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California Insurance and General Defense Update

An Insurer Cannot Defend a Suspended Corporation Unless it Intervenes in the Case

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Can an insurer defend its insured if that insured is a suspended corporation? This is a question that insurers have pondered since California Revenue and Taxation Code section 19719 was amended in 1998 to exempt insurers from criminal penalties for the exercise of certain powers, rights, or privileges of suspended corporations. The Third Appellate District of the California Court of Appeal answered that question on January 31, 2006 in Kaufman & Broad Communities, Inc. v. Performance Plastering, Inc. (2006), 2006 Cal. App. LEXIS 120, ___ Cal. App. 4th ___. The court held that an insurance company may not appear, answer or litigate the lawsuit in the name of its insured, the suspended corporation. Instead, the insurer must intervene in the case, becoming a party in its own name.

Revenue and Taxation Code section 23301 provides for the suspension of corporate powers, rights and privileges of a domestic corporation for failure to pay its taxes. This means that a suspended corporation cannot sue or defend a lawsuit while its taxes remain unpaid. Prior to 1998, Revenue and Taxation Code section 19719 imposed criminal penalties upon “Any person who attempts or purports to exercise the powers, rights, and privileges” of a suspended corporation. In 1998, section 19719 was amended to exempt an insurer or counsel retained by an insurer “who provides a defense for a suspended corporation is a civil action . . .”

In Kaufman & Broad, defense counsel retained by CalFarm Insurance Company answered a cross-complaint against a suspended corporation as “Performance Plastering, Inc., a suspended corporation, by and through its general liability insurance carrier, CalFarm Insurance Company.” CalFarm did not move to intervene in the action. Following the dismissal of the cross-complaint, the cross-complainant moved to strike Performance Plastering’s memorandum of costs and opposed the motion for attorney fees on the grounds that Performance Plastering was suspended and CalFarm was not a party to the action. The trial court granted the motion to strike and denied the motion for attorney fees. The Court of Appeal dismissed CalFarm’s appeal.

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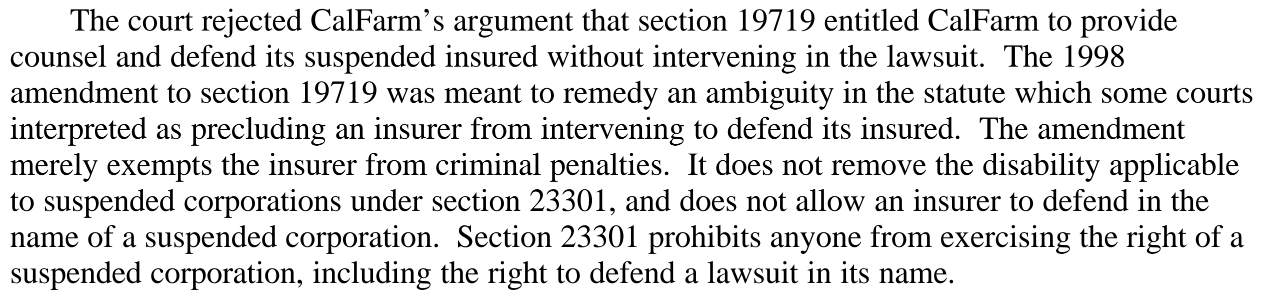

The court rejected CalFarm's argument that section 19719 entitled CalFarm to provide counsel and defend its suspended insured without intervening in the lawsuit. The 1998 amendment to section 19719 was meant to remedy an ambiguity in the statute which some courts interpreted as precluding an insurer from intervening to defend its insured. The amendment merely exempts the insurer from criminal penalties. It does not remove the disability applicable to suspended corporations under section 23301, and does not allow an insurer to defend in the name of a suspended corporation. Section 23301 prohibits anyone from exercising the right of a suspended corporation, including the right to defend a lawsuit in its name.

Instead, the only manner in which the insurer may defend or appear in the lawsuit is by intervening under Code of Civil Procedure section 287. By intervening, it can assert defenses on behalf of its insured. This conclusion is supported by the legislative history of section 19719. An enrolled bill report prepared by the Franchise Tax Board states that if the corporation is not revived, the absence of any mechanism for the insurance company to assert the suspended insured's claims "supports the conclusion that the insurance company must intervene in the lawsuit to protect the rights of its insured."

The court also rejected CalFarm's argument that forcing an insurance company to intervene waives coverage disputes in subsequent litigation under the direct action statue, Insurance Code section 11580(b)(2). In an ordinary case, a defending insurer waives its right to assert coverage defenses unless it provides an adequate reservation of rights. Accordingly, an insurer who intervenes can issue a reservation of rights, and assert that reservation in its pleadings in order to put the plaintiff on notice of coverage defenses. The insurance company thereby avoids any claim that it intentionally waived its reservation of rights. Additionally, the mere act of intervening will not create a bar to available coverage defenses under the doctrines of res judicata and collateral estoppel. Matters not at issue in the underlying litigation are not res judicata in subsequent coverage litigation. The same is true with regard to collateral estoppel. To the extent that issues relevant to coverage were not actually litigated in the underlying lawsuit, the insurer is not collaterally estopped from asserting them in a subsequent 11580 action.

Furthermore, the underlying plaintiff did not waive its rights to assert Performance Plastering's lack of capacity as a suspended corporation by failing to raise the issue until the end of the case. A corporation which indicates no intention to pay its delinquent taxes does not acquire an irrevocable license to continue the litigation simply because the other party fails to object at the earliest opportunity.

The court held that, because CalFarm never intervened, it was not a party. Therefore, it lacked standing to request fees and costs in the trial court and appeal the underlying decision. Because Performance Plastering continued to be a suspended corporation, it lacked the power to pursue or defend litigation. Therefore, the court dismissed the appeal.

Kaufman & Broad is important not only to insurers whose insureds are suspended, but to defense counsel as well. Attorneys, whether retained by insurers to defend a corporation, or retained directly by a defendant corporation, should always check corporate records to determine whether their client is in good standing. This information is available free of charge on the website for the California Secretary of State, at http://www.ss.ca.gov.

If the corporation is suspended, counsel should request that the corporation pay its back taxes and restore its corporate powers. Counsel can seek a stay of the proceedings for this purpose. U.S. v. 2.61 Acres of Land (9th Cir. 1985), 791 F. 2d 666, 672; Color-Vue v. Abrams (1996), 44 Cal. App. 4th 1599, 1606.

If an insured corporation cannot or will not cure the suspension, then the insurer should review its options carefully. Although Kaufman & Broad explains that it would be prudent for an intervening insurer to plead the existence of a reservation of rights in order to preserve those rights for future coverage litigation, it does not address other issues insurers may face.

For example, insurers need to determine whether to defend to the extent of resolving both liability and coverage issues, or only liability issues. Additionally, seeking to intervene may cause the plaintiff to attempt to obtain a default if the insured has not yet appeared, or was suspended at the time it first appeared. An insurer who seeks to intervene also faces issues concerning the retention of counsel. If the insured's suspension is discovered during the litigation, the insurer faces the question of whether counsel that has been representing the insured can or should represent the insurance company in intervention. The insurer faces a similar question if it owes a defense to other insureds in addition to the suspended corporation. It may need an attorney to defend those insureds, and another to pursue intervention. Therefore, insurers should analyze their options when preparing to intervene.