UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
CIVIL MINUTES—GENERAL

Case No.	**CV 20-11085-DMG (PDx)**	Date	September 29, 2021
Title	***Pacific West Bank v. AIG Specialty Insurance Company, et al.***	Page	1 of 7

Present: The Honorable DOLLY M. GEE, UNITED STATES DISTRICT JUDGE

KANE TIEN	NOT REPORTED
Deputy Clerk	Court Reporter
Attorneys Present for Plaintiff(s)	Attorneys Present for Defendant(s)
None Present	None Present

Proceedings: IN CHAMBERS—ORDER RE DEFENDANTS' MOTION TO DISMISS [18]

Plaintiff Pacific Western Bank ("PacWest") filed a Complaint on December 7, 2020 against Defendants AIG Specialty Insurance Company ("AIG"), Federal Insurance Company ("Federal"), and XL Specialty Insurance Company ("XL"), alleging breach of contract against AIG, and anticipatory breach of contract and tortious breach of the duty of good faith and fair dealing against AIG, Federal, and XL (collectively, "the Insurers"). [Doc. # 1.]

On January 21, 2021, AIG filed a motion to dismiss ("MTD"), which was joined by Federal and XL. [Doc. ## 18, 20, 22]. The motion has been fully briefed. [Doc. ## 28, 31.] For the following reasons, the MTD is **DENIED**.

I.
FACTUAL AND PROCEDURAL BACKGROUND[1]

PacWest is a bank that marketed asset financing products to insurance companies. Compl. ¶ 26. In one such product, PacWest would buy certain assets that, for regulatory reasons, insurance companies could not show on their balance sheets ("non-admitted assets") and lease them back to the companies as "admitted assets" that purportedly could be. *Id.* at ¶¶ 26-27. One of PacWest's customers for whom it engaged in these "sale-leaseback" transactions was Physicians United Plan, Inc. ("PUP"), a health maintenance organization. *Id.* at ¶¶ 28-32.

In March 2014, the Florida Office of Insurance Regulations determined that the admitted assets that PacWest leased back to PUP should be reclassified as non-admitted assets. *Id.* at ¶¶ 33, 35. As a result, PUP became unable to meet the financial requirements mandated by state regulations and consented to enter into receivership. *Id.* at ¶ 35. The Florida Department of Financial Services was appointed as PUP's receiver ("the Receiver"). *Id.* at ¶ 36.

[1] Because the Court need not and does not rely on the documents for which PacWest requests judicial notice, PacWest's request for judicial notice [Doc. # 29] is **DENIED as moot**.

On May 20, 2016, the Receiver sued PacWest for damages that PUP allegedly suffered from PacWest's perpetration of "a scheme . . . to hide PUP's financial condition from Florida's insurance regulators." *Id.* at ¶¶ 37-38. The Receiver alleged that PacWest "designed and intended the Sale-Leaseback Transactions, from their inception, as a device to artificially inflate PUP's financial condition to circumvent state regulatory requirements" and "encouraged, actively participated in, rendered substantial assistance to and had actual knowledge or constructive knowledge and a general awareness of, breaches of fiduciary [sic] by PUP's officers." *Id.* at ¶ 39. The Receiver sought damages in excess of $100 million. *Id.* at ¶ 41.

At all relevant times, PacWest held a bankers' professional liability insurance policy issued by AIG, as well as parallel excess liability policies issued by Federal and XL ("the Policies"). *Id.* at ¶¶ 15-16, 21-24. The Policies provided that the Insurers would "pay the Loss of any Insured that arises from any Claim first made against such Insured . . . for any Wrongful Act of the Insured in the rendering of or failure to render Professional Services." *Id.* at ¶ 16. The Policies also included an exclusion that barred coverage for any claim:

> alleging, arising out of, based upon or attributable to the bankruptcy, insolvency, conservatorship, receivership or liquidation of, or suspension of payment by, any broker or dealer in securities or commodities, or any bank or banking firm, or any insurance or reinsurance entity, investment company or investment banker or any Insured; provided, however, this exclusion will not apply to Wrongful Acts solely in connection with an Insured's investment on the behalf of the claimant in the stock of any of the foregoing entities.

