because of property damage in general, regardless of by whom it is suffered.

(Emphasis added.)

In *Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.* (1996) 45 Cal.App.4th 1, the insured was sued by building owners for the cost to remove and otherwise deal with asbestos containing building materials ("ACBM") in their buildings. The insured had manufactured the ACBMs. The insurers argued that these costs did not constitute property damage and, therefore, were not covered. The *Armstrong* court held, at 93, as follows:

> In our view . . . the damages allegedly suffered by the building owners from the presence of the ACBM cannot be considered solely economic loses . . . [A]batement costs [that is, the cost of removing the insured's product from the buildings] or the costs of inspecting, assessing, and maintaining the in-place ACBM are not the "property damage." They are "damages because of property damage." That is, they are the alternative measures of the physical injury to the building. [Citations omitted.] The fact that the measure of damages is economic does not preclude a physical injury.

Thus, the cost to remove and replace the valves constitutes "damages because of" the on-going contamination of the water with lead.

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2. The Motives for Replacing the Valves Are Irrelevant

Implicit in much of Zurich's argument is that the true motive of Armenta and the intervenors is the protection of the public's health, not the avoidance of property damage. Motive, however, is irrelevant:

> It is immaterial whether motivations other that protection of property -- for example, protection of the health of persons living near hazardous waste sites – also contribute to the [claim]. The Court of Appeal's emphasis on the fact that the agencies' objectives may be regulatory rather than proprietary is misplaced. Whatever their dominant motive, the event precipitating their legal action is contamination of property. The costs that result from such action are therefore incurred "because of" property damage.
>
> *AIU ins. Co. v. Superior Court, supra*, 51 Cal.3d at 842-843.

Further, it is the property damage – the contamination – that would be the instrument of injury to the public. Thus, Armenta and the intervenors necessarily seek to avoid both. At the very least, Zurich cannot eliminate at least the possibility that Armenta and the intervenors seek removal and replacement in order to avoid the contamination of the water, i.e., to avoid the on-going property damage.

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3. Zurich's Argument that Removal and Repair Costs Would Be "Prophylactic" Is Wrong

Zurich argues that the costs in question are "prophylactic" costs designed to respond to the threat of future harm and have nothing to do with past, existing, or present property damage. Under *AIU Ins. Co. v. Superior Court, supra*, 51 Cal.3d 807, 843, "prophylactic" costs incurred to avoid property damage in the future, where no property damage has yet occurred, are not "damages because of property damage."

However, Zurich's argument here is premised on there being no on-going property damage to the water. If there is on-going property damage, the *AIU* case finds that the costs to avoid further property damage are "preventative" costs that fully satisfy the "damages because of property damage requirement."

As was demonstrated in 2. above, on-going property damage to the water cannot be eliminated as a possibility under the allegations against the insureds. (In fact, those allegations very clearly state that on-going property damage is occurring.) As such, this second half of Zurich's argument also collapses.

C. The "Your Product" Exclusion Does Not Apply

This exclusion reads, in its entirety, as follows: "This insurance does not apply: . . . . . 'Property damage' to 'Your Product" arising out of it or any part of it." The definition of "Your Product" does not include any tangible property other than the insured's own product. Thus, this exclusion only applies to property damage to the insured's product itself. Property damage to other property is unaffected by the exclusion. Here, the water that has suffered the property damage is not the insureds' product, so the exclusion can have no application here.

D. The "Impaired Property" Exclusion Does Not Apply

The definition of "property damage" in CGL policies defines that term in the alternative, as either (1) "physical injury to tangible property," or (2) "loss of use of tangible property". Picking up this distinction, the "Impaired Property" exclusion only applies to the latter form. That is, by its terms it only comes into play if there is property damage to either "impaired property" or "property that has not been physically injured". Because the water in question has been physically injured by contamination with lead, the second of these alternatives cannot apply.

The first alternative – for property damage to "impaired property" – cannot apply either. The term "impaired property" requires that the property "cannot be used or is less useful . . ." Here, however, use of the water is not the issue. As Zurich point out, the water has been, and

continues to be, used and consumed. The property damage alleged is the physical injury to the water, not loss of use of the water. At the very least, then, Zurich cannot eliminate the possibility that the claims against the insureds involve something more that the loss of use form of property damage.

Therefore, the "Impaired Property" exclusion cannot eliminate the possibility of there being a covered claim against the insureds here.

E. About the Fact that this Products-Related Liability Is Covered while Others Are Not

Zurich and CICLA try to make something of a seeming incongruity in CGL policy coverage for product liability related risks: As discussed above, the "Your Product" exclusion generally bars coverage for product liability claims involving property damage to the insured's product itself but makes no attempt to bar coverage for the cost of removing and replacing product that is defective in another way. The "Impaired Property" exclusion catches some instances of the latter, but it nevertheless leaves most others completely unaffected by the policy's exclusions.

Zurich and CICLA struggle heroically to argue away this coverage, taking a stand at every hedgerow – by attempting to push the scope of the term "property damage" back from its recognized scope, by attempting to suppress the expansive effect of the "damages because of" provision, and

by attempting to stretch each of the two exclusions well beyond the limits of its actual wording.

The unspoken and underlying rationale behind all of these arguments is that it is illogical and inconsistent for the policy to bar coverage for some product-related liabilities and allow coverage for others. However, any seeming illogic and inconsistency here is a matter of superficial appearances only. The CGL policy is rife with fine distinctions within a class of risks; yet, the coverage results of these distinctions are fully intended. For example, in *Maryland Cas. Co. v. Reeder, supra*, 221 Cal.App.3d 961, the court recognized an intended coverage distinction in a CGL exclusion regarding an insured general contractor's defective work, whereby there was coverage for the defect if the work was performed by a subcontractor but excluded if the defective work was performed by the general contractor's own employees. Nevertheless, the *Reeder* court found that the insurer there had consciously based a large part of his premium for that very distinction.

Finally, it would have been easy for the policy drafters to have written a product exclusion that excluded not only property damage to the insured's product itself but also the cost to remove and replace product that was defective in other ways. They did not. Obviously, this omission was intended. In any event, it is the policy language that controls, not the insurer's understanding and intent in regard to that language.

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CONCLUSION

For the foregoing reasons, United Policyholders respectfully urges the Court to uphold the decision of the Superior Court.

Date: Aug. 19, 2003

Respectfully submitted,

LAW OFFICES OF SCOTT C. TURNER

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Scott C. Turner
Attorney for United Policyholders

Of Counsel: Amy Bach
LAW OFFICES OF AMY BACH

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LAW OFFICES OF SCOTT C. TURNER

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Scott C. Turner
Attorney for United Policyholders and on his own behalf