Recent Court Decisions

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Airline's Failure to Move Asthmatic Passenger Away From Smoke Causing His Death Is "Accident" Within the Meaning of the Warsaw Convention

Olympic Airways v. Husain, 124 S. Ct. 1221, 157 L. Ed. 2d 1146, 2004 U.S. Lexis 1620 (U.S. Supreme Court—February 24, 2004)

In December 1997, Dr. Abid Hanson took a trip with his family and friends from San Francisco to Athens and Cairo, flying Olympic Airways. When he discovered that Olympic permitted smoking during international flights, he was more than a bit upset because he had a "history of recurrent anaphylactic reactions" to cigarette smoke. He made it to Europe and Africa but died on the return flight. On that return flight, Hanson and his wife (Rubina Husain, who as executor of his estate prosecuted the claim) begged airline personnel to move him further away from the smoking section of the airplane, but the flight crew refused, falsely claiming that the flight was full and also neglecting to tell Hanson that the flight had 28 "nonrevenue passengers" (i.e., airline employees), 15 of whom were farther away from the smoking section and could have switched seats with Hanson. In addition, it appears from the Court's discussion of the facts that the airline also declined to ask any of the smokers to refrain from or reduce their smoking due to Hanson's condition and failed to do so even when he began exhibiting signs of distress. As if in a bad horror movie, Hanson's condition steadily worsened during the flight but the airline nonetheless did not move him away from the smokers. He began having an allergic reaction and died despite being given shots of epinephrine, CPR, and oxygen.

Hanson's estate sued Olympic Airways, seeking recovery pursuant to Article 17 of the Warsaw Convention, an international compact governing recovery for injuries on international airplane flights. Article 17 of the Convention provides

> The carrier shall be liable for damage sustained in the event of the death or wounding of a passenger or any other bodily injury suffered by a passenger if the accident which caused the damage so sustained took place on board the aircraft or in the course of any of the operations of embarking or disembarking.

See 2004 U.S. LEXIS 1620 at *10.

In a Warsaw Convention claim, the plaintiff must first establish a *prima facie* case of liability by showing that the injury was "caused" by an "accident" within the meaning of Article 17. If the plaintiff makes this showing, the airline is then given the opportunity to demonstrate that it took "all necessary measures to avoid the damage" or that it was impossible for the airline to take such measures. *See id.* at *11 (citing Article 20 of the Convention). In a sense, the Convention is a bit more pro-plaintiff than most state tort law in that the claimant need only prove "accidental" injury, with a presumption of negligence created by the Convention and the defendant required to disprove or rebut the presumption of airline negligence. However, damages available under the Convention are capped at set maximums in a manner similar to state workers' compensation statutes unless the plaintiff can show that the injury resulted from "wilful misconduct" by the airline, in which case the cap is not operative. The airline also has the opportunity to show comparative negligence by the plaintiff passenger, which, if shown, reduces the amount of any award of damages. *See id.* at *11.

In the *Husain v. Olympic* case, plaintiff first filed the action in California state court as a wrongful death claim. The airline removed the case to federal court because the case was controlled by the Warsaw Convention. The federal district court found that the airline was responsible for Hanson's death and that the scenario qualified as an "accident" under Article 17 of the Convention. The U.S. Court of Appeals for the Ninth Circuit affirmed. The U.S. Supreme Court reviewed the case focusing on the question of whether the incident was an "accident" within the meaning of the Convention.

Under the facts of the case, the airline was hard pressed to argue that it did all it could for Hanson or that it was not negligent, probably wilfully so. However, Olympic argued that although its crew's conduct may have been something less than helpful, it was not accident, triggering an inquiry into the confines of the term "accident" as it is used in the Convention. Although *Husain v. Olympic* is not an insurance case, the issues of accident, fortuity, and negligence presented in the case are similar to the questions presented when these concepts are at issue in matters of insurance coverage.

Applying the Warsaw Convention, the Supreme Court had previously interpreted the term "accident" to mean "an unexpected or unusual event or happening that is external to the passenger" but not to include "the passenger's own internal reaction to the usual, normal, and expected operation of the aircraft." *See Air France v. Saks*, 470 U.S. 392, 105 S. Ct. 1338, 84 L.Ed. 2d 289 (1985). Olympic Airways essentially argued that Hanson died because his own body was tragically allergic to smoke and that his death thus resulted from internal causes rather than from external forces. Plaintiff argued that although Hanson was fatally sensitive to smoke, his death would not have happened but for the external force of being negligently exposed to lots of smoke by the airline. Property insurers and counsel will appreciate that this is almost a human parallel of the debates surrounding inherent vice in the property insurance arena or the degree to which injury brought about by business operations is or is not an "accident" or "occurrence." The Supreme Court framed the issue as

> whether the "accident" condition precedent to air carrier liability under Article 17 is satisfied when the carrier's unusual and unexpected refusal to

> assist a passenger is a link in a chain of causation resulting in a passenger's preexisting medical condition being aggravated by exposure to a normal condition in the aircraft cabin.

See id. at *5.

The Court in a 6–2 decision answered the question in the affirmative (Justices Scalia and O'Connor dissented whereas Justice Breyer did not participate). Justice Thomas's majority opinion examined the text of the Convention as well as the general concepts of accident and fortuity in both American and French law. The Warsaw Convention is written in French, where under French law, in similar fashion to American law, the term accident is used to describe injury that is viewed as fortuitous, unexpected, or unintended. The court also noted that Article 18 of the Convention regarding lost baggage uses the term "occurrence" rather than "accident" but found this to suggest something closer to strict liability for property loss whereas liability for bodily injury caused by an accident required something more in the nature of an unforseen incident.

Olympic argued that since it permitted smoking on international flights, Hanson's death did not result from an accident but from his own internal reaction to business as usual on the flight, something akin to a passenger having an attack of appendicitis on a flight. The Supreme Court disagreed, emphasizing the degree to which the airline at several key points was doing more than just allowing smoking on an international flight. It was repeatedly refusing a passenger's reasonable requests for reasonable accommodations due to a medical condition. According to the Court, "exposure to the smoke and the refusal to assist the passenger are happenings that both contributed to the passenger's death" from the external poisonous (for Hanson) effect of the smoke. *See id* at *19–*20. The Court also rejected the Dissent's view that two cases regarding deep vain thrombosis injuries on flights, one from Australia and one from the United Kingdom, argued for a different result. In effect, the Court distinguished deep vein thrombosis, which can occur from a passenger merely flying on a regular flight, and the more involved, individualistic events of Dr. Hanson trying in vain to be relocated to a less-smoky part of the airplane.

