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THE EHRLICH LAW FIRM

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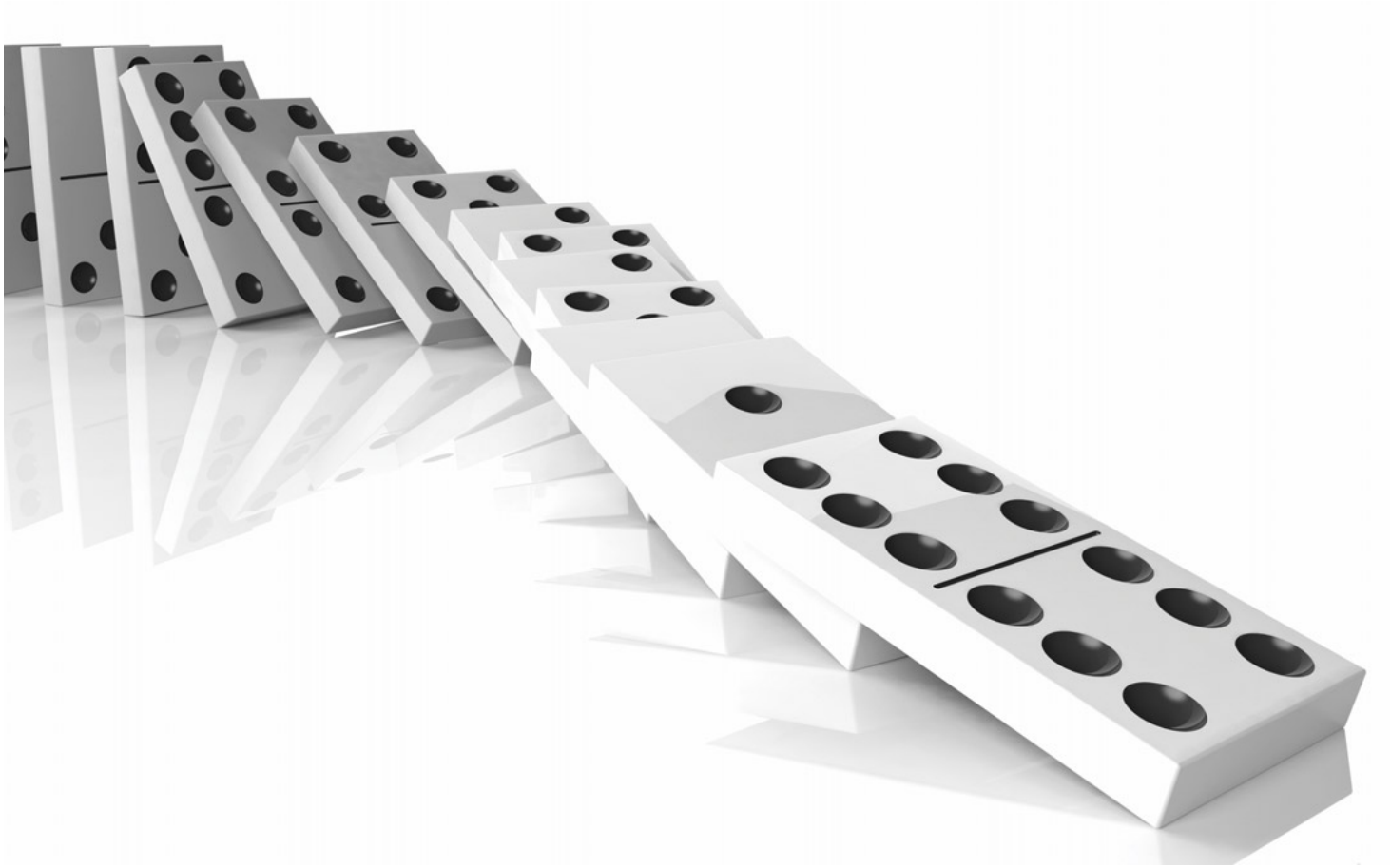

"We meant it when we said it."

IN *LIBERTY SURPLUS v. LEDESMA & MEYER CONSTRUCTION CO.*, THE CALIFORNIA SUPREME COURT REAFFIRMS THAT AN "ACCIDENT" CAN BE THE UNINTENDED CONSEQUENCE OF THE INSURED'S DELIBERATE ACTS

Since the 1950s, the California Supreme Court has held that an "accident" for the purposes of third-party liability coverage, means "an unexpected, unforeseen, or undesigned happening *or consequence* from either a known or an unknown cause." Yet, the Court of Appeal and the Ninth Circuit have frequently stated that the unintended or unexpected consequences of the insured's deliberate conduct can seldom, if ever, constitute an "accident."

