UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	CV 15-02416-SVW-LPRx	Date	January 4, 2017
Title	*Office Depot, Inc. v. AIG Specialty Insurance Company*		

Present: The Honorable	STEPHEN V. WILSON, U.S. DISTRICT JUDGE

Paul M. Cruz	N/A
Deputy Clerk	Court Reporter / Recorder
Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:
N/A	N/A

Proceedings: IN CHAMBERS ORDER GRANTING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT [66][69]

Having read and considered the papers presented by the parties, the Court finds this matter suitable for determination without oral argument. *See* Fed. R. Civ. P. 78; Local Rule 7-15. Accordingly, the hearing scheduled for January 9, 2017 at 1:30 p.m. is VACATED and OFF CALENDAR.

I. BACKGROUND

In March 2009, David Sherwin filed a *qui tam* lawsuit (the "*Sherwin*" suit) against Office Depot Inc. ("Office Depot"), alleging violations of the California False Claims Act ("CFCA"). Complaint, ¶¶ 7–8. Office Depot filed a claim with its insurer, AIG Specialty Insurance Company ("AIG"), seeking defense and indemnification. *Id.* ¶¶ 23–24. AIG denied coverage. Office Depot settled the *Sherwin* suit in 2014 and filed the present lawsuit on April 2, 2015, claiming that AIG is obligated to reimburse Office Depot for a portion of the settlement amount. *Id.* ¶ 11.

On May 18, 2015, AIG moved to dismiss, arguing that (1) insurance coverage of the *Sherwin* suit is precluded by California Insurance Code § 533 ("§ 533"); (2) Office Depot's claim for breach of the implied duty of good faith and fair dealing must be dismissed or abated pending resolution of the coverage issue; and (3) Office Depot's declaratory judgment claim is duplicative of its other claims. Dkt. 19.

On June 6, 2016, the Court granted in part and denied in part AIG's motion to dismiss Office

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Depot's complaint. Dkt. 35. The Court's order, as modified July 21, 2016, dkt. 48, dismissed the indemnity claim because "causes of action that include the intent to induce reliance are precluded from insurance coverage under § 533 as a matter of law . . . . The CFCA creates one such cause of action." *Id.* at 9. The Court concluded that the duty to defend issue was not properly before it and made no rulings on that issue. *See* dkt. 49.

On November 23, 2016, the parties made cross-motion for summary judgment on whether AIG had a duty to defend the *Sherwin* lawsuit. *See* dkts. 66, 69. For the following reasons, the Court GRANTS AIG's motion for summary judgment, and accordingly DENIES Office Depot's motion.

II. LEGAL STANDARD

Summary judgment is appropriate if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The meaning and construction of an insurance policy is a question of law. *Blue Ridge Ins. Co. v. Stanewich*, 142 F.3d 1145, 1147 (9th Cir. 1998). There is no dispute of fact in this case.

The parties agree that California law applies. California courts have often considered the specific scenario of whether a duty to defend attaches even if indemnifying the underlying claim is barred by § 533. In *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263 (1966), the court dismissed an argument that when indemnity is barred by § 533, there cannot be a duty to defend. *Id.* at 277. The court explained that the duty to defend arises when "the *facts* alleged do fairly apprise the insurer that plaintiff is suing the insured upon an occurrence which, if his allegations are true, gives rise to liability of insurer to insured under the terms of the policy." *Id.* at n. 15 (internal citations omitted) (emphasis in original). In the same footnote, the court acknowledged that "the obligation to defend does not mature if . . . the nature of the alleged intentional tort compels a finding of intentional wrongdoing such as malicious prosecution." *Id.*

The California courts established two paths to determine if the duty to defend is triggered even when section § 533 bars indemnity: (1) if the underlying lawsuit creates a potential for coverage, or (2) there is a reasonable expectation of coverage "in light of the nature and kind of risks covered by the policy." *B & E Convalescent Center v. State Compensation Ins. Fund*, 8 Cal. App. 4th 78, 92 (1992). The first path is triggered when a defendant can be held liable for something less than willful conduct. *See Republic Indem. Co. v. Superior Court*, 224 Cal. App. 3d 492, 501 (Ct. App. 1990), *reh'g denied and opinion modified* (Oct. 11, 1990) ("Because Mr. Fisher could have recovered from Alpha for conduct

which was not 'wilful' under section 533 that statute did not absolve Republic of its duty to defend."). However, if the underlying action has no potential for recovery without proof of willful conduct, then there is no duty to defend under the first path. *See B & E Convalescent Center,* 8 Cal. App. 4th at 95.

The second path, a reasonable expectation of coverage, was further explained by the *B & E* court:

> As we have already noted, section 533 precludes only *indemnification* of willful conduct and not the *defense* of an action in which such conduct is alleged. . . . However, we read this statement of principle to mean only that an insurer and an insured are free to contract for the provision of a defense to a claim which can not [sic] be indemnified.

Id. at 100-01 (internal citations and quotation marks omitted) (emphasis in original). The Court emphasized that when considering the policy language, "Section 533, as an implied term of the [] liability policy, is as much a part of the insurance contract as any express exclusion." *Id.* at 100.

