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FILED
CLERK, U.S. DISTRICT COURT
02-05-02
FEB - 5 2002
CENTRAL DISTRICT OF CALIFORNIA
BY [Signature] DEPUTY

CLERK

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

Case No. CV 01-05363 - GAF (Ex)

MERCHANTS BUILDING
MAINTENANCE, GUARD SYSTEMS,
INC.

Plaintiffs,

v.

CERTAIN UNDERWRITERS AT
LLOYD'S, AND DOES 1 THROUGH
100, INCLUSIVE

Defendants.

ORDER RE: DEFENDANT AND
COUNTER-CLAIMANT'S MOTION FOR
SUMMARY JUDGMENT

ENTERED
CLERK, U.S. DISTRICT COURT
FEB - 6 2002
CENTRAL DISTRICT OF CALIFORNIA

I.

INTRODUCTION

This action involves a dispute over whether an insurer Certain Underwriters at Lloyd's ("Lloyd's") is obligated to defend and indemnify an insured, Guard Systems, Inc. ("GSI"), in a sexual harassment lawsuit filed against it by a former employee of GSI, Sheila Medrano. The insured tendered defense of the lawsuit to Lloyd's under an employment practices insurance policy (the "Policy"). Lloyd's denied coverage,

1 however, on the grounds that GSI's claim did not fall within the scope of Policy
2 coverage, and that the claim also came under a Policy provision excluding coverage.
3 Plaintiffs GSI and Merchants Building Maintenance ("Merchants") then filed suit
4 against Lloyd's, alleging causes of action for declaratory relief, breach of contract and
5 insurance bad faith in connection with Lloyd's denial of their claim. Lloyd's
6 responded by filing a counterclaim against the Plaintiffs, seeking a judicial declaration
7 that it has no duty to defend or indemnify GSI in their lawsuit with Ms. Medrano (the
8 "Medrano Action").

9 In the interim, this Court granted Plaintiffs' motion for voluntary dismissal
10 without prejudice of the complaint, and Defendant and Counter-Claimant's motion for
11 leave to file a supplemental counterclaim. Now pending before the Court is Lloyd's
12 Motion for Summary Judgment with respect to the claims relating to the Medrano
13 Action. In the motion, Lloyd's asserts that it is entitled to relief as a matter of law
14 because no genuine dispute remains as to whether it has a duty to defend or
15 indemnify GSI in the Medrano Action. In support of this argument, Lloyd's contends
16 that Medrano's harassment claim was not "first made" during the Policy period, and
17 furthermore, the Policy's prior knowledge provision excludes coverage for the
18 Medrano Action. After reviewing the Policy terms relevant to this coverage dispute,
19 the Court concludes that the undisputed facts establish that Medrano's harassment
20 claim was not first made during the effective dates of the Policy, and thus, the
21 Medrano Action falls outside the scope of the Policy's coverage.

22 Without a genuine dispute as to Lloyd's duty to defend or indemnify, the Court
23 concludes that the insurer is entitled to the declaratory relief sought. Accordingly, the
24 Court **GRANTS** Lloyd's motion with respect to those claims relating to the Medrano
25 Action.

1 II.

2 **FACTUAL BACKGROUND**

3 In light of Plaintiffs and Counter-Defendants' Notice of Non-Opposition to this
4 motion, the Court deems the following facts undisputed.

5 **A. THE PARTIES**

6 Plaintiffs Merchants and GSI are both insureds under an Employment
7 Practices Liability Insurance Policy issued by Defendant Lloyd's.