The Supreme Court's recent decision in *Liberty Surplus Insurance Corporation v. Ledesma & Meyer Construction Company, Inc.* (2018) 5 Cal.5th 216, __, 233 Cal.Rptr.3d 487, 489, should resolve the controversy. In *Liberty Surplus* the Court relied on the "or consequence" portion of the definition of "accident" to hold that an employer's deliberate acts of hiring, retaining, and supervising an employee who commits an intentional tort can qualify as an accident that triggers liability coverage.

The *Liberty Surplus* decision is therefore significant for two reasons: First, it expressly holds that, absent an exclusion, an employer's comprehensive general liability policy will provide coverage for claims based on negligent hiring, retention, and supervision of employees. Second, the decision should resolve the debate in the lower courts about whether and when the unintended consequences of the policyholder's deliberate acts can qualify as an "accident" and therefore an "occurrence." The latter result will undermine one of the more potent coverage defenses that insurers have relied on in third-party cases, and will broaden the scope of liability policies to provide the type of coverage that most policyholders would expect.

The facts of the *Liberty Surplus* decision

In 2003, the policyholder, Ledesma & Meyer Construction Company ("L&M),

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contracted with the San Bernardino Unified School District to manage a construction project at a middle school. In 2003, L&M hired Darold Hecht as an assistant superintendent and assigned him to the project. In 2010, Jane Doe, a 13-year-old student at the school, sued in state court alleging that Hecht had sexually abused her. Doe's claims include a cause of action against L&M for negligently hiring, retaining, and supervising Hecht.

L&M tendered the defense to its insurers, Liberty Surplus Insurance Corporation and Liberty Insurance Underwriters, Inc. (collectively, Liberty). Liberty defended L&M under a reservation of rights. It also sought declaratory relief in federal court, contending it had no obligation to defend or indemnify L&M. The commercial general liability policy at issue provided coverage for "bodily injury caused by an 'occurrence,'" which the policy defined as "an accident." The district court granted summary judgment to Liberty, finding that its policy provided no coverage to L&M on the cause of action for negligent hiring, retention, and supervision.

The court reasoned that Doe's injury was not caused by an "occurrence" because the "alleged negligent hiring, retention and supervision were acts antecedent to the sexual molestation .... While they set in motion and created the potential for injury, they were too attenuated from the injury-causing conduct committed by Hecht." The court relied on a line of district court authority that had previously held that negligent supervision does not constitute an "occurrence" under California law. And it also relied on *Merced Mutual Ins. Co. v. Mendez* (1989) 213 Cal.App.3d 41, 261 Cal.Rptr. 273 (*Merced*), for the proposition that an employer's deliberate acts of hiring, retaining, and supervising an employee cannot be considered an "accident" and therefore do not constitute an "occurrence." As the district court put it, "First, the supervision and retention are still not the injury-causing acts. Second, courts have rejected the argument that the insured's intentional acts of hiring, supervising, and retaining are accidents, simply because the insured did not intend for the injury to occur." (*Liberty Surplus*, 233 Cal.Rptr.3d at 490.)

The Supreme Court's answer to the Ninth Circuit's certified question

After oral argument of the appeal of the summary judgment, the Ninth Circuit asked the California Supreme Court to resolve the issue of whether an employer's negligent hiring, retention, or supervision of an employee who commits an intentional tort can constitute an "occurrence" under a liability policy. The Court agreed to answer the question and filed its opinion in early June 2018.

The opinion begins with the definition of "accident" that applies to liability policies. In *Delgado v. Interinsurance Exchange of Automobile Club of Southern California* (2009) 47 Cal.4th 302, 308, 97 Cal.Rptr.3d 298, the Court had previously held that, unless the policy provides otherwise, "an accident is an unexpected, unforeseen, or undesigned happening or consequence from either a known or an unknown cause." This definition becomes part of the policy and cannot be challenged as ambiguous. (*Ibid*.)

The Court further noted that, under *Delgado*, "Under California law, the word 'accident' in the coverage clause of a liability policy refers to the conduct of the insured for which liability is sought to be imposed." (*Id*., 47 Cal.4th at p. 311; 97 Cal.Rptr.3d 298.)