In addition, the *Husain v. Olympic* Court strongly rejected the airline's argument that an accident could never result from an airline's failure to act. Said the Court:

> The fallacy of petitioner's position that an "accident" cannot take the form of inaction is illustrated by the following example. Suppose that a passenger on a flight inexplicably collapses and stops breathing and that a medical doctor informs the flight crew that the passenger's life could be saved only if the plane lands within one hour. Suppose further that it is industry standard and airline policy to divert a flight to the nearest airport when a passenger otherwise faces imminent death. If the plane is within 30 minutes of a suitable airport, but the crew chooses to continue its cross-country flight, "the notion that this is not an unusual event is staggering."

See id. at *22, quoting *McCaskey v. Continental Airlines, Inc.*, 159 F. Supp. 2d 562, 574 (S.D. Tex. 2001).

In essence, the *Husain v. Olympic* Court is taking a view of the meaning of "accident" under the Warsaw Convention that is largely congruent with the concept of accidental or fortuitous injury in the context of insurance. Palpably injurious conduct (e.g., dropping a bowling ball on the passenger's head) is not required but where there is negligence that permits external forces to cause injury there is an "accident" and the negligent entity is responsible, even if the negligence took the form of unreasonable failure to act.

The main distinction between a Warsaw Convention accident and an insurance accident (leading to injury or damage triggering policy coverage) appears to be that an airline might not be responsible for a passenger's injuries even where there is negligence if the negligence is part of the airline's usual, standard operating procedure and the type of injury suffered is internal rather than external. Both would appear to be required to avoid liability for negligence causing passenger injury. For example, if the airline's standard operating procedure on XXXAir is to fail to secure the overhead compartments containing luggage and a suitcase falls on a passenger, this would be externally caused injury and would appear to create Warsaw Convention liability even if such happenings were not all that unusual, due to the airline's chronic negligence in failing to secure carry-on luggage. In that sense, the "unusual event" part of the *Saks/Husain* definition of "accident" appears to focus more on the injury than on the airline's conduct. For example, it is unlikely that Olympic Airways could have defeated the Hanson/Husain claim by arguing that there was nothing unusual happening because the airline is always rude and indifferent to its passengers.

But other instances of airline policy, even if questionable, would appear to take a case out of unusual event status, at least where the passenger's injury is not the result of external stimuli on the flight, for example, where the standard operating procedure of an airline is to insist that passengers stay seated within one-half hour of an airport (the rule for flights in or out of Reagan National Airport in Washington, D.C. as a result of terrorism concerns) and a passenger claims that the additional time of forced sitting brought on deep vein thrombosis, an internal injury to the passenger, there would appear to be no recovery under the Warsaw Convention. But if a passenger had a particular medical condition making him more susceptible to deep vein thrombosis and requested a reasonable accommodation from the airline (e.g., an aisle seat or one on the exit row to allow for more stretching and movement during the flight), this would appear to be equivalent to Dr. Hanson's situation and could create a cause of action if the airline steadfastly refused to heed the passenger's warnings. Similarly, an airline refusal to bring water to a diabetic or badly dehydrated passenger ("I'm sorry sir, in-flight service has been suspended due to turbulence") would seemingly be actionable. Cases of that type would turn on the reasonableness of the airline's conduct, much like ordinary negligence cases.

The Scalia/O'Connor Dissent in *Husain v. Olympic* reads more as a general plea for limited liability in situations of this type than as a treatise on fortuity or the Warsaw Convention. Justices Scalia and O'Connor found no cause for relief against the airline even though they agreed that volitional conduct by a defendant (e.g., deciding to drive fast on a wet road) could nonetheless cause an accident, a view of the Warsaw Convention that accords with domestic tort and insurance law. However, these two Justices appeared to believe that an injury caused by inaction could only be an accident

if the inaction was intended to cause injury (e.g., failing to attempt first aid or call an ambulance while a passenger bleeds to death on the ramp of an airplane), a result quite different than that found under tort and insurance law. The *Husain* Dissent quoted approvingly from a British opinion stating that inaction cannot be a liability-causing event under the Warsaw Convention, a position that, if it were the law, would make the Convention quite a bit more restrictive than American tort law. *See id.* at *26–*27.

However, as the *Husain* majority implicitly suggests, the Convention appears not to have been designed to be that much more restrictive than regular tort law. The Convention, ratified by the U.S. Senate in 1934, was designed to provide some protections for the then-fledgling airline passenger industry (a policy that still may make sense in light of current economic pressures on airlines) by restricting theories of liability to a degree and, more important, capping damages in instances of ordinary, nonwilful negligence. It does not appear that the intent of the Convention was to erect a substantial barrier to passenger recovery where the airline errs badly and causes injury or that the Convention was to be an immunity treaty. *See* Andreas Lowenfeld and Eric Mendelsohn, *The United States and the Warsaw Convention*, 80 HARV. L. REV. 497 (1967). In the 21st century, the Supreme Court majority opinion makes more sense and is in greater accord with the liability regime affecting other businesses. The Dissent's view would give airlines (a group already favored by special liability-limiting legislation after the September 11 tragedy), an unduly favored position relative to other businesses serving the public and potentially being sued by injured customers.

In addition, as in the *Bajwa v. Metropolitan Life* murder-for-insurance case discussed below, one might also wonder why Olympic Airways chose this factual dispute on which to make its stand as to what constitutes an "accident" under the Warsaw Convention. The facts of the case are helpful to the plaintiff in a way they are not for other sorts of injuries during travel such as deep vein thrombosis or air sickness. In addition, the Hanson/Husain claim, although undoubtedly serious and costly to settle or pay after judgment, is only one case. By contrast, liability for things like deep vein thrombosis, which might affect thousands of passengers over time, would seem a more serious financial threat to the airlines. Also, the facts of the Hanson death are not only pretty good for asserting causation due to negligence, they are pretty unflattering to the airline. Readers of Supreme Court cases or news accounts of the case (and there are more than 1.2 million lawyers in the United States alone) will probably think twice before booking with Olympic Air. A year or so of fares lost to competing carriers probably dwarfs whatever funds Olympic will eventually pay for its part in Dr. Hanson's death.