8 **B. THE MEDRANO ACTION**

9 **1. Medrano Reports Sexual Harassment By Her GSI Supervisor**

10 On March 9, 1999, Sheila Medrano approached GSI's Operations
11 Manager, Louis Perry, to report sexual harassment by her immediate supervisor,
12 William Lyles. (SUF ¶ 1). This report was the first time Medrano made GSI aware of
13 her sexual harassment claim. (*Id.*) Medrano informed Perry that Lyles had "made a
14 sexual sound and grabbed her," and that she did not want to work at her existing post
15 anymore. (SUF ¶ 2). According to Medrano, Lyles stated that "he was waiting for
16 [Medrano to make] one more mistake to get even." (*Id.*) Perry memorialized
17 Medrano's allegation in writing on that same date, and reported the complaint to
18 Larry Krininger, GSI's District Manager. (SUF ¶ 3). Later that afternoon, Krininger
19 met with Medrano, and requested that she come back the following day with a written
20 statement. (SUF ¶ 4).

21 **2. GSI's Investigation of Medrano's Report**

22 Medrano submitted her written report to Krininger on March 10, 1999. (*Id.*) In
23 her written statement, Medrano outlined particular instances of alleged harassment
24 by her supervisor, noting that she told Lyles that she could sue him, and he stated
25 she had come close to being fired. (SUF ¶ 5). After receiving the written statement,
26 Krininger interviewed Medrano about the alleged harassment, and promised her that
27 GSI would conduct a full investigation. (SUF ¶ 6). Krininger recorded this interview
28 in a March 10, 1999 memorandum entitled "Alleged Sexual Harassment (Sheila

1 Medrano and William Lyles)." (Id.) He then submitted the memo, along with a copy
2 of Medrano's written statement, to the Vice President of GSI, Leo Austin. (Id.)

3 Lyles also participated in an interview regarding the harassment allegations on;
4 March 10, 1999. (SUF ¶ 7). Jake Schmidt, Chief Investigator for the related
5 company Risk Control, Inc. ("Risk Control"), conducted the interview, and then
6 prepared a formal report on March 11, 1999, entitled "Sexual Harassment claim
7 alleged against William Lyles." (Id.)

8 **3. Medrano's Workers' Compensation Claim and Subsequent Complaints**

9 Medrano did not receive a job reassignment from GSI, and never returned to
10 work for the company after March 10, 1999. (SUF ¶ 8). Thereafter, she filed an
11 employee's claim for workers' compensation on March 19, 1999, describing her injury
12 as "constant stress and harassment." (SUF ¶ 9). Medrano's lawyer notified GSI by
13 certified letter dated March 23, 1999 that Medrano had submitted this claim to the
14 Workers' Compensation Appeals Board. (Id.)

15 On April 12, 1999, the California Department of Fair Employment and
16 Housing ("DFEH" or the "Department") sent a letter to Krininger notifying GSI that
17 Medrano had filed a complaint with the Department, and had requested an immediate
18 Right-To-Sue Notice. (SUF ¶¶ 10-11). The DFEH indicated Medrano had received
19 the requested notice, which permitted her to bring a civil action against GSI within
20 one year. (SUF ¶ 10).

21 Medrano then proceeded to file a lawsuit against GSI in Los Angeles Superior
22 Court on May 24, 1999 (the "Medrano Action"). (SUF ¶ 12). The summons and
23 complaint were served on GSI on June 2, 1999. (SUF ¶ 13). GSI then tendered
24 defense of the lawsuit to Lloyd's under the Policy, but because the Policy contains a
25 \$25,000 self-insured retention provision, Lloyd's had no obligation to GSI until the
26 defense exceeded \$25,000. (SUF ¶¶ 14 and 28).

1 **C. THE EMPLOYMENT PRACTICES LIABILITY INSURANCE POLICY**

2 **1. The Insurance Application**

3 On April 1, 1999, GSI, Merchants, Risk Control, Merchants Landscape
4 Services ("Merchants Landscape") and others submitted an insurance application
5 ("Application") to Lloyd's for a claims first made and reported policy. (SUF ¶¶ 15-16).
6 Krista M. Haas signed the Application on behalf of GSI, representing her title as
7 "Human Resources Director." (SUF ¶ 23).