The Court emphasized that "[i]t is important to keep in mind that a cause of action for negligent hiring, retention, or supervision seeks to impose liability on the employer, not the employee." Hence, the analysis of whether L&M's negligent hiring, retention, and supervision of Hecht constituted an "accident" turns on *L&M's* negligent conduct; *not* Hecht's deliberate conduct. This means that the fact that Hecht acted intentionally and criminally does not mean that L&M's conduct was not an accident. L&M's conduct must be considered separately than Hecht's conduct.

The Court first rejected Liberty's argument that L&M's negligent conduct was "too attenuated" to satisfy the requirement in the policy's insuring clause that the occurrence must "cause" the bodily injury forming the basis for the claim. The Court first noted that "tort principles" supply the proper causation analysis for liability policies. (*Liberty Surplus*, 233 Cal.Rptr.3d at 492.) It further acknowledged that, "Causation is established for purposes of California tort law if the defendant's conduct is a 'substantial factor' in bringing about the plaintiff's injury." The district reasoned that L&M's actions set the chain of events that led to Doe's molestation in motion but did not legally cause Doe's injuries. The Supreme Court explained that this "reasoning runs counter to California cases expressly recognizing that negligent hiring, retention, or supervision may be a substantial factor in a sexual molestation perpetrated by an employee, depending on the facts presented." (*Liberty Surplus*, 233 Cal.Rptr.3d at 492.)

The Court noted that a fact finder could conclude that even though L&M's negligence was an indirect cause of the harm suffered by Doe, an injury may be the result of more than one cause. Hence, L&M's negligence could be considered a substantial factor in bringing about Doe's harm. (In fact, L&M had already been held liable to Doe in the underlying lawsuit.) In sum, from the standpoint of causation, Liberty had no coverage defense.

The Court then turned to the district court's reliance on *Merced*. The insured in *Merced* was sued for sexual assault. He claimed his conduct could be considered an "accident" because he mistakenly believed the victim had consented. He conceded that he intentionally engaged in the sexual conduct, but urged that he intended no injury. The court held that there was no accident. It explained that "[a]n accident ... is never present when the insured performs a deliberate act unless some additional, unexpected, independent, and unforeseen happening occurs that produces the damage." (*Merced*. 213 Cal.App.3d at 50, 261 Cal.Rptr. 273.) In *Merced*, there was no accident because "[a]ll of the acts, the

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manner in which they were done, and the objective accomplished occurred exactly as [the insured] intended. No additional, unexpected, independent or unforeseen act occurred." (*Ibid*.)

The Supreme Court held that the district court's reliance on *Merced* to find that L&M had no coverage was misplaced because *Merced* was distinguishable for two reasons. First, *Merced* did not involve a claim of negligent hiring or supervision by an employer; instead, the insured's intentional acts were the direct cause of the injury. Second, the argument made by L&M in support of coverage was different than the policyholder's argument in *Merced*. There, the insured acknowledged that he intended the acts that caused the injury, but not the injury. By contrast, L&M argued that Hecht's acts were neither intended nor expected from its perspective.

In addition to distinguishing *Merced*, the Court also noted that *Merced*'s definition of what constitutes an accident is consistent with the definition adopted in *Delgado*, and supports L&M's position. It explained, "Even though the hiring, retention, and supervision of Hecht may have been deliberate acts by L&M, the molestation of Doe could be considered an 'additional, unexpected, independent, and unforeseen happening ... that produce [d] the damage.'" (*Liberty Surplus*, 233 Cal.Rptr.3d at 494.)

The Court next went on to distinguish various cases that the district court had relied on. It explained that reliance on "trigger of coverage" cases, which examined which of two policies would cover a loss, or cases dealing with a territorial limitation in coverage, would provide little guidance on the issue of whether a given set of events or conduct constituted an occurrence. The Court noted, "Context matters in this area of the law. . . . Factors relevant to the application of a territorial limitation clause or the resolution of a dispute over whether an accident occurred during the policy period are not necessarily pertinent to all coverage questions." (*Liberty Surplus*, 233 Cal.Rptr.3d at 496.)

Ultimately, the Court concluded that L&M's conduct fit within the *Delgado* definition of "accident" – which extends to an "unexpected, unforeseen, or undesigned happening or consequence" – because "Hecht's molestation of Doe may be deemed an unexpected consequence of L&M's independently tortious acts of negligence." (*Liberty Surplus*, 233 Cal.Rptr.3d at 496-497.)