AGE DISCRIMINATION IN EMPLOYMENT ACT DOES NOT PREVENT BUSINESSES FROM OFFERING OLDER WORKERS BETTER RETIREMENT OR HEALTH PLAN THAN THAT AVAILABLE TO YOUNGER WORKERS

General Dynamics Land Systems, Inc. v. Cline, 124 S. Ct. 1236, 157 L. Ed. 2d 1094, 2004 U.S. Lexis 1623 (U.S. Supreme Court—February 24, 2004)

As the saying goes, youth is wasted on the young. But on the other hand, the law provides substantial protection to the old (who not incoincidently vote at about twice

the rate of the young). For example, the Age Discrimination in Employment Act ("ADEA") protects workers over the age of 40 years from adverse job actions because of age. It condemns age discrimination, at least against older workers. In that sense, it is like other civil rights laws that preclude businesses from discriminating against racial minorities or on the basis of gender. Laws preventing race or gender discrimination have generally been interpreted to permit so-called "reverse discrimination" suits by persons outside the protected groups if persons in the protected group are not only protected from discrimination but also given privileges denied to others. For example, a company could not give women executives a Mercedes as a company car while giving similarly ranked male executives a Kia.

In *Cline*, the Supreme Court was faced with the question of whether the ADEA contains the same bar to reverse discrimination. The Court concluded that because the ADEA differs in important ways from Title VII or other civil rights laws, a company may favor older workers without committing illegal age discrimination. In other words, the ADEA is a "one-way" antidiscrimination statute barring discrimination against those over 40 but not a "two-way" antidiscrimination statute barring all disparate treatment because of age.

In 1997, General Dynamics entered into a collective bargaining agreement with the United Auto Workers union, which "eliminated the company's obligation to provide health benefits to subsequently retired employees, except as to then-current workers at least 50 years old." *See* 2004 U.S. LEXIS 1623 at *8. In other words, General Dynamics' workers that were over 50 in 1997 would have a better retirement package than those under 50, meaning that it was generally more advantageous to be a 51-year-old company worker rather than a 49-year-old company worker. Dennis Cline was then over 40 (the age triggering ADEA protections) but under 50. Cline and others in this age group objected to the new health-benefit terms of the collective bargaining agreement, complaining to the Equal Employment Opportunity Commission (EEOC) that the agreement violated ADEA by discriminating against them with respect to terms and conditions of employment because of their age. The EEOC agreed and informally intervened to attempt a negotiated resolution with the company.

When negotiations failed, Cline sued General Dynamics. The trial court, determining that ADEA provided no cause of action for "reverse age discrimination," dismissed the claim. A divided panel of the U.S. Court of Appeals for the Sixth Circuit (covering the states of Michigan, Ohio, Kentucky, and Tennessee) reversed, finding that any disparate treatment because of age is forbidden by the ADEA unless it is clearly authorized by the Act (e.g., certain jobs with demanding physical requirements can exclude older applicants). Of particular influence to the Sixth Circuit was that the EEOC backed Cline on this question. Under the ordinary ground rules of administrative law, federal courts generally defer to the statutory analysis of a regulatory agency charged with enforcing a statute. Thus, the Sixth Circuit gave considerable deference to the EEOC's view that reverse age discrimination was actionable.

The Supreme Court reversed and held that the ADEA does not forbid a company's differential treatment of workers over 40. The Supreme Court refused to give the EEOC position the same degree of deference accorded by the appeals court, even though the EEOC had a regulation to this effect since 1981. According to the Court, deference to an administrative agency was not required unless the statutory interpretation question

was unclear, but the Court found no uncertainty after reviewing the ADEA's text, legislative history, and purpose. *See* 2204 U.S. Lexis 1623 at *34–*36.

The Court interpreted ADEA as a law that protects the over-40 worker from discrimination in favor of the under-40 worker but not as a law forbidding all age-based distinctions in company policy. Although the Act's text states that it prohibits discrimination "because of age," a closer look at the Act reveals that its operational language makes the under-40/over-40 boundary the key to determining what constitutes illegal age discrimination and what constitutes mere difference in company policy regarding employees within the protected over-40 group. *See id.* at *16–*19 (also reviewing legislative history of the ADEA). In reviewing the legislative history at greater length, the Court minimized the import of some Senate floor commentary that could be read as favorable to Cline's position because it was insufficiently specific and failed to evidence a congressional intent to permit reverse age discrimination suits. *See id.* at *32–*34.

The Court majority also noted that almost all lower court cases regarding the issue (the case under review being almost the lone exception) had found no cause of action for 40-something workers against over-50 workers and that in spite of this Congress had not acted to reverse these decisions despite some history of Congress acting to overturn other judicial interpretations of the ADEA with which it disagreed. *See id.* at *23–*25.

Justices Scalia and Thomas dissented, reading the ADEA text more favorably to plaintiff Cline and finding that the statutory interpretation question was at least sufficiently unclear as to require the Court to defer to the EEOC's position on the issue. *See id.* at *37–*39. In a separate dissent, Justices Thomas and Kennedy went further, arguing that the ADEA text in fact clearly condemned all forms of age discrimination, not only discrimination against over-40 workers in favor of under-40 workers. *See id.* at *39–*48. This dissent also read the ADEA legislative history more favorably to plaintiff Cline. *See id.* at *47–*49. Finally, the Thomas/Kennedy dissent also argued that as a matter of public policy, the better reading of the ADEA was to prohibit all forms of age discrimination rather than permitting companies to give over-50 workers a better deal than 40–50 year-old workers, whatever the company's financial concerns. *See id.* at *50–*60.