8 Section II of the Application addressed applicant Loss History, and included
9 the following question:

10 B. Has any Director, Officer, Manager, Supervisory Employee or Partner
11 knowledge of any circumstances at the date this Application is signed,
12 which could reasonably give rise to a claim or any reasonable way to
13 foresee that a claim may be brought? PLEASE PROVIDE A FULL
14 DESCRIPTION OF ANY CIRCUMSTANCES ON A SEPARATE SHEET.

15 (SUF ¶ 17)(emphasis in original).¹ The Application indicated a response of "No" to
16 this question. (SUF ¶ 18).

17 The next question in Section II inquired into whether the applicant has "been
18 involved in any charges, inquiries, investigations, grievance or other hearings before
19 the Equal Employment Opportunity Commission [("EEOC")] or any other
20 governmental agency." (SUF ¶ 19). Again, the Application indicated a "No"
21 response. (*Id.*) Furthermore, at the close of the Loss History section, the form
22 explicitly advised: "The Applicant acknowledges that any claims or incidents reported
23 in, or that should have been reported in, this Section II, will be excluded from
24 coverage." (SUF ¶ 20).

25 _____
¹ This list is not exhaustive. For example, but not by way of limitation, we consider it

1 Section V of the Application inquired into whether the applicant wished to
2 declare any Material Facts, and asked the applicant to check one of the two boxes,
3 one with the label "None" and the other with the label "See attached." (SUF ¶ 21).²
4 The Application contained a check next to the box marked "None." (Id.) Finally, the
5 last page of the Application form concluded with a warranty, located directly above
6 the signature line, which provided:

7 The Applicant warrants after full investigation and inquiry that the
8 statements set forth herein are true and include all material information.

9 The Applicant on behalf of the Proposed Insurers further warrants that
10 if the information supplied on this application changes between the date
11 of this application and the inception date of the Policy, it will immediately
12 notify us of such change. Signing of this application does not bind
13 [Lloyd's] to offer nor the Applicant to accept insurance, but it is agreed
14 that this application shall be the basis of the insurance and will be
15 attached and made part of the Policy should a policy be issued.

16 (SUF ¶ 22).

17 **2. The Insurance Policy**

18 After receipt and review of the Application, Lloyd's issued the Policy effective
19 May 15, 1999 to May 15, 2000. (SUF ¶¶ 24 and 26). And on May 17, 1999, Ms.
20 Haas sent a letter to GSI's insurance broker informing him that the information
21 contained in the Application had not changed. (SUF ¶ 25).

22 The Policy's coverage form, entitled "Employment Practices Insurance, Claims
23 First Made and Reported," includes the following prefatory language:

24 This policy covers Discrimination, Sexual Harassment and Inappropriate
25 Employment Conduct liability within the terms, conditions, limitations and
26

27 ² The Application defined a Material Fact as "one likely to influence assessment of this risk, the
28 premium charged and the terms and conditions imposed by [Lloyd's]. If [the applicant is] in any
doubt as to whether a fact would be considered material [the applicant] should declare it. All
information requested in this proposal is material." (Id.)

1 exclusions set forth in this policy. It has been issued in reliance upon
2 statements made to us in the application and any attachments thereto
3 which, application and attachments, are incorporated herein and form
4 part of this policy ... READ THIS POLICY CAREFULLY TO DETERMINE
5 THE EXTENT OF COVERAGE. IMPORTANT: THIS IS A CLAIMS
6 FIRST MADE AND REPORTED POLICY WHICH INCLUDES COSTS
7 OF DEFENSE WITHIN THE COVERAGE LIMITS.

8 (SUF ¶ 27)(emphasis in original).

