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IN THE SUPREME COURT OF CALIFORNIA

EN BANC

SUPREME COURT
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Deputy

PITZER COLLEGE,
Petitioner,

vs.

INDIAN HARBOR INSURANCE COMPANY,
Respondent.

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

PETITIONER'S REPLY BRIEF

MURTAUGH MEYER NELSON & TREGLIA
MICHAEL J. MURTAUGH (STATE BAR NO. 57874)
LAWRENCE J. DIPINTO (STATE BAR NO. 147320)
THOMAS N. FAY (STATE BAR NO. 290907)
2603 MAIN STREET, 9TH FLOOR
IRVINE, CALIFORNIA 92614-6232
(949) 794-4000 • FAX: (949) 794-4099
mmurtaugh@mmnt.com / ldipinto@mmnt.com / tfay@mmnt.com

ATTORNEYS FOR PETITIONER
PITZER COLLEGE

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PETITIONER'S REPLY BRIEF

INTRODUCTION

This Court granted review of two important questions of first impression in this case under California Rule of Court 8.548. These questions implicate important public policy issues regarding insurance coverage in the State of California, and are not straightforwardly controlled by existing law or precedent. California's strong public policy disfavoring forfeitures of insurance coverage based upon inconsequential technicalities compels the result sought by Pitzer—that the notice-prejudice rule should apply here to both the notice provision and consent provision, in spite of the policy's choice of law provision.

In its brief, Respondent Indian Harbor argues otherwise, by increasingly desperate means. Indian Harbor mischaracterizes this Court's governing precedent and invents a heretofore-unknown element of a well-understood test adopted by this Court. Indian Harbor plays word games, unmoored from substance, to belittle myriad precedential decisions describing California's public policy, and resorts to counting decisions of the California Courts of Appeal in an attempt to argue for a universal rule. Indian Harbor even mischaracterizes its own coverage and the structure of its own insurance policy.

These arguments must fail. At its core, this case presents the same question that insurers and insureds have brought to this Court and to the Courts of Appeal of this State on innumerable occasions: will California permit an insurer to disclaim coverage over a technical, non-substantive failure of the insured to comply with the terms of the policy without a showing of prejudice? This Court's answer—California's answer—has always been a resounding no. This basic jurisprudential principle of California law, applied to this case, should lead this Court to answer both certified questions in the affirmative.

ARGUMENT

I. INDIAN HARBOR REPEATEDLY MISCHARACTERIZES *NEDLLOYD*

This Court's seminal case on enforcement of contractual choice of law provisions is *Nedlloyd Lines B.V. v. Superior Court* (1992) 3 Cal.4th 459. In that case, this Court adopted the "fundamental policy" test, from Section 187 of the Restatement Second of Conflict of Laws, to serve as California's test for determining whether or not to give effect to a contractual choice of law provision. (*Nedlloyd*, *supra* at 464-466.)

In an attempt to breathe life back into its argument that a quirk of New York law allows it to disclaim coverage over an inconsequential delay in providing notice, Indian Harbor repeatedly mischaracterizes multiple aspects of the *Nedlloyd* case, including the test applied by the *Nedlloyd* Court, the authority relied upon (including both secondary authority and previous decisions), the causes of action and specific issues at stake in the case, and the application of the decision in subsequent cases. These mischaracterizations underlie nearly every argument raised by Indian Harbor on the subject of late notice.[1]

The proper reading of *Nedlloyd* compels a single conclusion: the notice-prejudice rule is a fundamental policy of the State of California.

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[1] The sole meaningful exception is Indian Harbor's argument concerning the application of the notice-prejudice rule to claims-made-and-reported policies, which is equally erroneous, but for different reasons, as discussed below.

A. Indian Harbor Mischaracterizes the Test Adopted in *Nedlloyd*

Indian Harbor contends, incorrectly, that (1) the *Nedlloyd* test includes a third prong restricting "fundamental policies" to those set forth in statutes or constitutions, and (2) the *Nedlloyd* Court articulated a distinction between "strong" and "fundamental" public policies. In making these arguments, Indian Harbor mischaracterizes the *Nedlloyd* test, the underlying authority relied upon by the *Nedlloyd* Court, and subsequent application of *Nedlloyd*, including by this Court.

1. Indian Harbor erroneously contends that the *Nedlloyd* test includes a third prong restricting "fundamental policies" to those set forth in statutes or constitutional provisions.

In *Nedlloyd*, this Court adopted the test set forth in section 187 of the Restatement Second of Conflict of laws:

> In determining the enforceability of arm's-length contractual choice-of-law provisions, California courts shall apply the principles set forth in Restatement section 187, which reflect a strong policy favoring enforcement of such provisions. [fn. omitted][¶] More specifically, Restatement section 187, subdivision (2) sets forth the following standards: 'The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable

law in the absence of an effective choice of law by the parties.'[fn. omitted] (*Nedlloyd*, *supra* at 464-465.)

This Court then provided a brief, authoritative summary of the test:

> Briefly restated, the proper approach under Restatement section 187, subdivision (2) is for the court first to determine either: (1) whether the chosen state has a substantial relationship to the parties or their transaction, or (2) whether there is any other reasonable basis for the parties' choice of law. If neither of these tests is met, that is the end of the inquiry, and the court need not enforce the parties' choice of law. [fn. omitted] If, however, either test is met, the court must next determine whether the chosen state's law is contrary to a *fundamental* policy of California. [fn. omitted] If there is no such conflict, the court shall enforce the parties' choice of law. If, however, there is a fundamental conflict with California law, the court must then determine whether California has a 'materially greater interest than the chosen state in the determination of the particular issue . . . .' (Rest., § 187, subd. (2).) If California has a materially greater interest than the chosen state, the choice of law shall not be enforced, for the obvious reason that in such circumstance we will decline to enforce a law contrary to this state's fundamental policy. [fn. omitted] (*Nedlloyd*, *supra* at 466.)