GEORGIA STATUTE PROHIBITING USE OF ARBITRATION CLAUSES IN INSURANCE AGREEMENTS NOT PREEMPTED BY FEDERAL ARBITRATION ACT DUE TO MCCARRAN–FERGUSON ACT

McKnight v. Chicago Title Ins. Co., F.3d, 2004 U.S. App. LEXIS 1436 (U.S. Court of Appeals for the Eleventh Circuit—January 30, 2004)

The United States Arbitration Act, 9 U.S.C. Sections 1–16 was originally enacted in 1926 but has become much more important during the past 20 years due to broad application of the Act by the U.S. Supreme Court. In particular, the Court has held that the Federal Act creates substantive federal law applicable in both state and federal court and a national policy in favor of arbitration rather than trial, assuming the parties have agreed to arbitrate rather than litigate. In addition, the Supreme Court and other courts have tended to find sufficient agreement whenever there is a written arbitration

provision in a contract, even if there are some practical concerns about the quality of the consent involved due to preprinted forms, small print, situations where reading the agreement is impractical, etc.

Generally, then, an arbitration clause that is part of an insurance policy or an application for insurance would presumably be enforced as long as the policy reflects a transaction involving interstate commerce (which is a requirement for the Act's application). However, the Georgia Arbitration Code (Ga. Code. Ann. Section 9-9-1, et seq.), which generally makes arbitration agreements specifically enforceable, expressly exempts arbitration provisions from its scope. The question thus arose: was the Georgia law making insurance arbitration clauses unenforceable a state law regulating insurance and therefore protected from federal preemption under the McCarran–Ferguson Act, 15 U.S.C. Section 1011, *et. seq*.? Or was the Georgia law "merely" an arbitration statute that was preempted by the Federal Arbitration Act? In *McKnight v. Chicago Title*, a federal court of appeals concluded that the Georgia law regulated insurance and was therefore immune from federal preemption.

In 1991, Charles and Jean McKnight bought property in Georgia and purchased title insurance from Chicago Title. The insurance policy contained a provision making arbitrable all disputes where the amount at issue was $1 million or less. In 2001, when the McKnights attempted to subdivide the property, they learned that the easement on their property was only 20-ft wide, not the 50 ft stated in the title insurance policy. The McKnights made a claim against Chicago Title for the diminished value of the land. Chicago Title denied coverage and the McKnights sued. Chicago Title moved to compel arbitration. The federal trial court refused, holding that a Georgia statute providing an insurance-only exception to arbitration was protected against federal preemption because McCarran–Ferguson generally vests insurance regulation power in the states and precluded federal preemption.

Chicago Title appealed to the Eleventh Circuit, which affirmed the trial court and denied the motion for arbitration. Said the Court:

> If the state has an anti-arbitration law enacted for the purpose of regulating the business of insurance, and if enforcing, pursuant to the Federal Arbitration Act, an arbitration clause would invalidate, impair, or supersede that state law, a court should refuse to enforce the arbitration clause.

Id. at *6, citing *Standard Security Life Ins. Co. of N.Y. v. West*, 267 F.3d 821, 823 (8th Cir. 2001). Reviewing the McCarran–Ferguson Act, which was passed in 1945 to overrule the Supreme Court's decision in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944) which made insurers subject to federal antitrust law, the Court noted that in passing the Act,

> Congress was seeking to leave to the states the "relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement." Thus "statutes aimed at protecting or regulating this relationship, directly or indirectly are laws regulating the 'business of insurance.'" Later, in *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119 (1982), the Court enumerated "three criteria relevant in determining whether a particular practice is part of the 'business of insurance:'"

> *first*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry. None of these criteria is necessarily determinative in itself. . .
>
> Based on these definitions of law regulating the business of insurance, we conclude, like the only other two federal courts of appeals to address this question have concluded, that a provision in a state's arbitration code excepting insurance contracts is a law regulating the business of insurance.

Id. at *8–*9 (emphasis in original), citing *Standard Security Life of New York v. West*, 267 F.3d at 824 and Mutual *Reinsurance Bureau v. Great Plains Mut. Ins. Co.*, 969 F.2d 931, 934–35 (10th Cir. 1992).

The Eleventh Circuit found that the Georgia statute, by determining the type of dispute resolution that might be agreed upon, clearly affected the relationship between insurer and policyholder and the transfer of risk between them, meeting the first prong of the *Pireno* test for determining what comprises the business of insurance. The Court also found that the form of available dispute resolution was a matter integral to the relationship between insurer and policyholder, meeting the second prong of the *Pireno* test. Because the Georgia law applied only to entities within the insurance industry, the third prong of the *Pireno* test was met as well. In addition, at least one Georgia state court had characterized the statutory exception for insurance arbitration agreements as an insurance regulation law. *See Continental Ins. Co. v. Equity Residential Props. Trust*, 255 Ga. App. 445, 565 S.E.2d 603, 605-06 (Ga. Ct. App. 2002).

ESTATE OF VICTIM IN MURDER-FOR-INSURANCE SCHEME HAS CAUSE OF ACTION AGAINST LIFE INSURER FOR ISSUING POLICY WITHOUT KNOWLEDGE OF CQV

Bajwa v. Metropolitan Life Insurance Co., 2004 Ill. LEXIS 5 (Illinois Supreme Court—January 23, 2004)

In a strange case of litigation noire, the Illinois Supreme Court has found that plaintiff (the administrator of the deceased person insured under a life policy) has a cause of action against the insurer for alleged negligent issuance of the policy—without knowledge of the decedent—to a person who lacked an insurable interest in the decedent.

In December 1992, Muhammad U. Cheema stepped into a Met Life agency and applied for a policy on the life of Muhammad A. Cheema. U. Cheema falsely claimed to be the son of A. Cheema. U. Cheema filled out the applications, designated himself as beneficiary, and arranged for deduction of premiums from his bank account. Then, according to the Illinois Supreme Court

> U. Cheema then told the agent that he would take the application to his "father" to obtain his signature. This was a violation of Met Life's standard procedural rules, requiring that the agent meet personally with the proposed insured to witness the signature on the application and to propound

> certain questions to the proposed insured. Nevertheless, [Met Life account representative Imtiaz] Sheikh agreed to this deviation from procedure, and U. Cheema returned the application with it signed "A. Cheema." Agent Sheikh then signed Part A of the application, under the heading "Witness," indicating that he had personally witnessed the proposed insured sign the application. When the policy was contested following the decedent's death, Sheikh admitted that he had not witnessed the proposed insured's signature.