Subsequent courts found a duty to defend under the "reasonable expectation" analysis when "the express promise to provide a defense to malicious prosecution claims was clearly sufficient to create an objectively reasonable expectation . . . that a defense would be provided," *Downey Venture v. LMI Ins. Co.*, 66 Cal. App. 4th 478, 509 (1998), or when the insured was promised a "defense even though he had committed a willful criminal act," *Marie Y. v. Gen. Star Indem. Co.*, 110 Cal. App. 4th 928, 959 (2003). Though an insured's reasonable expectations are measured "in light of the nature and kinds of risks covered by the policy," *Downey Venture*, 66 Cal. App. 4th at 509, even the *Downey* court recognized that the distinction between general liability provisions and a promise to defend a specific cause of action is "important." *See id.* Thus, courts have found no duty to defend when the insured "cannot point to a policy provision making a specific promise of coverage for conduct as to which indemnification was nonetheless precluded by section 533." *Mez Indus., Inc. v. Pac. Nat. Ins. Co.*, 76 Cal. App. 4th 856, 878 n. 21 (1999), *as modified* (Dec. 21, 1999).

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III. ANALYSIS

In accordance with California precedent, this Court will analyze (A) whether there was any potential for coverage, and (B) whether Office Depot had a reasonable expectation of coverage.

A. Potential for Coverage

This Court has already found that liability under the CFCA necessarily includes a finding of a "willful" act for purposes of § 533. *See* dkt. 48. Office Depot spends most of its briefing rearguing this point. Though the issue is not properly before the Court via a motion for reconsideration, the Court will nonetheless expand upon its previous analysis.

To be liable under the CFCA a representation must be made, and it must be false. *See* Cal. Gov. Code § 12651(a)(1) and (2) (2007). Specifically, a party must knowingly present a claim for payment or approval, or knowingly make a statement to get a claim paid or approved. *Id.* The party makes this claim or this statement in order to achieve the result, payment of the claim.

The party presenting the claim or making the statement might be liable under the CFCA for reckless misrepresentations if that party is deliberately indifferent to the truth of the statement. *See Thompson Pac. Constrs., Inc. v. City of Sunnyvale*, 155 Cal. App. 4th 525, 549-50 (2007). However, "[u]nder California law, negligent misrepresentation is a species of fraud, and, 'California law prohibits indemnification for intentionally harmful conduct such as fraud or misrepresentation.'" *F.D.I.C. v. Gen. Star Nat. Ins. Co.*, 2012 WL 398352, at *7 (C.D. Cal. Feb. 7, 2012); *see also see also Employers Insurance of Wausau v. Musick, Peeler & Garrett,* 871 F.Supp. 381, 386 (S.D.Cal.1994) ("Under California Civil Code 1688, Insurance Code 533 and the case law interpreting those provisions, insurance may not indemnify anyone from fraud or from negligent misrepresentation."). The policy for this is clear:

> Since insurance is designed to protect against contingent or unknown risks of harm, rather than harm that is intended or expected ..., it is well settled that intentional or fraudulent acts are deemed purposeful rather than accidental ... [I]t is likewise established that negligent misrepresentations ... are considered purposeful rather than accidental for the purpose of insurance coverage.

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Chatton v. National Union Fire Insurance Co., 10 Cal.App.4th 846, 861 (1992). It is axiomatic that if *negligent* misrepresentations are considered fraudulent for insurance purposes, then *reckless* misrepresentations are as well.

Some California cases find that reckless conduct can be indemnified, but do not consider reckless misrepresentations. *See Reshamwalla v. State Farm Fire & Cas. Co.*, 112 F. Supp. 2d 1010 (E.D. Cal. 200) (§ 533 did not bar indemnity for teenager recklessly tossing debris into traffic), *Mulkins v. Allstate Ins. Co.*, 216 F.3d 1083 (9th Cir. 2000) ((§ 533 did not bar indemnity for insured who brandished knife but claimed he did not intend to use it). *Chatton's* policy discussion explains the difference in the outcomes for these cases. The insureds in *Reshamwalla* and *Mulkins* may have acted recklessly, but did not intend the ultimate result. Thus, insurance is designed to protect the *unknown risks* of these actions. *See Chatton*, 10 Cal.App.4th at 861. Someone who makes a reckless misrepresentation, however, does so *with the intent* of achieving the ultimate result—a person who submits a claim is intending for it to be paid. Thus, if that person is reckless about the truth of falsity of the information in that claim, any possible harm created by inducing a government agent to rely on that information is "intended or expected" and thus the act is "deemed purposeful rather than accidental." *See id.* Thus, though specific intent of fraud is not *required*, *see* Cal. Gov't Code § 12650(B)(3), any person who "burie[s] his head in the sand and fail[s] to make simple inquiries which would alert him that false claims are being submitted", *see San Francisco Unified School Dist. v. First Student, Inc.*, 224 Cal. App. 4th 627, 646 (2014) certainly *expects* the harm to occur. This is intentionally harmful conduct.