This Court carefully and explicitly twice set forth the proper test, once quoting the Restatement, and once in its own words. The Court described a two-prong test (once a substantial relationship between the chosen state and the parties or their transaction is established):

(1) Does the chosen state's law conflict with a fundamental California policy? and

(2) Does California have a materially greater interest than the chosen state in the outcome of the dispute?

Curiously, however, Indian Harbor contends that the *Nedlloyd* test contains a third prong: that the "fundamental policy" in question must arise from a statute or constitutional provision. (Respondent's Brief, p. 26-28.) This third prong cannot be found in this Court's lengthy, explicit description of the proper test, quoted above. In fact, the words "statute" and "constitution" do not appear in that section of the opinion, or in any of the footnotes in that section. (*Nedlloyd*, *supra* at 464-466, fn. 2,3,4,5,6.) Instead, this Court repeatedly used the broader terms "law" and "policy." (See *Nedlloyd*, *supra* at 465-466, fn. 4,5,6.) The only place that the words "statute" or "constitution" appear in *Nedlloyd* is in connection with the Court's *application* of the test to the breach of fiduciary duty cause of action at issue therein. (*Nedlloyd*, *supra* at 471.) Notably, under the facts of *Nedlloyd* itself, Indian Harbor's third prong (if it existed) should have neatly disposed of the plaintiff's cause of action for breach of the implied covenant of good faith and fair dealing, a judicially-created doctrine not found in any statute or constitutional provision; instead, this Court holistically considered whether that doctrine constituted a fundamental policy on its own merits, and concluded that it did not. (*Nedlloyd*, *supra* at 468.)

Indian Harbor's supposed third prong also cannot be found in the Restatement section adopted by the Court in *Nedlloyd*. Like this Court's description of the test in *Nedlloyd*, the Restatement speaks in terms of

"law" and "policy," not "statutes" or "constitutions." (Restatement 2d Conflict of Laws, § 187.) Moreover, comment (g) to the Restatement makes clear that there is no such third prong: "No detailed statement can be made of the situations where a 'fundamental' policy of the state of the otherwise applicable law will be found to exist."

The cases that have followed *Nedlloyd* have all cited (and typically quoted) the language from *Nedlloyd* quoted above in describing the appropriate test. This Court's decision in *Washington Mutual Bank, FA v. Superior Court* (2001) 24 Cal.4th 906, 916-917 is a typical example. Indian Harbor cannot identify even a single post-*Nedlloyd* case that applies this alleged third prong.

Last, Indian Harbor's "statutes or constitutions only" conception of the definition of a "fundamental policy" under *Nedlloyd* runs into a major hurdle in this Court's decision in *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148. In that case, this Court held that an adhesive consumer arbitration agreement with a class action waiver was unconscionable under California law. (*Discover Bank, supra* at 161-163.) Because the agreement at issue in that case also contained a choice-of-law provision, this Court also repeated the *Nedlloyd* test (as quoted above) and instructed the Court of Appeal to apply the test on remand – *to a judicially-created rule, not specifically embraced by any statute or constitutional provision.* (*Id.* at 173-174.) In subsequent cases, both the California Court of Appeal and the

Ninth Circuit held that this unconscionability doctrine was indeed a fundamental policy of the State of California. (*Klussman v. Cross Country Bank* (2005) 134 Cal.App.4th 1283; *Omstead v. Dell, Inc.* (9th Cir. 2010) 594 F.3d 1081.)

In an attempt to explain this away, Indian Harbor creatively argues that the *Discover Bank* Court changed ("expanded") the *Nedlloyd* rule. (Respondent's Brief, p. 26.) Nonsense. The *Discover Bank* Court simply "summarized California's choice-of-law provisions," rather than modifying them, and instructed the court below to apply them on remand. (*Discover Bank*, *supra* at 173.) Even Justice Baxter's dissent in *Discover Bank*, which argues at length that unconscionability should not be considered a "fundamental policy" of the State of California under *Nedlloyd*, does not posit that "fundamental policies" are limited to "statutes and constitutions" or that the majority in *Discover Bank* somehow altered the underlying *Nedlloyd* test. (*Discover Bank*, *supra* at 174-178 (Baxter, J., concurring and dissenting).) One might expect Justice Baxter to be particularly aware of changes to or errors in application of the *Nedlloyd* decision, if only because he wrote it. To accept Indian Harbor's characterization of *Discover Bank* is to conclude that this Court, in a closely split decision (4-3), significantly altered the nature of a basic conflict-of-laws rule in this state *without either the majority or the dissent commenting upon the change.*

In reality, *Discover Bank* merely contemplates the ordinary application of the holistic *Nedlloyd* "fundamental policy" test to a judicially-created rule. This result would be startling if Indian Harbor's purported third *Nedlloyd* prong existed—but there is no such prong, which makes the *Discover Bank* decision a natural one.

Indian Harbor's mischaracterization of the *Nedlloyd* test is an unwarranted attempt to change California's choice-of-law rules, which this Court should reject. In *Nedlloyd*, this Court adopted the Restatement test, which does not limit its application to statutes or constitutional provisions, and the Court reaffirmed that test in *Washington Mutual* and *Discover Bank*. There is no reason to alter it or depart from it in favor of an invented bright-line rule that both the Restatement and this Court's jurisprudence reject.