Id. at *3.

In addition, the medical examination conducted by a paramedical examiner revealed several suspicious discrepancies between Part A and Part B of the applications. Also, the person that was examined by the paramedic was three inches taller and 20 pounds lighter than the actual decedent person insured. Met Life's internal underwriter noticed additional irregularities and wondered by the supposed son was beneficiary rather than A. Cheema's wife, why the beneficiary was paying premiums, and why a policy of $200,000 was sought when A. Cheema's income did not qualify for such a large policy. But nonetheless, Met Life issued the $200,000 policy in January 1993.

Following issuance, Met Life received several calls with questions about coverage scenarios in the event of A. Cheema's death, which was not long in coming. A. Cheema was found stabbed and beaten to death in his apartment in early 1993. The executor of the A. Cheema estate sued, alleging that U. Cheema murdered A. Cheema for the life insurance money and that this murder-for-insurance scheme was facilitated by Met Life's negligence, which included failure to follow its own rules. The trial court granted Met Life's motion to dismiss, finding no cause of action for negligent issuance of a life insurance policy. The appellate court reverse, finding that such a claim was recognized under Illinois law. The Supreme Court affirmed and upheld the cause of action.

Both the appellate court and the Supreme Court found that most states have permitted a decedent's representative to maintain an action against an insurer for wrongful issuance of a life policy where (1) the insurer knew or should have known that the person obtaining the policy had no insurable interest in the life insured; (2) the insurer knew that the person insured had no knowledge of the policy and did not consent to its issuance; or (3) the insurer had actual knowledge of the beneficiary's intent to commit murder and failed to take action. *See id.* at *7, *10–*11, citing cases. Relying on prominent older cases such as *Ramey v. Carolina Life Ins. Co.*, 244 S.C. 16, 135 S.E.2d 362 (1964) and *Liberty National Life Ins. Co. v. Weldon*, 267 Ala. 171, 100 So. 2d 6996 (1957), the *Bajwa v. Met Life* court agreed with these precedents that an insurance company has a duty to use reasonable care not to issue a life insurance policy without the knowledge or consent of the insured. Said the Court:

> We believe that it is reasonably foreseeable that a policy taken out on someone's life without his knowledge or consent could lead to injury or death at the hands of the person who procured the policy, and that there is a sufficient likelihood of injury. The rule against issuing these kinds of policies

> is designed to protect human life, and policies issued in violation of the rule are not considered "dangerous" because they are illegal, [but] they are illegal because they are dangerous.

Id. at *10–*20, quoting *Ramey v. Carolina Life Ins. Co.*, 244 S.C. 16, 24, 135 S.E.2d 362, 366 (1964).

The Illinois Court also determined that a burden of due care should be placed on the life insurer and that this was a modest burden in relation to the potential harm likely to be avoided. Met Life argued that an insurer should be liable only when it has actual knowledge that the insurance policy is being purchased in connection with the perpetration of a crime or fraud but the Court strongly rejected this argument. *See id.* at *21–*23. Met Life also unsuccessfully attempted to argue that it had discharged its duties by noting that the person examined by its paramedical had produced an identification card identifying him as A. Cheema.

> In essence, Met Life is advocating that, as a matter of law, simple verification of a state identification relieves it of any duty to investigate further and trumps the following anomalies known to Met Life: (1) discrepancies between the application and the medical exam existed; (2) the son, not the wife was the beneficiary; (3) the proposed insured was not present for the meeting with the agent to sign Part A of the application; (4) someone claiming to be the son, not the insured, procured the policy; (5) the amount of coverage was in excess of the guidelines; (6) and Met Life received a number of suspicious phone calls following issuance of the policy. The problem with Met Life's argument is that procedurally this case is before this court on a Section 2–615 motion to dismiss, which tests the legal sufficiency of plaintiff's complaint. None of the allegations of plaintiff's fourth amended complaint mention any reliance on the state identification care, nor is reliance on the identification card mentioned in any of plaintiff's exhibits. Thus, the matter has no bearing on whether plaintiff stated a cause of action. We further observe that the question of Met Life's reliance on the identification card—in the face of the anomalies in the application process and the subsequent suspicious phone calls—is germane to the question of whether Met Life breached the standing are cared by issuing the policy and continuing it until the decedent's death. This is a quintessential question of fact to be resolved by the trier of fact.

See id. at *32–*33.

Although trial awaits on the claim, the Court's recitation of the allegations and uncontested facts alone is quite damning to the insurer. As a matter of dispute-resolution strategy, one might ask why Met Life chose this case on which to make its stand in asserting the legal position that an insurer has no duty to refrain from issuing a life insurance policy unless it has actual knowledge that the policy is party of a murder plot. Not only is the legal position arguably extreme, but the facts of the case are extremely damning and appear to show an insurance agent so eager to score a commission that he ignored not only common sense but also the insurer's own policies. Although it

is perhaps 20–20 hindsight, *Bajwa v. Metropolitan Life* certainly looks like a case that should have been quietly settled early in the proceedings. Now, Met Life and other insurers are faced with an unanimous Supreme Court opinion in a major state that holds insurers to a negligence standard in underwriting to avoid issuance of an insurance policy to criminal plotters.

INJURY TO BUILDING CAUSED BY NEGLIGENT SOIL ANALYSIS MAY CONSTITUTE OCCURRENCE UNDER CGL THAT IS NOT PRECLUDED BY BUSINESS RISK EXCLUSIONS OR SIMILAR LIMITATIONS ON COVERAGE

American Family Mutual Ins. Co. v. West American Insurance Co., 673 N.W.2d 65 (Wisconsin Supreme Court—January 9, 2004)

Construction defect litigation has been in something of a boom period during the past 15 years, a phenomenon of no small consternation to homeowners, builders, insurers, and state legislatures. In addition to its overall costs to society, shoddy home construction and complex litigation resulting from housing problems also produces complex and costly insurance-coverage litigation. Commercial General Liability (CGL) insurers have attempted to minimize their exposure for these claims by generally arguing that they are not responsible for mere defects in housing but only for housing problems that cause classic third-party tort injury in the manner of a building collapse that injures bystanders or adjoining property. Builders seeking coverage (supported by plaintiff homeowners and associations seeking deeper defendant pockets) have argued, with significant but mixed success, that the CGL policy is indeed triggered by many allegations of shoddy construction so long as the poor construction causes physical injury to tangible property other than the errant contractor or engineer's own work.