The implications of the *Liberty Surplus* decision

The Supreme Court's decision in *Liberty Surplus* is likely to have ramifications that extend far beyond the decision's direct holding because several aspects of the Court's analysis are inconsistent with principles frequently asserted in appellate decisions.

For example, the Court explains that, "[T]he term 'accident' is more comprehensive than the term 'negligence' and thus includes negligence. . . . *Accordingly, a policy providing a defense and indemnification for bodily injury caused by 'an accident' promises coverage for liability resulting from the insured's negligent acts*." (*Liberty Surplus*, 233 Cal.Rptr.3d at 490, emphasis added.)

Yet, several earlier appellate decisions suggest just the opposite. For example, *Quan v. Truck Ins. Exchange* (1998) 67 Cal.App.4th 583, 596, 79 Cal.Rptr.2d 134, 141, says, "In *American Internat. Bank v. Fidelity & Deposit Co. of Maryland* (1996) 49 Cal.App.4th 1558, 1572-1573, 57 Cal.Rptr.2d 567, the court noted the 'misapprehension' that all claims for negligence must at least potentially come within the policy and therefore give rise to a duty to defend. That is not so. 'Negligent' and 'accidental' are not synonymous."

Liberty Surplus agrees that the terms are not synonymous, but rejects the suggestion in *Quan* and *American International* that policies that promise coverage for accidently caused harm do not necessarily cover negligently caused harm.

Most significantly, the *Liberty Surplus* decision indisputably holds that the definition of "accident" prescribed in *Delgado* extends to the unexpected or unintended *consequences* of the policyholder's deliberate conduct. This has been a point of substantial debate in the Court of Appeal and in the Ninth Circuit.

For example, in *State Farm Fire & Casualty Co. v. Superior Court* (*Wright*) (2008) 164 Cal.App.4th 317, 325, 78 Cal.Rptr.3d 828, 833 ("*Wright*"), the court acknowledged that numerous cases "stand for the proposition that where the [insured's] conduct is deliberate or volitional, the incident is not an 'accident' for the purposes of insurance law." But the *Wright* court also observed, "the term 'accident' has also been used to refer to the unintended or unexpected consequence of the act." (*Id*.)

In *Wright*, policyholder deliberately threw his friend into a swimming pool at a party, intending to get him wet as a joke. But he failed to use enough force to direct his friends' body all the way into the pool. His friend landed short, and fractured his clavicle on a concrete step. State Farm argued that because the policyholder acted intentionally in throwing his friend into the pool, there was no "accident" and hence no coverage.

The *Wright* court held otherwise, relying on the line of cases that suggest that an accident can include the unexpected or unintended consequences of the insured's deliberate acts. The court explained:

> Although he deliberately picked Wright up and threw him at the pool, Lint [the insured] did not intend or expect the consequence, namely, that Wright would land on a step. Lint miscalculated one aspect in the causal series of events leading to Wright's injury, namely, the force necessary to throw Wright far enough out into the pool so that he would land in the water. It is undisputed that Lint did not intend to hurt Wright; he merely intended that Wright land farther out into the water and "get ... wet." No doubt Lint acted recklessly. But . . . Lint rashly threw Wright at the pool without expecting that Wright would land on the cement step. Stated otherwise, the act directly responsible for Wright's injury, throwing too softly so as to miss the water, was an unforeseen

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> or undesigned happening or consequence and was thus fortuitous. [Citation omitted.] The event here was an accident because not all of the acts, the manner in which they were done, and the objective accomplished transpired exactly as Lint intended.

(Citations omitted.] (*Wright*, 164 Cal.App.4th at pp. 328-329, 78 Cal.Rptr.3d at 836.)

After *Wright* was decided, several other appellate courts have harshly criticized it. (It shows up with a red flag in West's Keycite citator.) For example, in *Fire Ins. Exchange v. Superior Court* (*Bourguignon*) (2010) 181 Cal.App.4th 388, 392-393, 104 Cal.Rptr.3d 534, 537-538, the court stated, "Where the insured intended all of the acts that resulted in the victim's injury, the event may not be deemed an 'accident' merely because the insured did not intend to cause injury. [Citations omitted.] The insured's subjective intent is irrelevant. [Citations omitted.] Indeed, it is well established in California that the term 'accident' refers to the nature of the act giving rise to liability; not to the insured's intent to cause harm." The *Bourguignon* court expressly noted that the *Wright* decision "seems to stand in variance to this rule." (*Id*., 181 Cal.App.4th at 393, fn. 1, 104 Cal.Rptr.3d at 537, fn. 1.)