Finally, to the extent that the Court is concerned about the primacy of the Legislature in policymaking, Indian Harbor helpfully points out Insurance Code § 11580.23, which was originally enacted in 1988. (Respondent's Brief, p. 33, fn. 11.) As Indian Harbor points out, this statute enacts the notice-prejudice rule in the uninsured motorist context (and therefore does not apply here). (Id.) Indian Harbor fails to mention subsection (b) of the statute: "The Legislature hereby finds that this section is declarative of existing law. . . ." In other words, nearly thirty years ago the Legislature signaled its approval of the "existing" notice-prejudice rule.

2. Indian Harbor erroneously argues that *Nedlloyd* articulates a meaningful distinction between "strong" and "fundamental" public policies.

Indian Harbor contends that this Court, in adopting the Restatement test in *Nedlloyd*, established the rule that only "fundamental," *but not "strong,"* public policies could rise to a level sufficient to overcome a contractual choice of contrary law from another state. This argument fails for at least four reasons: (1) there is no authority in *Nedlloyd* or anywhere else for the proposition that "fundamental" means something meaningfully different from "strong" in this context; (2) this Court cited with approval decisions of the California Courts of Appeal and the Ninth Circuit using the "strong" formulation of the test in *Nedlloyd* itself; (3) this Court used the "strong" formulation on at least one occasion after *Nedlloyd*; and (4) Indian Harbor fails to offer any difference in meaning between the two words in terms of the application of the test (other than, conveniently, the conclusion that the notice-prejudice rule is merely "strong" and not "fundamental").

The first reason is discussed in Pitzer's Opening Brief (at p. 34) and is self-explanatory – Indian Harbor fails to point to a single decision of this Court (or any other court applying California law) that distinguishes between a "strong" public policy and a "fundamental" public policy for choice of law purposes.

Pitzer's Opening Brief also discusses the second reason (at p. 33-34), namely that this Court cited with approval decisions of the California

Courts of Appeal and the Ninth Circuit using the "strong" formulation of the *Nedlloyd* test (or other similar formulations). Indian Harbor's only rebuttal to this argument is to suggest that Pitzer has misread *Nedlloyd*, and that in fact, this Court in *Nedlloyd* articulated a different standard from that previously set forth by the California Courts of Appeal and the Ninth Circuit. (Respondent's Brief, p. 25.)

Indian Harbor's reading of *Nedlloyd* is at odds with the plain language of the decision. As this Court wrote:

> Prior Court of Appeal decisions, although not always explicitly referring to the Restatement, also overwhelmingly reflect the modern, mainstream approach adopted in the Restatement. (*Mencor Enterprises, Inc. v. Hets Equities Corp.* (1987) 190 Cal.App.3d 432, 435-436, 235 Cal.Rptr. 464 [explicit reference to Restatement section 187]; *Hall v. Superior Court* (1983) 150 Cal.App.3d 411, 417, 197 Cal.Rptr. 757 [no explicit reference]; *Ashland Chemical Co. v. Provence* (1982) 129 Cal.App.3d 790, 794-795, 181 Cal.Rptr. 340 [no explicit reference]; *Gamer v. DuPont Glore Forgan, Inc.* (1976) 65 Cal.App.3d 280, 287, 135 Cal.Rptr. 230 [explicit reference to Restatement section 187].) [fn. omitted] [¶] **We reaffirm this approach**. (*Nedlloyd, supra* at 464 (emphasis added).)

Pitzer's Opening Brief also discusses the third reason that Indian Harbor's invented distinction between "strong" and "fundamental" policies fails (at p. 34) – that *this very Court* used the "strong" formulation of the test interchangeably with the "fundamental" formulation in the *Discover Bank* case, which was decided long after *Nedlloyd*. Here, again, Indian Harbor's only response is to argue that this Court, in *Discover Bank*, was

simply quoting *America Online, Inc. v. Superior Court* (2001) 90 Cal.App.4th 1, which quoted *Hall*, *supra*, which pre-dated *Nedlloyd*. (Respondent's Brief, p. 24.) Indian Harbor ignores (perhaps relying upon its argument debunked in the previous paragraph) that the *Nedlloyd* case itself cites *Hall* with approval. Indian Harbor also fails to explain why, if "fundamental" is so different from "strong," this Court used the two terms interchangeably and (under Indian Harbor's approach) instructed a lower court to apply a supposedly wrong and outdated standard. The (unlikely) implication of Indian Harbor's argument is that this Court simply made a mistake in applying its own precedent.

The last reason that Indian Harbor's argument on this point fails is less technical and more substantive. At its core, Indian Harbor's argument that "fundamental" is different from "strong" is driven by the fact that courts throughout the United States have repeatedly described California's notice-prejudice rule as a "strong" public policy of the State of California. (See, e.g., *Service Management Systems, Inc. v. Steadfast Ins. Co.* (9th Cir. 2007) 216 Fed.Appx. 662, 664 ("California's strong public policy"); *National Union Fire Ins. Co. of Pittsburg PA v. General Star Indem. Co.* (3d Cir. 2007) 216 Fed.Appx. 273, 280 ("strong public policy"); *National Semiconductor Corp. v. Allendale Mut. Ins. Co.* (D.Conn. 1982) 549 F.Supp. 1195, 1200 ("strong and abiding policy").) As a result, Indian Harbor is reduced to mere word games, arguing that previous courts using

the word "strong" should be ignored because they didn't use the word "fundamental."