In general, the insurer position against coverage has been losing ground in the courts. For example, in the key California case of *Vanderberg v. Superior Court*, P.2d (Cal. 1999), court rejected the extreme insurer position that a CGL policy need never respond unless the claim was legally styled as a tort. Rather, the matter is controlled by policy language, which provides for coverage when an "occurrence" causes injury or damage. No particular legal styling by plaintiff is required. In many other cases, CGL coverage has been found where the work of one subcontractor caused physical injury to other parts of a building or piece of property. In addition, many of the older cases finding no coverage because damage resulted from substandard work have been correctly held to have been "legislatively overruled" by the ISO's 1986 revision of the CGL to create an exception to the "own work" exclusion where the work is performed by a subcontractor of the policyholder.

The recent Wisconsin Supreme Court case of *American Family Mutual Insurance Co. v. American Girl, Inc.*, 673 N.W.2d 65 (January 9, 2004) continues this trend and arguably clarifies it further in favor of policyholders, also finding coverage in the case of poor soil study that creates building problems. The analysis of the Court's majority opinion is thorough, appreciative of historical context, and properly applies the insights of secondary sources of policy meaning, making more use than most courts of treatise discussion (full disclosure: my treatise was one of those cited by the Court). Because it is a sound opinion from a state high court pertaining to an issue facing many courts

in a new realm, it may have significant impact. However, *American Family v. American Girl* was also a 3–2 opinion in that two Justices did not participate. In addition, the two dissenting Justices enthusiastically embraced what might be regarded as the strong CGL insurer position against coverage, a factor that provides some solace for insurers and a potential source of citation and argumentation.

In 1994, Pleasant Company (which later changed its name to American Girl), entered into a contract with Renschler Company for the design and construction of a large distribution center warehouse near Interstate Highway 94 in central Wisconsin. To build the "94DC," Renschler, which held an American Family policy, hired Lawson, a soils engineer to assess soil conditions for construction. Finding the soil poor for these purposes, Lawson recommended "rolling surcharging" to prepare the soil for holding buildings. Renschler accepted Lawson's analysis and recommendation.

Rolling surcharging is not, as the name suggests, a new interest or late charge strategy used by credit card companies. Rather, it refers to the process of putting large quantities of earth on top of natural ground in order to firm up the natural ground so that it is solid enough and stable enough to support the weight of new construction. The "rolling" occurs as the earth used to compress the natural ground is moved throughout portions of the property so that the owner does not need to purchase, haul, and apply the massive quantities of earth required to surcharge an entire site simultaneously.

The rolling surcharge in question occurred comparatively rapidly as the building was substantially complete in August 1994, a fact that suggests to even laypersons that perhaps the soil had insufficient time to compact and solidify due to the surcharging. In any event, after American Girl occupied the building in Fall 1994, it soon began to sink. By Spring 1995, the settlement at one end of the structure was eight inches. Things deteriorated from there. By early 1997, the settlement "approached one foot" and the building was buckling, "steel supports were deformed, the floor was cracking, and sewer lines had shifted." *See* 673 N.W.2d at 71. American Family was notified in August 1997. By late 1999 or early 2000, settlement had reached 18 inches and the building was dismantled. It was "undisputed that Lawson's faulty soil engineering advice was a substantial factor in causing the settlement of the 94DC." *See* 673 N.W.2d at 72.

American Girl filed an arbitration claim against Renschler, prompting Renschler to request defense and coverage from American Family. American Family responded with a declaratory judgment action seeking a finding of no coverage. Renschler joined several other insurers in the declaratory judgment action. The trial court found coverage under the American Family policy. The intermediate Court of Appeals held that other insurers in for the 1997 and thereafter period were absolved from coverage because "the known loss doctrine precluded coverage, because the extent of the settlement problem was known before any of those policies came into effect." *See* 673 N.W.2d at 72. As to American Family CGL policies from 1994 through 1997, the appeals court held that the contractual liability or "liability assumed by contract" provision of the policies precluded coverage since Renschler and Lawson had hold harmless agreements in the Lawson subcontract.

The Wisconsin Supreme Court reversed and found coverage, rejecting not only the contractual liability exclusion defense of American Family but also rejecting several other American Family defenses to coverage. The Court began with a review of the

history of the CGL and its business risk exclusions (the "your work," "your product," and "your property" exclusions), including the 1986 revision that created the subcontractor exception to the "your work" exclusion. *See* 673 N.W.2d at 73. The Court also found that the "economic loss" doctrine limiting contract claimants to contract damages rather than tort damages (e.g., pain and suffering, punitive damages) did not operate to preclude insurance coverage in cases of this type. The Court observed that

> The economic loss doctrine generally precludes recovery in tort for economic losses resulting form the failure of a product to live up to contractual expectations. The economic loss doctrine is "based on an understanding the contract law and the law of warranty, in particular, is better suited than tort law for dealing with purely economic loss in the commercial arena."
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> The economic loss doctrine operates to restrict contracting parties to contract rather than tort remedies for recovery of economic losses associated with the contract relationship. The economic loss doctrine is a remedies principle. It determines how a loss can be recovered—in tort or in contract/warranty law. It does not determine whether an insurance policy coverages a claim, which depends instead upon policy language.
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> To the extent that American Family is arguing categorically that a loss giving rise to a breach of contract or warranty claim can *never* constitute "property damage" within the meaning of the CGL's coverage grant, we disagree.

See 673 N.W.2d at 75 (citations omitted, quoting *Daanen & Janssen, Inc. v. Cedarapids, Inc.*, 216 Wis. 2d 395, 403-04, 573 N.W.2d 842 (1998), emphasis the Court's).