In *State Farm General Ins. Co. v. Frake* (2011) 197 Cal.App.4th 568, 584, 128 Cal.Rptr.3d 301, 313, the court noted that *Wright* was decided before the Supreme Court's decision in *Delgado*, which "stands in contrast to the reasoning of *Wright*." The *Frake* court stated, "To the extent *Wright* ruled that the term 'accident' applies to deliberate acts that directly cause unintended harm, such a holding is contradictory to well-established California law. We are not aware of any California decision that has cited *Wright* approvingly or adopted its analysis." (*Id*., 197 Cal.App.4th at 585, 128 Cal.Rptr.3d at 314.)

Similarly, recent decisions of the Court of Appeal have stated that, "The term "accident" refers to the nature of the insured's conduct, and not to its unintended consequences. . . . When an insured intends the acts resulting in the injury or damage, it is not an accident merely because the insured did not intend to cause injury. The insured's subjective intent is irrelevant." (*Albert v. MidCentury Ins. Co*. (2015) 236 Cal.App.4th 1281, 1291, 187 Cal.Rptr.3d 211, 219.)

The Ninth Circuit has taken a similar view: "The term 'accident' refers to the happening of the event itself and not the consequences of that act." (*Blue Ridge Ins. Co. v. Stanewich* (9th Cir. 1998) 142 F.3d 1145, 1148; *Shelter Island Inc. v. St. Paul Fire & Marine Ins. Co*. (9th Cir. 2002) 32 Fed.Appx. 243, 244–245 ["An insured's act is not an 'accident' if the act was intentional; "[T]he term 'accident' refers to the insured's intent to commit the act giving rise to liability, as opposed to his or her intent to cause the consequences of that act."])

In a case decided days before *Liberty Surplus* was argued, *Crown Tree Service, Inc. v. Atain Specialty Insurance Company* (9th Cir. 2018) 713 Fed.Appx. 684, 685, the Ninth Circuit affirmed a summary judgment in favor of the insurer against a tree service who removed trees from a third party's property under the reasonable belief that the trees were on its client's property. The court held that the tree service's reasonable mistake about who owned the trees (or about where the property line was) could not convert its intentional act of cutting the trees into an "accident."

The *Liberty Surplus* decision calls these statements and rules into question. The Court acknowledges that L&M's acts of hiring, retaining, and supervising Hecht were "deliberate acts." (*Id*., 233 Cal.Rptr.3d at 494.) Even so, it held that they could be considered "accidents" for the purposes of liability coverage because the harm that resulted from those deliberate acts was "an unexpected, unforeseen, or undesigned happening or consequence of its hiring, retention, or supervision of Hecht." (*Id*. at p. 496.)

It is true that L&M's conduct was an indirect cause of the harm; not the direct cause. Insurers are likely to point to that distinction in cases where the policyholder relies on the "unintended consequence" portion of the definition of "accident" to argue that there is coverage. This distinction should not allow insurers to defeat coverage, however, because the definition of "accident" does not distinguish between "direct" and "indirect" causes, nor does the tort-causation method that the Court adopted in *Liberty Surplus*. Rather, the test mirrors the substantial-factor approach in negligence cases. If the policyholder's intentional conduct produces unintended consequences, it can be an accident. Nothing in the definition of "accident" adopted by the Court, or the analysis relied on in *Liberty Surplus* suggests that the "unexpected consequence" portion of the definition of "accident" is only operational in cases involving indirect harm.

This is not to say that *all* consequences from the insured's deliberate acts will qualify as an accident. The Court's prior cases make clear that there is no accident when the insured intended to cause the very consequence that resulted from its deliberate act. (See, e.g., *Hogan v. Midland National Ins. Co*. (1970) 3 Cal.3d 553, 559, 91 Cal.Rptr. 153 [holding that there was no coverage for lumber that was deliberately sawn too wide in an attempt to compensate for the saw's propensity to undercut].) There is also no coverage where the insured intends to cause harm, or engages in conduct that is inherently harmful, like child abuse. (See, e.g., *Delgado*, 47 Cal.4th at 312, 97 Cal.Rptr.3d at 305 [insured's intentional assault and battery committed with intent to cause harm not an accident*]; J. C. Penney Casualty Ins. Co. v. M. K*. (1991) 52 Cal.3d 1009, 1021, 278 Cal.Rptr. 64, 70 [no coverage for inherently harmful act, like child molestation; "The act is the harm. There cannot be one without the other. Thus, the intent to molest is, by itself, the same the intent to harm."])