Id., Ex. 1 at 60 [Doc. # 1-1] (the "Insolvency Exclusion" or "Exclusion").[2]

On April 18, 2016, PacWest provided notice of PUP's claims to AIG, and subsequently provided notice to XL and Federal as well. *Id.* at ¶¶ 43, 46, 49. AIG denied coverage, in part based on the Insolvency Exclusion—a position that XL and Federal subsequently adopted. *Id.* at ¶¶ 45, 47, 48. The Insurers' denial of coverage led PacWest to file this lawsuit alleging their breaches of the Policies. As of the time its Complaint was filed, PacWest had incurred more than $5.3 million in defense costs in connection with the underlying PUP action (the "PUP Action"). *Id.* at ¶ 52.

[2] All page references herein are to the page numbers inserted by the CM/ECF system.

II. LEGAL STANDARD

Federal Rule of Civil Procedure 12(b)(6) states that a defendant may seek dismissal of a complaint for failure to state a claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6). A court may grant such a dismissal only where the plaintiff fails to present a cognizable legal theory or fails to allege sufficient facts to support a cognizable legal theory. *Shroyer v. New Cingular Wireless Servs., Inc.*, 622 F.3d 1035, 1041 (9th Cir. 2010) (quoting *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001)). On a motion to dismiss, a court may consider documents attached to the complaint, documents incorporated by reference in a complaint, or documents subject to judicial notice. *U.S. v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003).

To survive a Rule 12(b)(6) motion, a complaint must articulate "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citing *Twombly*, 550 U.S. at 556). In evaluating the sufficiency of a complaint, courts must accept all factual allegations as true. *Iqbal*, 556 U.S. at 678 (citing *Twombly*, 550 U.S. at 555). Legal conclusions, in contrast, are not entitled to the assumption of truth. *Id.*

III. DISCUSSION

The Insurers argue that PacWest's claims against them should be dismissed because the Insolvency Exclusion bars PacWest from coverage for the underlying PUP Action as a matter of law. They maintain that the Exclusion applies because the PUP Action is a claim "alleging, arising out of, based upon or attributable to the. . . insolvency, . . . receivership or liquidation of . . . any insurance or reinsurance entity." MTD at 7. PacWest responds, *inter alia*, that the Insolvency Exclusion applies only when the insolvent insurance entity is a third party, not the claimant in the underlying action. Opp. at 6-7. The question is one of contractual interpretation.

A. Insurance Policy Interpretation Principles

Insurance policies "are contracts and, therefore, are governed in the first instance by the rules of construction applicable to contracts." *Montrose Chem. Corp. v. Admiral Ins. Co.*, 10 Cal. 4th 645, 666 (1995). Accordingly, "the mutual intention of the parties at the time the contract is formed governs its interpretation," and that "intent is to be inferred, if possible, solely

from the written provisions of the contract." *Id.* In other words, "[i]f the meaning a layperson would ascribe to the language of a contract of insurance is clear and unambiguous, a court will apply that meaning." *Id.* at 666-67. On the other hand, "[a] policy provision will be considered ambiguous when it is capable of two or more constructions, both of which are reasonable." *Foster-Gardner, Inc. v. Nat'l Union Fire Ins. Co.*, 18 Cal. 4th 857, 868 (1998). "If an asserted ambiguity is not eliminated by the language and context of the policy, courts then invoke the principle that ambiguities are generally construed against the party who caused the uncertainty to exist (i.e., the insurer) in order to protect the insured's reasonable expectation of coverage." *Id.*

Insurance "coverage is interpreted broadly so as to afford the greatest possible protection to the insured," while "exclusionary clauses are interpreted narrowly against the insurer." *MacKinnon v. Truck Ins. Exch.*, 31 Cal. 4th 635, 648 (2003) (internal punctuation excluded). Accordingly, insurers must "phrase exceptions and exclusions in clear and unmistakable language." *Id.* Whereas the insured has the burden to establish that the claims fall within the basic scope of coverage, the insurer must demonstrate that the claim is specifically excluded. *Id.*