The *American Family v. American Girl* Court also rejected the insurer argument that the loss did not result from an "occurrence" since the loss had its roots in volitionally provided engineering services rather than happening because of the application of external forces or through the activities of persons outside the distribution center business project. According to the Court.

> No one seriously contends that the property damage to the 94 DC was anything but accidental (it was clearly not intentional), nor does anyone argue that it was anticipated by the parties. The damage to the 94 DC occurred as a result of the continuous, substantial, and harmful settlement of the soil underneath the building. Lawson's inadequate site-preparation advice was a cause of this exposure to harm. Neither the cause nor the harm was intended, anticipated, or expected. We conclude that the circumstances of this claim fall within the policy's definition of "occurrence."

See 673 N.W.2d at 76 (footnote omitted). Added the Court

> We agree that CGL policies generally do not cover contract claims arising out of the insured's defective work or product, but this is by operation of the CGL's business risk exclusions, not because a loss actionable only in contract can never be the result of an "occurrence" within the meaning of the CGL's initial grant of coverage. This distinction is sometimes overlooked, and has resulted in some regrettably overbroad generalizations about CGL policies in our law case.
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> [T]here is nothing in the basic coverage language of the current CGL policy to support any definitive tort/contract line of demarcation for purposes of determining whether a loss is covered by the CGL's initial grant of coverage. "Occurrence" is not defined by reference to the legal category of the claim. The term "tort" does not appear in the CGL policy.

See 673 N.W.2d at 76–77 (footnotes omitted).

In reaching this result, the Wisconsin Court specifically found that neither the widely cited business risk case of *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788 (N.J. 1979) or Professor Henderson's famous article (Roger Henderson, *Insurance Protection for Products Liability and Completed Operations: What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 441 (1971)) state that claims for property damage due to breach of contract can never be a CGL "occurrence." *See* 673 N.W.2d at 77. In similar fashion, the *American Family v. American Girl* Court also found that the damage to the distribution center was not "expected or intended" by Renschler or Lawson. *See* 673 N.W.2d at 79.

As to the contractual liability exclusion, the Court again rejected the insurer's argument, finding that no coverage obtained because the liability exposure of the general contractor and soil engineer was liability it would have faced regardless of any contract provisions and hence was not gratuitously assumed by the policyholder. *See* 673 N.W.2d at 79–80. Quoting a major insurance treatise, the Court noted that

> Although, arguably, a person or entity assumes liability (that is, a duty of performance, the breach of which will give rise to liability) whenever one enters into a binding contract, in the CGL policy and other liability policies an "assumed" liability is generally understood and interpreted by the courts to mean the liability of a third party, which liability one "assumes" in the sense that one agrees to indemnity or hold the other person harmless.

See 673 N.W.2d at 80, quoting ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE Section 132.3 at pp. 36–37. Rather, the contractually assumed liability that precludes CGL coverage "refers to a specific contractual assumption of liability [that would otherwise not exist] by the insured as exemplified by an indemnity agreement." *See* 673 N.W.2d at 81, citing Holmes §132.3. According to the Court, this view is

> Consistent with the general purposes of liability insurance because it enables insurers to enforce the fortuity concept by excluding from coverage any policyholder agreements to become liable after the insurance is in force

> and the liability is a certainty. Limiting the exclusion to indemnification and hold-harmless agreements furthers the goal of protecting the insurer from exposure to risks whose scope and nature it cannot control or even reasonably foresee. The relevant distinction "is between incurring liability as a result of a breach of contract and specifically contracting to assume liability for another's negligence."

See 673 N.W.2d at 81, quoting *Olympic, Inc. v. Providence Washington Ins. Co.*, 648 P.2d 1009, 1011 (Wash. 1982) and citing JEFFREY W. STEMPEL, LAW OF INSURANCE CONTRACT DISPUTES Section 14.14 p. 14-141 (2d ed. 1999 & Supp. 2003).

The *American Family v. American Girl* Court also rejected the business risk defenses to coverage, finding that the injuries claimed by American Girl due to construction problems did not stem from mere dissatisfaction with Renschler's resulting building product but instead were for damages caused to American Girl's property due to injuries inflicted by the defective construction and soil preparation. Although much of the injuries claimed by American Girl were because of damage to the policyholder's "own work" in building the distribution center, the Court found that the clear language of the policy, provides coverage through an exception to the "your work" exclusion when "the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor." See 673 N.W.2d at 82–83. In adopting this view, the *American Family v. American Girl* Court embraced the analysis of two leading cases in the area, *Kalchthaler v. Keller Construction Co.*, 224 Wis. 2d 387, 591 N.W.2d 169 (Ct. App. 1999) and *O'Shaughnessy v. Smuckler Corp.*, 543 N.W.2d 999 (Minn. Ct. App. 1996). The Court observed that

> This interpretation of the subcontractor exception to the business risk exclusion does not "create coverage" where none existed before, as American Family contends. There is coverage under the insuring agreement's initial coverage grant. Coverage would be excluded by the business risk exclusionary language, except that the subcontractor exception to the business risk exclusion applies, which operates to restore the otherwise excluded coverage.

See 673 N.W.2d at 83.

The dissenting Justices argued (quite erroneously in my view) that the American Girl claim against contractor Renschler was not covered because it sounded in contract rather than tort and because it resulted from intentionally undertaken activity (the building project). Much of the position of the dissenting Justices on these issues is clearly outside the mainstream views of courts and commentators (although it was, nonethless reflective of 40 percent of the participating Supreme Court's view on the subject). Regarding the role of business risk exclusions, the dissent argued a position less outside the mainstream in contending that there should be no coverage because coverage under the circumstances would run counter to the "purpose of a CGL policy." According to dissenting Justice Roggensack, the CGL policy

> is written to cover the risks of injury to third parties and damage to the property of third parties caused by the insured's completed work. It is not

> written to cover the business risk of failing to provide goods or services in a workmanlike manner to the second party to the contract.

See 673 N.W.2d at 92 (citations omitted).