9 The Policy covers "Loss amounts that the insured is legally obligated to pay on
10 account of a Claim because of an Insured Event to which this policy applies." (SUF ¶
11 29). The Policy applies only if the following circumstances are met:

12 (1) A Claim is first made against the Insured in accordance with the
13 WHEN COVERAGE IS PROVIDED section;³

14 (2) The Claim is first reported in accordance with the WHEN COVERAGE
15 IS PROVIDED section and the CONDITION section ... ; and

16 (3) The Insured Event takes place within the Coverage Territory.⁴

17 (SUF ¶ 29)(emphasis in original). Moreover, the section entitled "WHEN
18 COVERAGE IS PROVIDED" includes the following representations:

19
20 ³ "Claim" is defined within the Policy as a "written complaint or written charge received by the
21 Insured or a written demand received by the Insured in which damages are alleged or where
22 specific charges of Discrimination, Sexual Harassment or Inappropriate Employment Conduct
23 are made." (SUF ¶ 30). "Claim includes a civil action, suit or an administrative proceeding or
24 an arbitration proceeding" (*Id.*) And sexual harassment means "unwelcome sexual
advances, requests for sexual favors or other verbal or physical conduct of a sexual nature that
... (3) create a work environment that interferes with performance." (SUF ¶ 31).

25 ⁴ The Policy defines an "Insured Event " as "actual or alleged act of Discrimination, Sexual
26 Harassment, and/or inappropriate Employment Conduct, by an Insured against an Employee
27 or former Employee or applicant for employment with an insured entity." (SUF ¶ 31). And "One
28 Insured Event" is defined as "(1) one or more covered allegations which are related by an
unbroken chain of events; or (2) class action or multiple plaintiff suits arising out of related
Insured Events." (SUF ¶ 30).

1 A. This policy applies only to Claims arising out of an Insured Event
2 which are first made or brought and reported during the Policy
3 Period. A Claim is considered to be first made on the date the Claim
4 is made and not the date the Insureds are served or first receive
5 notice of a Claim. All Claims because of One Insured Event will be
6 considered to have been made or brought on the date that the first of
7 those Claims was first made or brought.

8 (Id.)

9 Finally, the Policy also contains a prior knowledge exclusion, which provides,
10 in pertinent part:

11 In consideration of the premium charged, it is hereby understood and
12 agreed that if any director, officer, member, partner, manager or
13 supervisory employee of an insured entity is aware, as of the inception
14 date of this policy, of any fact, circumstance or situation which could
15 reasonably give rise to any Claim for Discrimination, Sexual Harassment
16 or Inappropriate Employment Conduct ... being brought against any
17 Insured, then the Claim subsequently arising therefrom shall be excluded
18 from coverage.

19 (SUF ¶ 32).

20 **D. RELEVANT PROCEDURAL BACKGROUND**

21 **1. Plaintiffs' Claim and Defendant's Counterclaim**

22 GSI tendered defense of the Medrano Action to Lloyd's under the Policy,
23 and Lloyd's subsequently denied coverage. Thereafter, on May 15, 2001, Plaintiffs
24 Merchants and GSI brought suit against Lloyd's, alleging causes of action for
25 declaratory relief, breach of contract, and insurance bad faith. Lloyd's answered the
26 complaint, and brought a counterclaim for declaratory relief against the Plaintiffs and
27 Counter-Defendants, seeking a judicial declaration that it had no duty to defend or
28 indemnify GSI in the Medrano Action.

1 Plaintiffs then filed a motion for voluntary dismissal without prejudice pursuant
2 to Federal Rule of Civil Procedure 41(a)(2). In an order dated January 2, 2002, this
3 Court granted Plaintiffs' motion, dismissed the complaint without prejudice, yet
4 concluded no controlling authority authorized the involuntary dismissal of the
5 counterclaim.

6 **2. Lloyd's Motion for Summary Judgment**

7 On December 5, 2001, Lloyd's filed a motion for summary judgment with
8 respect to the entire action. Prior to resolution of that motion, however, the Court
9 issued the January 2, 2002 Order dismissing Plaintiffs' complaint. In light of this
10 dismissal, the Court continued the hearing then set for Lloyd's summary judgment
11 motion in order to afford Plaintiffs an opportunity to adequately respond to the motion
12 with respect to the remaining counterclaim. Plaintiffs and Counter-Defendants
13 subsequently responded by filing a Notice of Non-Opposition to the summary
14 judgment motion on January 16, 2002.

