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Ameron — A Big Leap Away From Foster-Gardner

Law360, New York (January 18, 2011) -- On Nov. 18, 2010, the California Supreme Court issued its opinion in Ameron International Corp. v. Insurance Company of the State of Pennsylvania et al., Case No. S153852.

The question posed by Ameron was whether a proceeding before the U.S. Department of Interior Board of Contract Appeals constitutes a "suit" under a commercial general liability insurance policy that does not expressly define the word "suit." This question appeared to challenge the decade-old decision of the Supreme Court in Foster-Gardner Inc. v. National Union Fire Ins. Co. of Pittsburg et al. (1998) 18 Cal.4th 857, which defined "suit" to mean only actions in a court of law.

In the end, while the court kept the basic holding of Foster-Gardner, Ameron embraced the "functional equivalent" test that Foster-Gardner explicitly rejected, and held that quasi-judicial adjudicative proceedings will also be deemed a "suit" under policies that do not define the term "suit" because such proceedings are functionally equivalent to actions in a court of law.

The Foster-Gardner Rule

Over a decade ago, the California Supreme Court decided Foster-Gardner, which found that the undefined term "suit" contained in a standard CGL policy meant "an actual court proceeding initiated by the filing of a complaint." In so ruling, the court adopted a strict "literal meaning" approach and expressly eschewed the "functional" or "hybrid" approaches, wherein a "suit" could also mean other civil proceedings not pending in a court of law but which function in similar ways.

In adopting the "literal" approach, Foster-Gardner, the court held that the term "suit" is unambiguously understood to mean a proceeding that is pending before a court of law.

The court reasoned that the subject CGL policy's use of the terms "suit" and "claim" are not interchangeable, and therefore, the word "suit" could not be read in the same way as the word "claim." The court said that a claim is more akin to a demand, threat, or an allegation without the benefit of being in a court of law, and that to read "suit" broadly to encompass mere demands, "however powerful," would increase the obligations of insurers beyond what the parties had originally

contemplated.

The court also examined the functional and hybrid approaches in interpreting the term "suit," both of which the court rejected. In both approaches, the term "suit" is deemed ambiguous. The functional approach employs the broadest reading deeming any pre-complaint environmental agency activity a suit, regardless of the gravity of the demand.

The hybrid approach, on the other hand, looks to the coerciveness or seriousness of the agency activity to determine whether a pre-complaint notice would be considered a suit. Under the hybrid approach, an agency letter that is initially not considered to be a suit may, nonetheless, become a suit if the agency escalates the demand with sufficient coerciveness, even without filing a formal lawsuit.

Ultimately, the court found it unpersuasive to use either the functional or hybrid approach primarily because the court deemed that a "suit" has always been traditionally understood to be an action in a court of law, notwithstanding alternative legal avenues that are being created by the legislature.

The court was also concerned that accepting either the function or hybrid approach would introduce uncertainty in the analysis of whether an insurer's duty to defend is triggered stating that "courts would have to rewrite unambiguous policy language on a case-by-case basis under the guise of interpretation."

Ameron: The Exception to the Foster-Gardner

Ameron opened up the term "suit" to include certain administrative proceedings, which deviated materially away from Foster-Gardner. While Foster-Gardner did not involve the specific administrative proceeding involved in Ameron, Foster-Gardner had previously rejected the argument that the term suit includes any proceeding that is a "substantive equivalent" of a suit.

Ameron International Corporation ("Ameron") was a subcontractor for Peter Kiewit Son's Company ("Kiewit"), which in turn, contracted with the U.S. Department of Interior's Bureau of Reclamation (the "Bureau") for the fabrication and installation of concrete siphons used in the Central Arizona Project aqueduct. Ameron manufactured the siphons used at the project. The siphons turned out to be defective, which eventually led to a proceeding before the U.S. Department of Interior Board of Contract Appeals ("IBCA") following an adverse ruling of the Bureau against Ameron.

The IBCA proceeding lasted for 22 days of hearings, dealt with contested factual issues, was heard by an administrative law judge, and involved questioning of witnesses.

Ameron tendered the claim to its insurers for defense and indemnity. The insurers, specifically those whose policies do not define the term "suit," denied Ameron's tender claiming that, under Foster-Gardner, the IBCA proceeding is not a "suit," and therefore, there is no duty to either defend or indemnify Ameron. Ameron commenced an action against the insurers in the California Superior Court, which dismissed Ameron's complaint following the sustaining of the insurers' demurrer.

Following Ameron's appeal, the Court of Appeal affirmed the trial court's decision, "reluctantly applying

Foster-Gardner's reasoning to those policies that did not define the term 'suit'" because the IBCA proceeding was an adjudicative administrative hearing before a federal administrative agency, rather than a court of law. The Supreme Court granted Ameron's petition for review.