B. The Insolvency Exclusion

The Insurers maintain that the plain language of the Insolvency Exclusion applies to the PUP Action. PUP, as a health maintenance organization, is an insurance entity, and it is clearly in receivership and/or is insolvent. The term "arising out of" is interpreted broadly to "connote[] only a minimal causal connection or incidental relationship"—even in exclusions. *The Travelers Prop. Cas. Co. of Am. v. Actavis, Inc.*, 16 Cal. App. 5th 1026, 1045 (2017). Because the sale-leaseback transactions that are the subject of the Receiver's claims allegedly led to PUP entering receivership, the claims are at least incidentally related to its receivership. "Any" insurance entity means *any* insurance entity, and the Exclusion does not contain any other limitation, including any language explicitly limiting these insurance entities to third-party non-claimants. Therefore, according to the Insurers, the PUP Action falls within the Insolvency Exclusion.

On the surface, this interpretation makes some sense. On the other hand, it would lead to some odd and incongruous results, as PacWest points out. The Exclusion contains an exception, which states: "this exclusion will not apply to Wrongful Acts solely in connection with an Insured's investment on the behalf of the claimant in the stock of any of the foregoing entities." Focusing on the last part of that clause—"on the behalf of the claimant in the stock of any of the foregoing entities," where "foregoing entities" refers to insurance entities—the language plainly contemplates that "claimants" and "insurance entities" are two distinct categories. To be sure, the PUP Action does not fall into the exception to the Exclusion, but the exception can nonetheless aid in the interpretation of the Exclusion as a whole. *See Palmer v. Truck Ins. Exch.*,

21 Cal. 4th 1109, 1115 (1999) (courts must interpret policy terms "in context" and "give effect to every part of the policy with each clause helping to interpret the other") (internal quotation marks and citations omitted).

Moreover, the Exclusion refers to insurance companies among a narrow and specific list of entities, along with banks, securities brokers, and investment companies. Banks like PacWest have all kinds of customers—restaurants, oil companies, airlines, to name just a few—indeed as well as other banks, insurance companies, securities brokers, and investment companies, all of whom are potential claimants against the bank. To single out the claims of those customers who happen to be banks, insurance companies, securities brokers, and investment companies for more limited coverage that turns on their own insolvency would be anomalous. But what each of those entities *do* have in common is that they are all financial institutions in which banks routinely invest their customers' deposits. It makes sense to exclude coverage for claims that relate to the insolvency of a third-party financial institution in which the bank invested customers' money. The insurer would not want to be held responsible for the insolvency of a third-party investee, a risk that it cannot accurately underwrite.[3] It makes less sense to bar claims for the bank's wrongful acts against a claimant merely because the claimant happens to be an insurance company.

It also makes little sense to bar claims from certain entities that happen to be insolvent, bankrupt, or in receivership. The result would be that if a wrongful act leads to the claimant's insolvency, the claim is not covered, but if the claimant remains solvent, then the claim is covered—no matter the size of the claim or what conduct is alleged. The logic is much clearer, however, if the insolvent entity is a third party. Those whose loss stemmed from an insolvent entity may, *because of the insolvency*, seek recovery instead from the bank that served as a middleman. The insurer reasonably would not want to cover losses that arise from a third party.

The Insurers rely heavily on *Zurich Specialties London Ltd. v. Bickerstaff, Whatley, Ryan & Burkhalter, Inc.*, 650 F. Supp. 2d 1064 (C.D. Cal. 2009). There, the court did find that an insolvency exclusion applied when the claimant was itself the insolvent entity. *Id.* at 1070-71. But there are important distinctions between *Zurich* and this case. First and foremost, the policy in *Zurich* did not include an exception to the exclusion or any other analogous language that clarified that the claimant and the insolvent entity were distinct. Second, rather than the revealingly narrow list of financial institutions in PacWest's Policies, the *Zurich* policy merely referred to claims arising out of the insolvency or bankruptcy of "the Insured or any other person, firm or organization." *Id.* at 1067. Third, the *Zurich* court's analysis did not quite

[3] Unless, if the investment of the customer's money in the stock of a third party was a wrongful act on the part of the bank, which is where the exception comes into play.