15 In the interim, on December 27, 2001, Lloyd's filed a Motion for Leave to File
16 First Amended and Supplemental Counterclaim. On January 17, 2002, Plaintiffs and
17 Counter-Defendants filed a Notice of Non-Opposition to this motion as well. Finding
18 good cause, the Court issued an order on January 31, 2002 granting Lloyd's motion,
19 and ordering filed the First Amended and Supplemental Counterclaim.

20 Before the Court is Defendant and Counter-Claimant's Motion for Summary
21 Judgment. Although Lloyd's framed the motion as one for relief from the entire
22 complaint, subsequent action by this Court described above requires the motion to be
23 construed as one for partial summary judgment of the counterclaim, addressing only
24 those causes of action related to the Medrano Action. Lloyd's asserts that is entitled
25 to relief as a matter of law because no genuine dispute remains over whether it has a
26 duty to defend or indemnify GSI for the Medrano Action.⁵ Lloyd's contends that

27
28 ⁵ Lloyd's points out that although Merchants is an insured under the Policy at issue in the
(continued...)

1 Medrano's harassment claim was not "first made" during the effective dates of the
2 Policy, and the Policy's prior knowledge provision excludes coverage for the Medrano
3 Action.

4 III.

5 ANALYSIS

6 A. THE LEGAL STANDARD UNDER RULE 56

7 Under the Federal Rules of Civil Procedure, summary judgment is proper only
8 where "the pleadings, depositions, answers to interrogatories, and admissions on file,
9 together with the affidavits, if any, show that there is no genuine issue as to any
10 material fact and that the moving party is entitled to a judgment as a matter of law."
11 Fed. R. Civ. P. 56(c). The moving party has the burden of demonstrating the
12 absence of a genuine issue of fact for trial. Anderson v. Liberty Lobby, Inc., 477 U.S.
13 242, 256 (1986). If the moving party satisfies the burden, the party opposing the
14 motion must set forth specific facts showing that there remains a genuine issue for
15 trial. Id.; see also Fed. R. Civ. P. 56(e).

16 B. LLOYD'S HAS NO DUTY TO DEFEND OR INDEMNIFY GSI AS A MATTER OF LAW

17 After reviewing the undisputed facts material to the claims at issue in this
18 summary judgment motion, the Court concludes that Medrano's claim of sexual
19 harassment was first reported to GSI prior to the effective date of the Policy, placing
20 it outside the scope of coverage under the Policy. Therefore, Lloyd's is entitled to a
21 judicial declaration that, as a matter of law, it has no duty to defend or indemnify GSI
22 in the Medrano Action.

23 In an action for declaratory relief on the issue of an insurer's duty to defend,
24 "the insured must prove the existence of a *potential for coverage*, while the insurer
25 must establish *the absence of any such potential*." Montrose Chemical Corp. of Cal.

26
27 ⁵(...continued)

28 pending action, the company was not sued by Medrano. Moreover, Lloyd's asserts that
Plaintiffs' First Amended Complaint does not explain why Merchants is seeking relief or how it
was allegedly harmed. (Mot. at 1 n. 1). This point is well taken by the Court.

1 v. Superior Court, 6 Cal. 4th 287, 300 (1993)(emphasis in original). In short, where
2 an insurer is successful in its motion for summary judgment regarding the duty to
3 defend, "the absence of a duty is clear." Id. at 301 (noting the insurer must present
4 evidence that the insured's claim cannot fall under policy coverage because of the
5 scope of the policy terms or the breadth of its exclusions). In contrast, an insurer's
6 duty to indemnify runs only to claims that are actually covered, i.e, the duty "entails
7 the payment of money in order to resolve liability" once it has been established. Buss
8 v. Superior Court, 16 Cal. 4th 35, 45-46 (1997)(collecting cases).