Indian Harbor's only attempt at articulating a *substantive* difference between a "fundamental" public policy and a "strong" public policy is a citation to certain cherry-picked dictionary definitions of those words, with no attempt at explaining how the perceived difference plays out in terms of application of the test. (Respondent's Brief, p. 23.) The implication of Indian Harbor's argument is that there are certain public policies that are "strong" but not "fundamental," yet, other than the particular public policy at issue in this case, Indian Harbor fails to identify even a single such strong-but-not-fundamental public policy, or *even to explain why the notice-prejudice rule itself is strong but not fundamental* (except to point out that it does not arise from a statute or constitution).

Indian Harbor's desperate last attempt at supporting its invented "strong" versus "fundamental" distinction is a strange counting exercise. (Respondent's Brief, p. 24.) Indian Harbor counts 27 post-*Nedlloyd* decisions applying the *Nedlloyd* test, and contends that 20 of them use the formulation "fundamental policy" to describe the test. (Respondent's Brief, p. 24.) Indian Harbor then attempts to minimize the various post-*Nedlloyd* cases (including this Court's decision in *Discover Bank*, *supra*) that use the "strong" formulation. (Respondent's Brief, p. 24-25.)

Indian Harbor's numerical analysis actually supports Pitzer's position that "strong" public policies are the same as "fundamental" public policies in this context. While most courts understandably used the *Nedlloyd* "fundamental" formulation, verbatim, a significant number of courts, *including this Court*, used "strong" interchangeably with "fundamental" in this context. Moreover, the fact that none of these 27 cases discuss a difference between "strong" and "fundamental" policies, despite both formulations seeing significant use, strongly suggests that the two terms are interchangeable.

B. Indian Harbor Mischaracterizes the Issues at Stake in *Nedlloyd*

In an effort to deride the decision in *Tri-Union Seafoods, LLC v. Starr Surplus Lines Ins. Co.* (S.D. Cal. 2015) 88 F.Supp.3d 1156, Indian Harbor argues that it "runs directly afoul" of *Nedlloyd*, but arrives at that conclusion through a misreading of the underlying causes of action in *Nedlloyd*. (Respondent's Brief, p. 31.)

Tri-Union involved the application of the *Nedlloyd* "fundamental policy" test to California's rule of imposition of tort remedies, including punitive damages, for insurer bad faith. (*Tri-Union*, *supra* at 1167.) The *Tri-Union* court concluded that California's insurer bad faith tort remedy was a "fundamental policy" of the State of California, and based upon that

conclusion, declined to enforce the New York choice of law provision at issue. (*Id.* at 1170-1171.)

Indian Harbor contends that *Tri-Union* is directly contrary to *Nedlloyd* by arguing that the issues at stake in the two cases were the same – namely, the "tort of bad faith." Indian Harbor is simply mistaken. While *Tri-Union* did involve imposition of tort remedies for insurer bad faith, *Nedlloyd* involved an alleged breach of the *contractual* implied covenant of good faith and fair dealing between two shipping companies. (*Nedlloyd*, *supra* at 468.) In rejecting the *Nedlloyd* plaintiff's argument that the implied covenant of good faith and fair dealing was a fundamental policy of the state of California, the *Nedlloyd* court cited *Foley v. Interactive Data Corp.* (1988) 47 Cal.3d 654, which explains the significant distinction between the implied contractual covenant at issue in *Nedlloyd* and the tort of insurer bad faith.

In *Foley*, this Court wrote, "[j]ust as the law of contracts fails to provide adequate principles for construing the terms of an insurance policy, the substantial body of law uniquely applicable to insurance contracts is practically irrelevant to commercially oriented contracts . . . . These [unique] features characteristic of the insurance contract make it particularly susceptible to public policy considerations." (*Foley*, *supra* at 690 (quoting Louderback & Jurika, *Standards for Limiting the Tort of Bad Faith Breach of Contract* (1982) 16 U.S.F.L.Rev. 187, 200-201, fns.

omitted).) Relying on this reasoning, the Court distinguished between the exceptional case of tort liability for bad faith in the insurance context and ordinary contractual remedies for breach of the implied covenant in other contexts, rejecting the plaintiff's claim that tort liability of this kind should be extended into the employment context. The Court wrote, "[i]n our view, the underlying problem in the line of cases relied upon by plaintiff lies in the decisions' uncritical incorporation of the insurance model into the employment context, without careful consideration of the **fundamental policies** underlying the development of tort and contract law in general or of significant differences between the insurer/insured and employer/employee relationships." (*Foley*, *supra* at 689 (emphasis added).)

The *Tri-Union* court, presented with the same argument Indian Harbor makes here, correctly determined that the rules applicable to insurance contracts are fundamentally different from those applied to ordinary contracts, like the stock purchase agreement at issue in *Nedlloyd*, and rejected the conclusion that *Nedlloyd*'s holding with respect to the *contractual* covenant of good faith and fair dealing in the ordinary commercial context governed the doctrine of *tort* liability for bad faith in the insurance context.

