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California Clarifies Scope of Reasonable Expectations for Additional Insureds

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Insurance policies often insure persons or entities other than the named insured, often because the named insured is obligated to obtain insurance to protect those other persons. In California, when a policy provision is ambiguous because it is susceptible to more than one reasonable interpretation, one of the tools the courts use is to examine the objective reasonable expectations of the policyholder. Of course, when there are both named insureds, and additional insureds, whose reasonable expectations matter?

On January 13, the California Court of Appeal clarified this issue in *Transport Insurance Company v. Superior Court*. It held the relevant reasonable expectations are those of the party who is seeking coverage. Thus, when it is an additional insured who is seeking coverage, the additional insured's objective reasonable expectations, not the named insured's objective reasonable expectations are relevant.

Vulcan Materials Corp. manufactured and sold PCE, a pollutant used by dry cleaners. R.R. Street & Co. was a distributor for Vulcan, and an additional insured under an umbrella policy issued by Transport Insurance to Vulcan. Vulcan and Street were sued in various pollution cases involving alleged soil and groundwater contamination by PCE. Street sought coverage under an umbrella policy issued to Vulcan by Transport. According to Street, because it was not covered under Vulcan's primary policies, the Transport policy had to drop down to protect it.

In prior coverage litigation between Vulcan and Transport, a different division of the Court of Appeal had found the term "underlying insurance" in the Transport policy to be ambiguous. Street argued Transport was collaterally estopped by the result in the prior case from arguing that "underlying insurance" was anything other than the policies identified in the Transport policy (thus meaning Street was entitled to coverage from Transport notwithstanding the fact it also had coverage under its own primary layer policies).

The Court of Appeal disagreed, holding that the ambiguous term "underlying insurance" had to be interpreted in light of the objective reasonable expectations of the party seeking coverage, the additional insured Street, not those of the named insured. The court also held there was no collateral estoppel because Street's objective reasonable expectations had not been adjudicated in the prior case.

The lesson from this case is in looking at an additional insured claim, if reasonable expectations are relevant, it is the additional insured's objective reasonable expectations, not the named insured's objective reasonable expectations that should be taken into account.