9 Moreover, the assessment of an insurer's defense and indemnification duties
10 calls for consideration of the insurance policy at issue. And when interpreting an
11 insurance policy, a court is to apply the ordinary rules of contract interpretation.
12 Palmer v. Truck Ins. Exch., 21 Cal. 4th 1109, 1115 (1999)(citations omitted).
13 Accordingly, this Court's interpretation of the Policy in the instant action is a question
14 of law. See id. (citation omitted).

15 Lloyd's argues that Medrano's sexual harassment claim was not first made
16 and reported during the Policy period, because although "a 'claim' may be 'made'
17 several times, it can only be 'first made' once." (Mot. at 12). In support of this
18 contention, Lloyd's claims that all of the various forms in which Medrano's claim of
19 sexual harassment was made and communicated to GSI encompass a "claim" as
20 defined by the Policy. These communications include Medrano's written statement to
21 GSI on March 10, 1999; the March 23, 1999 notice of Medrano's claim submitted to
22 the Workers' Compensation Appeals Board; and GSI's notice that Medrano had filed
23 a complaint with the DFEH and received a Right-to-Sue Notice on April 12, 1999.
24 (See Mot. at 13-14). Thus, because GSI has not shown that the Medrano claim was
25 first made during the Policy period, Lloyd's argues there is no dispute that the
26 Medrano Action falls outside the scope of the Policy's coverage. (See Mot. at 14).

27 After reviewing Medrano's March 10, 1999 written statement to GSI outlining
28 specific allegations of sexual harassment by Lyles, in light of the applicable Policy

1 terms, the Court concludes Lloyd's interpretation of this statement as a "Claim" within
2 the meaning of the Policy appears consistent with the language of the contract. The
3 Court also notes that GSI offers no opposition to, or contrary interpretation of, this
4 relevant Policy term. Furthermore, it is also undisputed that Medrano filed a
5 complaint with the DFEH prior to the effective date of the Policy. And while the Policy
6 clearly states that a "Claim is considered to be first made on the date the Claim is
7 made and not the date the Insureds are served or first receive notice of a Claim," GSI
8 also received notice of this "Claim" to the DFEH approximately one month before the
9 effective date of the Policy. Therefore, the Policy unambiguously provides coverage
10 only for those claims "which are first brought and reported during the Policy Period,"
11 and the evidence presented by Lloyd's shows GSI's claim does not satisfy this
12 provision.

13 By reaching the conclusion that the Medrano Action does not fall within the
14 Policy's scope of coverage, the Court finds it is unnecessary to consider Lloyd's
15 argument regarding application of the Policy's prior knowledge exclusion to coverage.
16 The Court concludes that the Plaintiffs and Counter-Defendants have presented no
17 evidence of the potential for coverage of the Medrano Action, while the Defendants
18 and Counter-Claimants have clearly established the existence of no possibility for
19 coverage. Therefore, no genuine dispute remains regarding Lloyd's duty to defend or
20 indemnify GSI in the Medrano Action, and Lloyd's is entitled to the declaratory relief
21 sought as a matter of law. Accordingly, the Court **GRANTS** the motion for partial
22 summary judgment.