II. INDIAN HARBOR'S REFERENCES TO PITZER'S "SOPHISTICATION" HAVE NO EFFECT UNDER CALIFORNIA LAW

Indian Harbor places significant emphasis on the assertion that Pitzer is a "sophisticated private institution that had others (including insurance professionals) negotiating and buying specialized insurance on its behalf." (Respondent's Brief, p. 29, 40.) Indian Harbor argues that this "sophistication" transforms the insurer-insured relationship from a situation characterized by grossly unequal bargaining power and contracts of adhesion, as it is ordinarily regarded, into an ordinary, mutually-negotiated contract situation. (Respondent's Brief, p. 29, 40.) This Court long ago rejected Indian Harbor's argument: "the relationship of insurer and insured is *inherently* unbalanced; the adhesive nature of insurance contracts places the insurer in a superior bargaining position." (*Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 820 (emphasis added).) This line of reasoning has been applied by California courts (including this Court) to cases involving individual insureds, as in *Egan*, but also to insureds as sophisticated as a bank (*Downey Savings & Loan Assn. v. Ohio Casualty Ins. Co.* (1987) 189 Cal.App.3d 1072, 1097 (quoting *Egan*)), or a national manufacturer of toys with three layers of excess insurance (*Kransco v. American Empire Surplus Lines Ins. Co.* (2000) 23 Cal.4th 390, 404-405).[2]

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[2] There is a single noteworthy exception to this general rule: when parties of equal bargaining power jointly negotiate and specially draft certain

In California, the insured-insurer relationship is generally considered to be "inherently unbalanced," and the insurer is considered, absent truly exceptional circumstances absent here, to have the upper hand.

III. CALIFORNIA LAW IS CONTRARY TO NEW JERSEY'S LAW ON CLAIMS-MADE-AND-REPORTED POLICIES, AND THIS COURT SHOULD NOT ADOPT NEW JERSEY'S ABERRATIONAL RULE

Indian Harbor contends that this Court should adopt the reasoning of a recently-decided case in the New Jersey Supreme Court, and decline to apply the notice-prejudice rule to claims-made-and-reported policies, regardless of whether the claim was reported within the policy period. (Respondent's Brief, p. 38.)

In *Templo Fuente De Vida Corp. v. National Union Fire Ins. Co. of Pittsburgh* (2016) 224 N.J. 189, the New Jersey Supreme Court considered whether to apply its notice-prejudice rule to a claims-made-and-reported policy covering directors' and officers' liability. (*Templo Fuente*, *supra* at 192.) The court decided that it would not apply the notice-prejudice rule because the insured (a financial services company with fourteen full-time employees) was a "particularly knowledgeable" insured, and because claims-made-and-reported policies typically are issued to such

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provisions of an insurance policy, courts will not necessarily strictly enforce those provisions, if ambiguous, against the insurer. (*AIU Ins. Co. v. Sup. Ct.* (1990) 51 Cal.3d 807, 823.) This rule is not applicable to form contracts like the one at issue in this case, which are considered contracts of adhesion. (*Id.*)

"sophisticated" insureds. (*Id.* at 208-210.) The court also specifically declined to consider the policy a contract of adhesion. (*Id.* at 210.)

The *Templo Fuente* decision is an aberrational one, at odds with the national consensus and, more specifically, with California law. The national consensus regarding application of the notice-prejudice rule to claims-made policies is that the notice-prejudice rule does not operate to *extend the policy period*, because such an extension would expand the range of covered risks at no cost to the insured, and effectively convert the claims-made policy into an occurrence policy. (See *Anderson v. Aul* (2015) 361 Wis.2d 63 (Wisconsin); *Bianco Professional Ass'n v. Home Ins. Co.* (1999) 144 N.H. 288 (New Hampshire); *Textron, Inc. v. Liberty Mut. Ins. Co.* (1994) 639 A.2d 1358 (Rhode Island); *Gulf Ins. Co. v. Dolan, Fertig and Curtis* (1983) 433 So.2d 512 (Florida); *Hasbrouck v. St. Paul Fire and Marine Ins. Co.* (1993) 511 N.W.2d 368 (Iowa); *Insurance Placements, Inc. v. Utica Mut. Ins. Co.* (1996) 917 S.W.2d 592 (Missouri); *Sletten v. St. Paul Fire and Marine Ins. Co.* (1989) 161 Ariz. 595 (Arizona); *Chas. T. Main, Inc. v. Fireman's Fund Ins. Co.* (1990) 406 Mass. 862 (Massachusetts).)

Invariably, however, in the cases arriving at this rule, the court reaches the rule by *distinguishing* between an "as soon as practicable" notice provision (like the one at issue here and in *Templo Fuente*) and the "reporting" requirement that the claim be reported within the policy period

– meaning that the two should be treated differently, and, by implication, that the notice-prejudice rule should be applied to the "as soon as practicable" notice provision. California law is consistent with this national consensus. (*Pacific Employers Ins. Co. v. Superior Court* (1990) 221 Cal.App.3d 1348.) Surprisingly, so is New Jersey law – or at least it was until *Templo Fuente*. (*Zuckerman v. National Union Fire Ins. Co.* (1985) 100 N.J. 304, 323-324.)

The basic rationale of the *Templo Fuente* decision is fundamentally flawed for three reasons. First, contrary to the assumption apparently made by the *Templo Fuente* court, claims-made-and-reported policies are frequently issued to sole practitioner professionals or small businesses providing professional services, including architects, engineers, attorneys, accounting professionals, professional fiduciaries, and many, many others, who cannot plausibly be argued to have the sophistication or bargaining power to effectively level the playing field with their insurers. Adopting Indian Harbor's proposed rule would treat insurance policies issued to such persons as if they were ordinary, mutually-drafted, commercial contracts, in total contravention of decades of insurance law jurisprudence in this State.

Second, as discussed above, and as this Court and other California courts have frequently held, the insurer-insured relationship is "*inherently* unbalanced," such that even large, highly-sophisticated entities are given special, extra-contractual judicial protection from insurer abuses.