The *Liberty Surplus* decision, however, not only appears to have re-affirmed that unintended consequences can qualify as an "accident," it also appears to have broadened the test for when that approach applies. Some of the appellate courts that have questioned whether

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unintended consequences can qualify as an accident have also acknowledged that they can, provided that the *Merced* test is met. (See, e.g., *Albert v. Mid-Century Ins. Co*., 236 Cal.App.4th at 1291, 187 Cal.Rptr.3d at 219; *Frake*, 197 Cal.App.4th at 579, 128 Cal.Rptr.3d at 309.)

Merced states that an accident may exist "when any aspect in the causal series of events leading to the injury or damage was unintended by the insured and a matter of fortuity." (*Merced*, 213 Cal.App.3d at p. 50, 261 Cal.Rptr. 273.) The court then proposes a test for this rule: "An accident is never present when the insured performs a deliberate act unless some additional, unexpected, independent, and unforeseen happening occurs that produces the damage." (*Ibid*.)

In my prior writing on this subject (and in my briefing to the Supreme Court in *Liberty Surplus*), I was critical of the rule proposed by the *Merced* court because it actually defines the concept of "accidental means," not "accident." The requirement in "accidental means" cases that the additional happening be "independent" used that term to mean outside of the causal chain initiated by the insured or independent of the insured's conduct – essentially as a superseding cause.

The *Liberty Surplus* decision, however, subtly redefines the term. When the Court says that L&M's negligent hiring, retention, and supervision of Hecht could be seen as satisfying the *Merced* test because Hecht's molestation of Doe qualified as the required "additional, unexpected, independent, and unforeseen happening," it cannot have used the term "independent" to mean wholly outside the causal chain initiated by L&M. That is because, as the Court acknowledged in its discussion of causation, L&M's negligent conduct fell *within* the causal chain leading to Doe's molestation. Indeed, it was a substantial factor in causing the molestation. Hence, to the extent that courts continue to follow the *Merced* test, they will have to apply it in the more limited way that the *Liberty Surplus* Court did. (I believe, however, that the test for "accident" is stated in the definition of that term adopted by the Supreme Court. The *Merced* test is an alternative test, which the Supreme Court described as "consistent" with the definition of "accident" that it has adopted. (*Liberty Surplus*, 233 Cal.Rptr.3d at 494.)

Ultimately, *Liberty Surplus* seems to represent a declaration by the Supreme Court – to both insurers and to the lower courts – that the purpose of liability insurance is to protect policyholders from the consequences of their negligent conduct, including acts performed deliberately but without sufficient due care to avoid producing harm to third parties. It therefore appears to signal a lack of patience with the argument often raised by insurers who seek to defeat coverage by claiming that there was no "occurrence" because the negligent act that has resulted in the policyholder being sued was performed deliberately. In many cases, this is akin to arguing that there should be no coverage for an auto-accident case because the policyholder deliberately drove his or her car.

The Court's view that the purpose of insurance is to cover the result of the policyholder's negligent conduct is bookended in the opinion, appearing in both the first and last paragraphs of the Court's legal analysis. In the first paragraph, the Court takes pains to point out that liability policies that offer coverage for bodily injury and property damage caused by accidents "promise coverage for liability resulting from the insured's negligent acts." (*Id*., 233 Cal.Rptr.3d at 490.) And the opinion concludes with a similar sentiment:

> Liberty's arguments, if accepted, would leave employers without coverage for claims of negligent hiring, retention, or supervision whenever the employee's conduct is deliberate. Such a result would be inconsistent with California law, which recognizes the cause of action even when the employee acted intentionally. The requirements for liability of this kind are not easily met, but they are well established. Absent an applicable exclusion, employers may legitimately expect coverage for such claims under comprehensive general liability insurance policies, *just as they do for other claims of negligence.*

(*Id*., 233 Cal.Rptr.3d at 500, emphasis added.)

Given the documented reluctance of many courts to find that the unintended consequences of the insured's intentional acts can constitute an "accident," it is not clear how clearly the Court's message in *Liberty Surplus* will be received. But it is undeniable that the message has been delivered.

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