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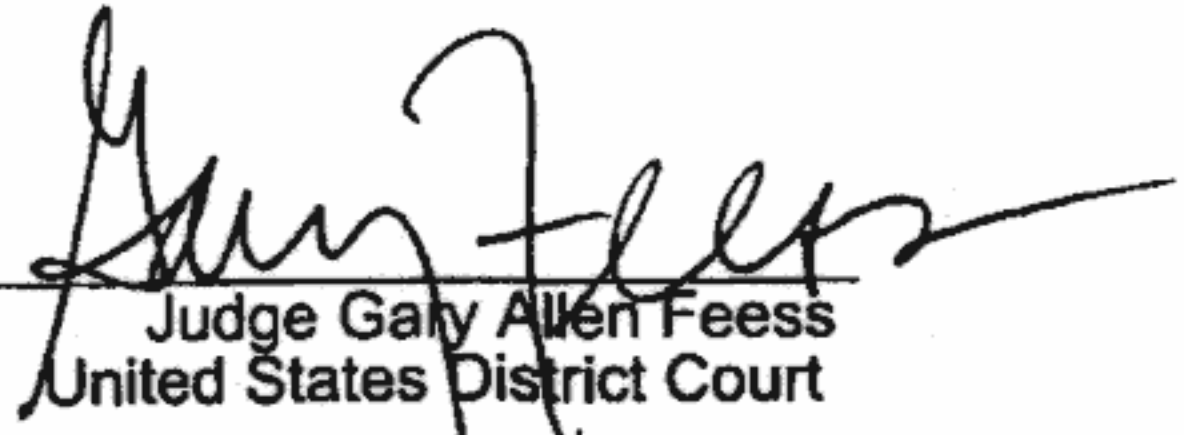
V.

CONCLUSION

For the reasons as stated above, Defendant and Counter-Claimant's Motion for Summary Judgment is **GRANTED** with respect to the First and Second Causes of Action in the First Amended and Supplemental Counterclaim.

IT IS SO ORDERED.

DATED: February 4, 2002


Judge Gary Allen Feess
United States District Court

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES — GENERAL

Case No: CV 01-5363 GAF (Ex)

Date: May 13, 2002

Title: MERCHANTS BUILDING MAINTENANCE, GUARD SYSTEMS, INC. V. CERTAIN
UNDERWRITERS AT LLOYD'S OF LONDON

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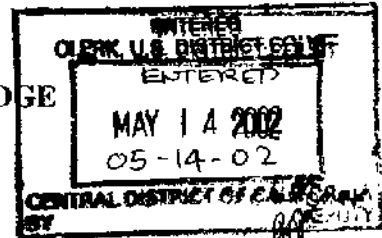
PRESENT

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HON. HARRY L. HUPP, JUDGE

Arlene Chavez

Deputy Clerk



Cynthia L. Mizell

Court Recorder

ATTORNEYS PRESENT FOR PLAINTIFF:

Jacquelyn Thomas
Daniel Friedenthal
M. Herxhultz ✓

ATTORNEYS PRESENT FOR DEFENDANTS:

Katy Nelson ✓
Alan Barbanel ✓

PROCEEDINGS: COUNTERCLAIMANT'S MOTION FOR SUMMARY JUDGMENT, FILED 4/8/02

ORDER (also, if applicable, findings and memorandum opinion):

The motion of counter-claimant Certain Underwriters at Lloyds of London (hereafter Lloyds) for summary judgment on the 3d, 4th, 5th, and 6th claims of the First Amended Counter-claim against Merchants Building Maintenance, Guard Systems, Inc. (hereafter GSI) is granted in part and denied in part. It is determined that Lloyds did not have the duty to defend or to indemnify GSI under its policy effective May 15, 2000, as to the claims of Patricia Chirino, and that Lloyds is entitled to judgment against GSI for the amount paid under said policy to indemnify GSI for the Chirino settlement and the reasonable costs of defense of the Chirino action. However, the amount to be paid as

The undisputed facts are that Lloyds insured a group of related corporations, including GSI, against claims for, among other items, sexual harassment. The Lloyd's policy was a "claims made" policy, meaning that it covered claims (as defined) made during the policy period. ("Claim" is defined as a "written complaint or written charge...in which damages are alleged..." and includes commencement of a suit

handle the situation herself, and tried to. The next day, the vice-president warned the alleged harasser. In February, 2000, GSI's president and vice-president of operations was informed by a client (GSI's customer) that Chirino felt she was being sexually harassed by Yanez. The vice-president interviewed Chirino. On March 1, 2000, Chirino wrote a letter to her superiors and Yanez, complaining of sexual harassment. She requested an apology from GSI and from Yanez. The letter ends "it is not my intention to take legal action. I simply want to be able to come to work without being sexually harassed by Mr. Ossie Yanez. However, if this matter is not resolve (sic), I will be force (sic) to take legal action."