Third, in any event, the notice-prejudice rule is applied without regard for the insured's sophistication. The notice-prejudice rule has been applied in California in favor of insureds as sophisticated as the Shell Oil Company (*Shell Oil Co. v. Winterthur Swiss Ins. Co.* (1993) 12 Cal.App.4th 715, 759-764), reinsurers (*Insurance Co. of State of Pennsylvania v. Associated Intern. Ins. Co.* (9th Cir. 1990) 922 F.2d 516), and a pension trust fund engaged in large-scale real estate development (*Pension Trust Fund for Operating Engineers v. Federal Ins. Co.* (9th Cir. 2002) 307 F.3d 944). The *Pension Trust Fund* case is particularly instructive here. In that case, the policy at issue was unusual: a claims-made policy without a reporting requirement. (*Pension Trust Fund*, *supra* at 955-956.) The Ninth Circuit concluded that, absent a reporting requirement, the only notice provision left in the policy was the standard "as soon as practicable" language from the occurrence-policy context, and that therefore the notice-prejudice rule applied. (*Id.* at 955-957.)

The New Jersey Supreme Court itself even seems to have recognized that its decision is out of step with the general consensus view on application of the notice-prejudice rule: "We recognize that a different conclusion may have been reached in other jurisdictions . . ." (*Templo Fuente*, *supra* at 210.)

California courts do not condition application of the notice-prejudice rule on the status of the insured. This Court should decline Indian Harbor's

invitation to change California law to match New Jersey's aberrational decision in this regard.

IV. INDIAN HARBOR'S ARGUMENTS AGAINST APPLICATION OF THE NOTICE-PREJUDICE RULE TO THE CONSENT PROVISION IN THE POLICY FAIL

A. The Coverage at Issue Herein is First Party Coverage

Indian Harbor contends that its policy in this case is a third party policy. In doing so, Indian Harbor points to the distinction between "loss" and "liability," the title of its policy, and the limits typically applicable to different types of coverage. However, Indian Harbor simply ignores the basic definitions of first and third party coverage, as set forth by this Court in *Montrose Chemical Corp. v. Admiral Ins. Co.* (1995) 10 Cal.4th 645, 663:

> [A] first party insurance policy provides coverage for loss or damage sustained directly by the insured (e.g., life, disability, health, fire, theft and casualty insurance). A third party liability policy, in contrast, provides coverage for liability of the insured to a 'third party' (e.g., a CGL policy, a directors' and officers' liability policy, or an errors and omissions policy). In the usual first party policy, the insurer promises to pay money to the insured upon the happening of an event, the risk of which has been insured against. In the typical third party liability policy, the carrier assumes a contractual duty to pay judgments the insured becomes legally obligated to pay as damages because of bodily injury or property damage caused by the insured. (*Montrose, supra* at 663.)

In other words, the distinction between first and third party coverage arises from the identity of the ultimate beneficiary. Either the beneficiary is the insured itself (or the insured's property), in which case the coverage is

first party coverage, or the beneficiary is a third party tort victim, in which case the coverage is third party coverage.

Here, as noted in Pitzer's Opening Brief, the insurance policy in question provides both first and third party coverage, but the coverage at issue in this case flows to Pitzer's benefit, not to the benefit of a third party. As such, this is a first party coverage situation.

Indian Harbor focuses on certain limiting language describing the remediation to be provided under the policy, and argues that this language demonstrates that Pitzer's coverage flows from legal liability, and that therefore the coverage is third party coverage. Indian Harbor is mistaken.

The coverage provided by the policy for "remediation expense" (i.e., the coverage at issue here) is triggered by "any POLLUTION CONDITION on, at, or migrating from any COVERED LOCATION . . . that is first discovered during the POLICY PERIOD, provided that the INSURED reports such . . . POLLUTION CONDITION to the Company, in writing, during the POLICY PERIOD or, where applicable, the EXTENDED REPORTING PERIOD." (E.R. 221.) Pitzer's campus is a "covered location" under the policy. "Remediation expense," meanwhile, means "expenses caused by a POLLUTION CONDITION and incurred to investigate, assess, remove, dispose of, abate, contain, treat or neutralize a POLLUTION CONDITION, to the extent required by [law]." (E.R. 224.) Reading these provisions together, the policy provides coverage for

remediation when a pollution condition on the covered property rises to the level that state, federal, or local law requires a cleanup, *regardless of the source of the pollution*, so long as the pollution is first discovered during the policy period.

This is a classic feature of first party insurance. As this Court put it in *Garvey v. State Farm Fire & Casualty Co.* (1989) 48 Cal.3d 395, 406, first party insurance "is unconcerned with establishing negligence or otherwise assessing tort liability." The remediation expense portion of this policy at issue here is similarly unconcerned with tort liability. Instead, coverage is triggered by the discovery of a sufficiently severe pollution condition on the insured location, regardless of fault. If Pitzer pollutes its own property, coverage is provided; if some third party pollutes Pitzer's property, coverage is also provided – tort liability is simply irrelevant to the coverage analysis.

Indian Harbor also argues that the defined limits of the policy demonstrate that it is a third party policy. (Respondent's Brief, p. 47.) In so arguing, Indian Harbor relies upon this Court's examination of certain common characteristics of third and first party coverage. (Respondent's Brief, p. 47, citing *Montrose Chemical Corp. v. Admiral Ins. Co.* (1995) 10 Cal.4th 645.)

Indian Harbor misunderstands the nature of the Court's discussion on the point in question. In the section of *Montrose* cited by Indian Harbor,

the Court was discussing differences between a "typical" first-party property insurance policy and a "typical" third-party, occurrence-based CGL policy. (*Montrose*, *supra* at 664.) For obvious reasons, not every first party policy will share all of its characteristics with a "typical" first-party property insurance policy, just as not every third party policy will share all of its characteristics with a "typical" third-party, occurrence-based CGL policy.