Although this statement is generally true, it fails both to appreciate that the degree of misfeasance by a contracting party can do more than fall below acceptable standards of workmanship, it can also cause collateral covered damage (e.g., to other property, cessation of business operations and lost profits) that might be covered under a CGL policy. More important, this portion of the Dissent appears to completely overlook both the 1986 addition of the subcontractor exception to the your work exclusion (the Dissent's passage quoted above cited a pre-1986 case applying now-outdated CGL language) and overlooks the degree to which the subcontractor exception restoring coverage is consistent with the fortuity concept and the purpose of the CGL.

Poor workmanship is generally not covered under a CGL because this strips the contractor policyholder of the incentive it should have to perform a job well. Although the subcontractor exception arguably also reduces contractor incentive to supervise subcontractors, it also recognizes the business realities of a construction project. Even the best general contractor and policyholder cannot reexamine everything done by a subcontractor. This would add great cost to building projects. Imagine a general contractor going over every inch of electrical wiring or every plumbing connection in a large home, warehouse, or factory. As a practical matter, the general contractor to a large degree is at the mercy of its subcontractors just as the homeowner or business is at the mercy of a general contractor.

Under these circumstances, it is appropriate to spread the risk of construction problems causing physical injury and damage through insurance, which allows for risk distribution and pooling and financing of this aspect of modern construction through premium payments imposed on builders (and customers as the premium payments are undoubtedly passed on through higher construction prices). If a general contractor/policyholder chronically chooses poor subcontractors, the insurance industry has implicitly decided that this should be addressed by refusing to provide insurance to the builder or raising its premiums rather than precluding coverage for damage caused by subcontractor's work. In the alternative, individual insurers such as American Family could remove the subcontractor exception to the your work exclusion, although they appear to have declined to do so.

TEENAGE SON OF DRUGSTORE OWNER NOT AN "INSURED" UNDER STORE'S INSURANCE POLICY; POLICY'S UNINSURED MOTORIST COVERAGE NOT AVAILABLE WHEN SON HURT IN ATV ACCIDENT

American Economy Insurance Co. v. Bogdahn, 2004 Okla. LEXIS 11 (Oklahoma Supreme Court—February 10, 2004)

The Hillcrest Pharmacy has been a fixture in Woodward, Oklahoma since the 1960s. In 1990, it was sold to the Bogdahn family. The drugstore was insured under a policy from American Economy Insurance Company. It provided comprehensive coverage to the Pharmacy as named insured, including uninsured motorist (UM) coverage in the event of an auto accident. On the policy, the Pharmacy was not only listed as

the named insured but was also identified as a corporation. The policy stated that "throughout this policy the words 'you' and 'your' refer to the Named Insured." The UM endorsement to the policy specifically stated

> We will pay, in accordance with Title 36, Oklahoma Statutes, all sums the "insured" is legally entitled to recover as compensatory damages from the owner or driver of an "uninsured motor vehicle." The damages must result from "bodily injury" sustained by the "insured" caused by an "accident."

B. Who Is an Insured

1. You.
2. If you are an individual, any "family member."
3. Anyone else "occupying" a covered "auto"...
4. Anyone for damages he or she is entitled to recover because of "bodily injury" sustained by another "insured."

See id. at *6–*7. The court also noted that

> The policy defines "family member" as "a person related to you by blood, marriage or adoption who is a resident of your household, including a ward or foster child."

In 2000, the minor son of the Pharmacy owners was badly hurt when he fell from the back of an all-terrain vehicle being driven by another boy. The ATV owned by parents of the other child was not insured. As a result, the Bogdahns as owners of the pharmacy, sought to collect under the drugstore policy's UM coverage. American Economy filed a declaratory judgment action in federal court, seeking a ruling on the matter. The trial court granted summary judgment to the insurer, concluding that the son was not an insured under the UM endorsement in the drugstore policy. The Bogdahns appealed. The federal appeals court for the Tenth Circuit (geographically encompassing the Great Plains and Rocky Mountain states) sought a ruling on the legal issues from the Oklahoma Supreme Court by certifying to the Court the question of whether the son was a person insured under the UM coverage. The Oklahoma Supreme Court rephrased the question into two separate questions as follows:

1. Is the definition of an insured in the UM endorsement of the American Economy policy issued to Hillcrest Pharmacy, Inc. ambiguous, such that the doctrine of reasonable expectations can be applied to define Blake Bogdahn [the son] as an insured?
2. If so, does the statutorily mandated UM selection/rejection form create a reasonable expectation of coverage for Blake Bogdahn such that the policy must be reformed to provide such coverage?

The Court answered "no" to the first question and therefore did not address the second question. Under the "middle" or majority approach to reasonable expectations analysis used in Oklahoma, the objectively reasonable expectations of a policyholder

regarding coverage are only invoked to determine coverage if the policy language is ambiguous or when an exclusion is "masked" by "technical or obscure language" or where the exclusionary language is hidden in nonexclusion provisions of the policy. *See Max True Plastering Co. v. U.S.F. & G. Co.*, 912 P.2d 861. In the instant case, the policy language at issue was not hidden or masked and was assessed according to its own linguistic terms.

Reviewing the policy language, the Oklahoma Supreme Court found it to be clear and unambiguous in providing that UM coverage was available only to the Pharmacy as a corporation and its agents. There was no coverage for family members of the company owners for accidents involving an uninsured third party tortfeasor. The *American Economy v. Bogdahn* Case provides a helpful "scorecard" of the states concerning the UM/who is an insured issue, concluding that only six states have precedent finding similar policy language ambiguous (i.e., reasonably susceptible of more than one meeting).

In a concurring opinion, one Justice questioned the procedural propriety of the Court's rephrasing of the question put to it by the federal appeals court. Under federal procedural law, a federal court may "certify" a question of state law to a state's highest court, seeking guidance on a legal point in the interests of better resolving a dispute that is in federal court (e.g., the American Economy declaratory judgment action) based on state law (e.g., Oklahoma law concerning insurance policy interpretation). Because of the balance of state and federal court authority and comity toward one another, the dissent viewed it as overbroad for the Oklahoma Court to change the question presented rather than following the federal court's original question. *See id.* at *16.