address the distinction between the insolvency of the claimant versus that of third parties. The dispute honed in on the term "arising out of," which the court found to mean that "the exclusion has no causation requirement" and "contains neither a 'but for' requirement, nor a requirement that the damaged company be insolvent at the time of any lawsuit." *Id.* at 1070. But PacWest's interpretation does not contradict any of these principles—the claim can "arise out of" insolvency in a broad sense, with no causation or temporal requirement, but still be limited by *other* language in the policy that clarifies it applies only to third parties.[4]

PacWest relies instead on *First Horizon Nat. Corp. v. Certain Underwriters at Lloyd's*, No. 11-2608, 2014 WL 1331052 (W.D. Tenn. Mar. 28, 2014). There, the policy language was identical to that in PacWest's Insolvency exclusion, including its exception. *Id.* at *6 ("arising out of . . . the bankruptcy . . . of . . . any . . . investment company . . . ; provided, however, this exclusion will not apply to Wrongful Acts solely in connection with an Insured's investment on behalf of the claimant in the stock of one of the foregoing entities") (ellipses in original). Using essentially the same textual analysis as this Court employs above, the *First Horizon* court reasoned that "[t]he text of the Exclusion plainly distinguishes investment companies and customers" and therefore concluded that "[n]o reasonable interpretation justifies application of the Exclusion when the loss arises from the bankruptcy of a customer of the insured." *Id.* It similarly also found that an alternative interpretation would be inconsistent with the purpose of the policy and its exclusion:

> The purpose of an [errors and omissions] policy is to provide insurance for loss to insureds resulting from claims of wrongdoing made by the insureds' customers. Under Defendants' interpretation, the Insolvency Exclusion would arbitrarily limit coverage based on the ability of a customer to absorb the cost of an insured's wrongdoing. For example, if an insured's wrongdoing causes a $15 million dollar loss, but the customer avoids bankruptcy, a policy would cover a $15 million settlement between the insured and its customer. If an insured's wrongdoing causes a lesser loss, for example $10 million, but that loss causes the customer to file for bankruptcy, a policy would not cover the loss.

Id.

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[4] Other non-binding cases the Insurers cite are similarly distinguishable. *See ACE Capital Ltd. v. Morgan Waldon Ins. Mgmt.*, LLC, 832 F. Supp. 2d 554, 570 (W.D. Pa. 2011); *Suntrust Banks, Inc. v. Certain Underwriters at Lloyd's of London*, No. 2014CV249230, 2019 WL 5549370, at *14 (Ga. Super. May 17, 2019). Like in *Zurich*, in neither of those cases did the policy include language that supplies a textual basis for distinguishing claimants from the insolvent entities.

First Horizon was decided under Tennessee law, and it is not binding on this Court. Nonetheless, the legal principles it applied are the same under California law, and the Court finds its analysis persuasive.

The Court recognizes that the Insolvency Exclusion could have more directly stated that it applied only to the insolvency "of third parties" or to insurance companies "other than the claimant." The Exclusion is not a model of clarity. For that reason, it is ambiguous. Given the text of the Exclusion as well as its purpose, an interpretation that limits the insolvent insurance entity to third parties is at least as reasonable as the opposing construction that extends to claimants that are insolvent insurance companies. Therefore, the Court must construe the Exclusion in favor of PacWest, the insured. Because in the PUP Action, the claimant is itself the insurance entity in receivership, the Insolvency Exclusion does not bar coverage as a matter of law. The Insurers' motion to dismiss PacWest's breach of contract and tortious breach of the implied covenant of good faith and fair dealing based upon the Insolvency Exclusion is therefore **DENIED**.[5]

IV.
CONCLUSION

In light of the foregoing, the Insurers' MTD is **DENIED**. The Insurers shall file their Answer to the Complaint within 21 days from the date of this Order.

IT IS SO ORDERED.

[5] Because the Insolvency Exclusion is ambiguous as to whether it applies when the insolvent insurance company is the claimant, the Court need not address PacWest's alternative argument that there are concurrent causes for the Receiver's claims other than receivership. *See* Opp. at 26-28.