In fact, in the paragraph directly after the paragraph relied upon by Indian Harbor, the *Montrose* Court wrote, "Yet another distinction between the two types of insurance coverage is that third party CGL policies do not impose, as a condition of coverage, a requirement that the damage or injury be discovered at any particular point in time." (*Id.*) By Indian Harbor's fallacious reasoning, the fact that a claims-made policy (like the one in this case) *does* contain "a requirement that the damage or injury be discovered at [a] particular point in time" (during the policy period) somehow demonstrates that all claims-made policies are first-party policies.

This is nonsense. While "typical" first and third party policies may tend to have certain other characteristics that differ from each other, the central characteristic that distinguishes first and third party policies is the identity of the ultimate beneficiary of the policy. Where the payments flow to or for the benefit of third parties, the policy involves third party coverage; where the payments flow to or for the benefit of the insured

itself, the policy involves first party coverage. Here, there can be no dispute that the coverage in this case is for payments that flow to or for the direct benefit of the insured, Pitzer, meaning that first party coverage is at issue.

Because the coverage at issue herein is first party coverage, this case presents a question of first impression – in the first party coverage context, does the notice-prejudice rule apply to breaches of the consent provision? Indian Harbor argues repeatedly that Pitzer seeks to "create a new exception," "make new law," or otherwise change the law. (Respondent's Brief, p. 45, 48.) In reality, regardless of the Court's decision in this case, the Court will be making new law.

B. Indian Harbor Fails to Acknowledge the Effect of the Structure of its Policy

Indian Harbor contends that the application of the consent provision in its policy is no different from the application of consent provisions in the third party liability coverage context. In so arguing, Indian Harbor fails to grapple with the significant ways in which its policy is different from the third party policies involved in the cases it relies upon, and the impact those differences have on the policy rationales that California courts have identified justifying strict application of consent provisions.

1. Under Indian Harbor's policy, the insured controls the remediation, not the insurer.

In the policy at issue here, Indian Harbor agrees to "pay on behalf of the INSURED for REMEDIATION EXPENSE . . . resulting from any POLLUTION CONDITION on, at, under or migrating from any COVERED LOCATION . . . that is first discovered during the POLICY PERIOD." (E.R. 221.) The policy also provides coverage for defense of claims against Pitzer under certain circumstances. (E.R. 221.) As discussed above, "REMEDIATION EXPENSE" means "expenses caused by a POLLUTION CONDITION and incurred to investigate, assess, remove, dispose of, abate, contain, treat or neutralize a POLLUTION CONDITION, to the extent required by [law]." (E.R. 224.) The policy also contains three provisions giving Indian Harbor control over the defense, investigation, or adjustment of any "CLAIM" (E.R. 230-231), but is silent as to any right of control on the part of the insurer over *remediation*.

Read together, these provisions can only mean one thing: Indian Harbor agreed to pay for remediation chosen by the insured, so long as the remediation chosen was reasonable. This is consistent with the typical first-party coverage situation, where an insurer "promises to pay money to the insured upon the happening of an event, the risk of which has been

insured against," rather than assuming direct control of repairs to the insured property. (*Montrose*, *supra* at 663.)

2. As a result, Indian Harbor's policy arguments in favor of strict enforcement of the consent provision in this context fail.

Indian Harbor argues that the policy justifications for strict enforcement of consent provisions in the third party coverage context apply with equal force to the first party coverage at issue here. (Respondent's Brief, p. 54-55.) Specifically, Indian Harbor contends that it is "just as difficult" for an insurer to "second-guess the scope of investigation and options for remediation costs after evidence is destroyed by undertaking remediation," as it is for an insurer to second-guess the amount of a tort settlement, and that the policy allows Indian Harbor to "control the remediation and approve costs through the consent provision." (Respondent's Brief, p. 55.) Neither of these arguments is meritorious.

Indian Harbor's first argument fails for fairly obvious reasons. A covered remediation will invariably involve experts and professionals assessing the site, creating reports and memoranda, and suggesting options for remediation, as well as contractors and vendors generating invoices with specific line items. This thorough documentation of the remediation and the underlying pollution condition stands in stark contrast to the subjective pain and suffering of an injured tort victim and the disputed sequence of events leading to liability for the insured in a third party

coverage situation. In fact, Indian Harbor's own expert was able to use this documentation to evaluate the specific lead levels in the soil and create a detailed analysis of the project and various alternatives, allowing him to do exactly the analysis that Indian Harbor claims is as difficult as assessing the reasonableness of a tort settlement after the fact. (E.R. 255.) Further, in practice, these are the very same reports, memoranda, and invoices upon which Indian Harbor would base its decision to grant or withhold consent, meaning that Indian Harbor has not lost access to the information it would rely upon to make this decision.

Indian Harbor's second argument fails because it arises from a false premise. As discussed above, Indian Harbor's policy does *not* vest Indian Harbor with control over remediation. Further, as set forth in Pitzer's Opening Brief, Indian Harbor benefits from its lack of control because it shields itself from potential tort exposure beyond the limits of its policy. At most, the consent provision gives Indian Harbor the right to veto unreasonable remediation expenses; it does not permit Indian Harbor to "control the remediation" or dictate the methods used.

Indian Harbor's final policy argument, that the three policy rationales for the notice-prejudice rule identified in Pitzer's Opening Brief do not apply to the consent provision, fails for much the same reasons. In particular, Indian Harbor misses the key point of distinction between this case and third party cases like *Gribaldo, Jacobs, Jones & Associates v.*

Agrippina Versicherunges A. (1970) 3 Cal.3d 434, which is the balancing of equities.

