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Supreme Court Distinguishes Foster-Gardner In Holding Insurer Had Duty To Defend And Indemnify Insured In Administrative Proceeding

On November 18, 2010, the California Supreme Court filed its decision in *Ameron International Corporation v. Insurance Company of the State of Pennsylvania et al.*, holding a federal administrative adjudicative proceeding before an administrative law judge of U.S. Department of Interior Board of Contract Appeals (IBCA) which involved 22 days of trial, numerous witnesses, and substantial evidence, was a “suit” for purposes of the duty to defend under policies that do not define the term “suit.”

Factual and Procedural Background

In this action, Ameron sought coverage from primary and excess carriers, which issued it general liability policies between 1978 and 1995, for the settlement of a contract dispute with the federal government and related defense costs. The underlying action was an administrative proceeding involving the IBCA. Ameron manufactured concrete siphons to be used in an Arizona aqueduct system. The siphons were defective requiring replacement or repair. Ameron challenged the government’s \$40 million demand for damages before the IBCA and later settled the claim for \$10 million.

In the coverage action, Ameron alleged that, because the IBCA acts in a “judicial capacity” when conducting hearings and deciding contested factual issues, the IBCA action was the functional equivalent of a lawsuit for which the policies provided coverage. The insuring language of the policies at issue in this appeal provided the insurers will pay all sums the insured becomes obligated to pay as damages and defend any suit seeking damages. The term “suit” was not defined in the policies. The trial court sustained the insurers’ demurrers and motion for judgment on the pleadings on the ground the government’s action against Ameron was not covered by the subject policies because the damages and expenses were not incurred in a “suit” – a civil action prosecuted in a court of law. The appellate court agreed that if the term “suit” is not defined in a policy, it means a civil action commenced by a complaint. The Supreme Court reversed, holding that the IBCA action, a quasi-judicial proceeding, employed to resolve government demands against interested parties, is a “suit” as a reasonable insured would understand that term.

Judicial Holding and Analysis

The trial and appellate courts relied on *Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal. 4th 857, which held that an environmental agency’s order identifying the insured as a party responsible for remediating environmental pollution was not a “suit” that would trigger an insurer’s duty to defend its insured. The Order required Foster-Gardner to monitor contamination at its site, to prepare and submit a remediation plan, and implement the plan to remediate the site. Foster-Gardner tendered its proposed defense to the Order to its insurers who refused to defend or agreed to defend subject to a reservation of rights. Applying a literal interpretation of the policies, the Supreme Court held that the policy term “suit” referred to a proceeding



brought in a court of law by the filing of a complaint. The Court consciously drew this “bright-line rule” to reduce the need for future litigation. The insurers relied on Foster-Gardner to argue that because the IBCA is not a court of law, any hearing before it is not the trial of a “suit” unless specifically indicated as such in the policy. Ameron argued that Foster-Gardner is not controlling because, unlike the pollution remediation order in Foster-Gardner, the IBCA proceeding was a “suit” as a reasonable insured would understand the term.

The IBCA is a quasi-judicial administrative agency board which holds hearings in which it considers and determines appeals from contracting officer decisions relating to contracts made by the Department of the Interior or other executive agency. IBCA proceedings, which require the filing of a complaint, involve the hearing and determination of a controversy by an administrative law judge who issues a decision and may award damages. The parties may subpoena witnesses who are subject to cross-examination. The judges are empowered to grant the same relief available to litigants asserting claims in the Court of Federal Claims, and their role is comparable to that of trial judges.

The IBCA proceeding provides contractors with their “day in court.” This case proceeded in a 22-day IBCA hearing in which witnesses testified and were cross-examined. The Court held that a reasonable insured would recognize such proceedings as a “suit” and would expect to be defended and indemnified by its insurer. The Court concluded that it is reasonable for the parties to a policy, which does not define the term “suit,” to expect a federal adjudicative administrative agency board proceeding to trigger the defense and indemnity provisions of the policy. Unlike the Order in Foster-Gardner, the IBCA proceeding was not merely a threat to take legal action; it was an administrative adjudicative action which triggered the insurers’ duty to defend and indemnify.

Comments and Implications

Justice Kennard, who filed a dissent in the Foster-Gardner case, filed a concurring opinion in this case, stating that Foster-Gardner “lies far outside the mainstream of American insurance law,” because when it was decided, it represented the minority view in the U.S., and since then, no court has adopted its “literal meaning approach,” or its resulting “bright line rule” in construing the term “suit.” She also stated that, in her opinion, the Ameron decision did not merely distinguish Foster-Gardner, but implicitly rejected its reasoning that the term “suit” unambiguously refers only to court proceedings.