In holding that the subject IBCA proceeding should be considered a "suit" under the policies that do not expressly define the term, the court concluded that Foster-Gardner does not apply in the case. In so holding, the court found the following significant and dispositive to its analysis:

- A pollution remediation order by a government agency, such as the one involved in Foster-Gardner, is significantly different from a quasi-judicial adjudicative proceeding, in that the former could not be considered a "suit" even under a reasonable insured expectation standard, while the latter is a "suit" as a reasonable insured would understand the term.
- The IBCA proceeding is a statutory creation, which requires many of the same procedural requirements as in an action in a court of law. Specifically, an IBCA proceeding requires the filing of a notice and "complaint" much in the same manner and form as a traditional complaint in a court of law. The court found it significant that the pleading requirements in an IBCA proceeding are consistent with, and meet the standards of, California's Code of Civil Procedure.
- IBCA proceedings are akin to court proceedings in that witnesses testify under oath and are subject to cross-examination by the opposing side, and all evidence presented is subject generally to rules of evidence. Moreover, the subject IBCA proceeding lasted 22 days, involved the examination and cross-examination of numerous witnesses, and involved submission of substantial evidence.
- IBCA proceedings are litigated before an administrative law judge, who has similar powers as a traditional trial judge, and who can grant "the same relief that would be available to a litigant asserting a contract claim in the Court of Federal Claims."
- The legislative purpose of IBCA proceedings provide that contractors have their "day in court."

After describing these dispositive factors, the court reasoned that given the nature of the subject quasi-judicial adjudicative IBCA proceeding, a reasonable insured would expect it to fall within the word "suit" under the subject policies, and therefore, would expect that the policies would provide coverage. Given that Ameron apparently had a choice of pursuing the case either through the IBCA proceeding or through the Court of Federal Claims, the court noted that Ameron would not have chosen the IBCA proceeding had it not expected that the IBCA proceeding would not be covered while the same claim litigated in the court of Federal Claims would be covered under the subject policies.

Thus, under its decision in Ameron, the Supreme Court has effectively abrogated a portion of Foster-Gardner's holding that a proceeding that is not pending before a court of law, but nonetheless a substantive equivalent of a suit, is still not a suit. Under Ameron, courts and insurers should now look to the nature and scope of the subject administrative or quasi-judicial proceeding to determine whether such proceeding could be considered a "suit."

The biggest factor to be considered is the manner in which the dispute is being handled by the subject administrative proceeding. Ameron dictates that if the subject administrative proceeding is sufficiently "adjudicative" or adversarial, then the proceeding is likely to be considered a "suit."

Other factors that should be considered are: (a) whether the statutory provision that governs the administrative proceeding considers the proceeding a complete and parallel alternative to an action in a court of law with similar substantive and procedural safeguards that are available in a traditional court of law; (b) whether the presiding officer of the proceeding has powers that are traditionally available to a judge in a court of law; (c) whether the scope of the proceeding is governed by an operative complaint; (d) whether the proceeding permits parties to examine and cross-examine witnesses, and introduce and challenge evidence much like in a traditional court of law; and (e) whether the end result of the proceeding results in a material benefit and consequence to the prevailing and non-prevailing parties, respectively, much similar to that of a traditional court of law.

While the Supreme Court has expressly preserved Foster-Gardner as good law — by expressly stating Foster-Gardner is inapplicable to the subject administrative adjudicative proceeding in Ameron — any analysis as to whether a non-court proceeding is considered a suit under a policy that has no express definition of the term "suit" will necessarily employ the analysis articulated in Ameron.

Foster-Gardner is arguably reduced to a single proposition that the traditional understanding of a "suit" is an action in a court of law. Ameron, however, now states that a "suit" may mean something else in addition to a court proceeding, depending on the specifics of the forum and manner by which the underlying claim is being resolved.

Impact of Ameron

The Ameron case expands the potential obligations of insurers concerning the duty to defend and/or duty to indemnify. Prior to Ameron, insurers for policies that do not have an express definition of the term "suit" could have declined to defend an insured against administrative proceedings, quasi-judicial adjudicative proceedings, or other proceedings that were not being litigated in a traditional court of law. Ameron effectively modifies the Foster-Gardner rule in that insurers' obligations may also now be triggered when the claim against the insured is pending before an administrative agency that is sufficiently adjudicative such that the proceedings looks more like a traditional court litigation, except for the forum on which the matter is being litigated.

On one hand, the California Supreme Court's decision in Ameron is not entirely surprising, given the nature and scope of the IBCA proceeding involved in the case. The IBCA proceeding operated much like a civil trial. The main difference was the forum where the proceeding was held. Moreover, while the presiding officer in the IBCA proceeding is an administrative law judge, the powers of the administrative law judge were truly akin to those of an ordinary court judge.

However, insurers now face a more challenging determination regarding defense and indemnity as to cases involving quasi-judicial or administrative proceedings that, while contentious, may not necessarily operate like a traditional trial in a court of law, or that do not have the same "complaint" requirements similar to California's Code of Civil Procedure. In such circumstances, insurers should consider how similar such proceedings are to civil litigation and, if there are apparent parallels, should consider providing at least a defense to an insured under a reservation of rights.

Courts will likely be asked to refine or clarify Ameron due to the inevitable disagreement that would arise between the insurers and their insureds regarding whether a certain administrative proceeding rises to the level of the Ameron standard such that the insurer's duty(ies) are triggered, which ironically, was a concern that was raised by the court in the Foster-Gardner decision. One possible benefit to insurers arising from Ameron may be early participation in cases by insurers which, in turn, may result in early settlement and overall economic savings.

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