As set forth in Pitzer's Opening Brief, one of the three principal policy justifications for the notice-prejudice rule is the inequity of the insurer receiving a windfall due to a technicality. Compliance with the notice provision is deemed a "technicality" because it does not protect any particular substantive right of the insurer under the contract. By contrast, in the context of consent provisions in third party coverage situations, the provision *does* protect a substantive right – the right of the insurer to control defense and settlement of the case. (*Jamestown Builders, Inc. v. General Star Indemnity Co.* (1999) 77 Cal.App.4th 341, 346 (consent provisions "are designed to ensure that responsible insurers . . . gain control over the defense and settlement of the claim").) Here, however, there is no substantive right of control being protected by the consent provision, which reduces the consent requirement to a technicality, just like a notice requirement.

C. Indian Harbor's Time-Based Argument for Strict Application of the Consent Provision Fails

Indian Harbor argues, without meaningful citation to authority, that non-coverage of Pitzer's remediation is not a "forfeiture" because it only affects costs that have already been incurred, rather than future costs, and that this (rather than loss of control over defense and settlement of the case)

is the distinction between consent and notice provisions that California courts have relied upon to treat them differently. (Respondent's Brief, p. 52-54.) Indian Harbor ignores both the legal definition of the word "forfeiture," and the practical application of the notice-prejudice rule to reach this conclusion.

"In the law, a 'forfeiture' is defined as 'A deprivation or destruction of a right in consequence of the nonperformance of some obligation or condition.'" (*Chase v. Blue Cross of California* (1996) 42 Cal.App.4th 1142, 1149 (quoting Black's Law Dictionary (6th ed. 1990) p. 650).) Unquestionably, then, the consent provision operates as a forfeiture, in both first and third party coverage situations, contrary to Indian Harbor's contention: the insured has a right to reimbursement of certain costs that it loses by virtue of its nonperformance of the condition of receiving consent from the insurer prior to incurring the costs.

Moreover, in practice, the notice-prejudice rule is applied not only to notice provisions, but also to cooperation provisions. (*Northwestern Title Security Co. v. Flack* (1970) 6 Cal.App.3d 134, 141.) Breaches of the cooperation clause often occur when an insurer has already incurred costs on behalf of its insured, and may give rise to a right on the part of the insurer to recover its already-incurred expenses. In other words, while the insured's loss of rights under a notice provision is entirely forward-looking, and the insured's loss of rights under a consent provision is entirely

backward-looking, the insured's loss of rights under a cooperation clause looks both forward (by excusing the insurer's obligation to continue defending), and backward (by giving the insurer the right to recover its previously-incurred expenses).

Therefore, because the notice-prejudice rule applies both to notice provisions and cooperation provisions, it cannot be driven by a technical distinction between forward-looking "forfeiture" and backward-looking "non-forfeiture," that, in any event, is not reflected in the precedent. Instead, as Pitzer has repeatedly pointed out, California's historic refusal to apply the notice-prejudice rule to consent provisions in the third party coverage context is driven by the insurer's right of control over defense and settlement of third party claims. (See *Jamestown*, *supra* at 346.) As a result, the policy justifications in the third party coverage context that justify strict enforcement of consent provisions do not apply to this policy, and the Court should therefore apply the notice-prejudice rule.

CONCLUSION

For the foregoing reasons, Pitzer respectfully requests that the Court answer the two certified questions in the affirmative.

Respectfully submitted,

MURTAUGH MEYER NELSON &
TREGLIA, LLP

Dated: August 11, 2017

By: /s/ *Thomas N. Fay*
MICHAEL J. MURTAUGH
LAWRENCE J. DI PINTO
THOMAS N. FAY
Attorneys for Petitioner PITZER
COLLEGE

CERTIFICATE OF WORD COUNT

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Dated: August 11, 2017

By: */s/ Thomas N. Fay*
THOMAS N. FAY
Attorneys for Petitioner PITZER COLLEGE

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I, the undersigned, declare that I am and was at the time of service of the papers herein referred to over the age of 18 years and not a party to the action, and I am employed in the county of Orange, California, within which county the subject mailing occurred. My business address is 2603 Main Street, 9th Floor, Irvine, CA 92614-6232. I am familiar with Murtaugh Meyer Nelson & Treglia, LLP's practice for collection and processing correspondence for mailing with the United States Postal Service and that the correspondence shall be deposited with the United States Postal Service the same day in the ordinary course of business.

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PETITIONER'S OPENING BRIEF

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Our File No.: 575-14369

Max H. Stern, Esq. Jessica E. La Londe, Esq. **DUANE MORRIS LLP** Spear Tower One Market Plaza, Suite 2200 San Francisco, California 94105-1127 *(ELECTRONIC COPY VIA E-MAIL AND ONE COPY VIA U.S. MAIL DELIVERY)*	*Attorneys for Defendant* **INDIAN HARBOR INSURANCE COMPANY** T: (415) 957-3000 F: (415) 957-3001 mhstern@duanemorris.com jelalonde@duanemorris.com
Katherine Nichols, Esq. **DUANE MORRIS LLP** 865 South Figueroa Street, Suite 3100 Los Angeles, California 90017-5460 *(ELECTRONIC COPY VIA E-MAIL AND ONE COPY VIA U.S. MAIL DELIVERY)*	*Attorneys for Defendant* **INDIAN HARBOR INSURANCE COMPANY** T: (213) 689-7400 F: (213) 689-7401 knichols@duanemorris.com
Office of the Clerk **SUPREME COURT OF CALIFORNIA** 350 McAllister Street San Francisco, California 94102-4797 *(ELECTRONICALLY SUBMITTED AND 8 COPIES VIA OVERNIGHT DELIVERY)*	T: (415) 865-7000