The Lloyds' policy was issued effective May 15, 2000. On October 18, 2000, Ms. Chirino filed her sexual harassment suit against GSI and Yanez. GSI tendered the suit to Lloyds, who defended under a reservation of rights, which included the information that if no defense or indemnity was owed, Lloyds reserved the right to make claim against GSI for any settlement paid out and for costs of defense. Lloyds settled the suit for policy limits (at GSI's demand) and incurred defense costs.

In the court's opinion, the information that GSI had when it submitted its application was precisely the type of information which the application form demanded. GSI was precisely informed that failure to reveal any such information would make any subsequent claim not covered under the policy. GSI argues that Ms. Chirino's reports to or known to her supervisors (including the president of the company) were not a "claim" as defined in the policy. This argument is irrelevant--what the question calls for is knowledge of circumstances "which could reasonably give rise to a claim", and the 2 oral and 1 written communication are certainly that. GSI also argues that Ms. Chirino disclaimed intention to take legal action. This also is irrelevant since the circumstances which could reasonably give rise to a claim are set forth, and the last phrase of Ms. Chirino's letter in any event makes her non-intention to make a claim contingent on what preventive action is taken. Whether any preventive action was insufficient or whether Ms. Chirino

changed her mind is not known, but the information known to GSI was precisely what Lloyds application form called for. The information not having been revealed, Lloyds had neither the duty to defend or the duty to indemnify, and, having taken the necessary form of reservation of rights, is entitled to be reimbursed for the settlement and reasonable costs of defense.

The defense was provided by counsel hired ^{or continued} by Lloyds. GSI states that, a reservation of rights having been taken, it was entitled to independent "Cumis counsel." GSI is probably right about this, but the record is devoid of any request or demand by GSI that it be allowed to hire its own counsel at Lloyds' expense. In any event, this can hardly have harmed GSI, since Lloyds, at GSI's demand, paid the policy limits in order to protect its insured (all in accord with the policy favored by California law).

GSI advances one other argument--that the fact that Lloyds did undertake the defense is evidence that the circumstances were so murky that there was a "potential" for coverage, and thus a duty to defend. This argument lacks merit. Anyone who reads California law from Gray v. Zurich forward must know that any insurer declining a defense does so at great peril and with punitive consequences if proven wrong. The insurer does, however, have a remedy, even if temporarily very expensive--defend under a reservation of rights. Further, any insurer which does not pay the policy limits on demand also takes great risks, especially when the insured demands that it be protected by a payment within policy limits. Again, compliance is often the prudent course, even if temporarily expensive, with the risks reduced by the possibility, if there really was no coverage and no duty to defend, to recoup the amounts paid out. California judicial policy is such that a prudent insurer in the position of Lloyds in this case, will often defend, and settle at the insured's demand, and attempt to recoup its losses by this type of suit when it is clear, as it is here, that there never was a duty to defend or indemnify. The chickens have come home to roost--GSI should have but did not report the Chirino incident at its peril, and is not covered, either for defense or indemnity, under the policy

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5/13/02

Page Five

effective May 15, 2000. It is determined that Lloyds is entitled to be reimbursed by GSI for the amount paid to settle plus reasonable defense costs. This much is determined on this motion for summary judgment.

There is an issue of fact--what is the measure of reasonable defense costs plus costs of settlement? This issue is not adjudicated on this motion, and is the only issue left in this lawsuit. The remainder of the issues are determined on this motion for summary judgment.

cc: Hon. Gary A. Feess

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ASC