Thus, this Court repeats that since the *Sherwin* lawsuit alleged a violation of the CFCA, and since the CFCA necessitates a finding of willful conduct, there was no potential for coverage. This case is not within the same scope as *Gray* and *Republic Indemnity*, in which the courts found that the plaintiffs (defendants in the underlying suits) could have been liable for less than willful conduct based on the allegations. Here, no such possibility existed. This case is more akin to *B & E Convalescent Center*, where the court considered causes of action that all *necessitated* a finding of willful conduct. The *Sherwin* suit alleged one cause of action, violation of the CFCA, that *necessitated* a finding of willful conduct. Thus, as in *B & E*, there was no potential for coverage.

Office Depot argues that since *Sherwin* could have amended their complaint to allege other causes of action, then the potential for coverage still exists. *See CNA Cas. of California v. Seaboard Sur. Co.*, 176 Cal. App. 3d 598, 606-07 (Ct. App. 1986). The *CNA* Court reaffirmed *Gray* in holding that "the insurer's duty is not measured by the technical legal cause of action pleaded in the underlying third party complaint,

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but rather by the *potential* for liability under the policy's coverage as revealed by the *facts* alleged in the complaint or otherwise known to the insurer." *Id.* at 606. The *CNA* Court analyzed a case that the district court dismissed due to the federal antitrust statute of limitations. *Id.* at 607-08. The insurance company argued that since an antitrust violation was not covered by their policy, they had no duty to defend the action. *Id.* at 608. In response, the appellate court looked at specific factual pleadings in the complaint and determined that many of them fell within the insurance company's policy coverages. *See, e.g.*, *Id.* ("Subparagraphs 21 (i) and (o) charged that WSBA misappropriated, stole and misused property interests and trade secrets and made misrepresentations to the Salveson plaintiffs 'in an effort to further eliminate the competition of plaintiffs.' These charges are arguably within Seaboard's coverage for piracy, unfair competition and idea misappropriation.").

Here, Office Depot states: "[t]he Relator's sole claim for relief alleged that Office Depot, 'its agents, employees and co-conspirators' violated the CFCA." Dkt. 78 at 6. This is the *only language* in the entire complaint that Office Depot provides as evidence it could have been held liable for vicarious liability.[1] Office Depot provides no analytical framework for how it could have been vicariously liable or negligently liable under the CFCA.[2] This conclusory language, untethered from any legal framework or specific factual allegations, is insufficient to show that the actual facts alleged under *Sherwin* could have held Office Depot liable for vicarious liability or negligence. Such a conclusion would trigger the duty to defend in every action against a corporation, since a "corporation acts only through its agents and employees." *Conklin Bros. of Santa Rosa, Inc. v. U.S.*, 986 F. 2d 315, 318 (9th Cir. 1993).

Further, Office Depot argues that the *Sherwin* settlement includes a release from any potential claims concerning vicarious liability or negligence, and therefore *Sherwin* had the potential for such claims. Office Depot cites no authority that language in a settlement is evidence of potential liability, and the Court finds that it is not. The mere fact that the *Sherwin* settlement included a release from vicarious and negligent liability is not evidence that these allegations were made or supported by the facts alleged in the complaint, but rather is evidence that a company always has an incentive to be as broad as possible in its release, whether or not the release is based in fact. For example, in the same sentence of the settlement Office Depot points this Court to, Office Depot was released from any liability "*from the beginning of the world* through the Effective Date." *See* dkt. 69-14 at 6 (emphasis added).

[1] Office Depot provides no language from the complaint to support its claim that it could have been liable for negligence.
[2] Further, they seem to ignore their own admission that the complaint "alleges wrongdoing based largely on Office Depot's sales and pricing practices, internal systems and controls." Dkt. 26 at 5.

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B. Reasonable Expectation

Office Depot misapplies the law when arguing it had a reasonable expectation of coverage. Office Depot cites at length policy language that could potentially be read to trigger coverage when considered on its own. This is not the test. Instead, the policy must be considered with § 533 as an implied term to the contract. *See B & E Convalescent Center,* 8 Cal. App. 4th at 100. Further, "[g]iven that we are here considering the scope of the policy's insuring clauses rather than any exclusionary provision, it is [the insured's] burden to demonstrate that the policy language is reasonably capable of such a construction. *Id.* at 101; *see also Dyer v. Northbrook Prop. & Cas. Ins. Co.*, 210 Cal. App. 3d 1540, 1547 (Ct. App. 1989) ("In *Gray*, broadly interpreting the insurer's duty to defend, the insurer unsuccessfully relied on an unclear exclusionary clause to assert it was not obligated to defend its insured. However, if the question concerns the scope of basic coverage, the burden of proof shifts to the plaintiff.").[3]

Here, Office Depot analyzes several policy clauses but fails to analyze whether any of these policies can lead to a reasonable expectation of a duty to defend *when read together with § 533*. There is no policy in the insurance provision that explicitly promises a defense based on allegations under the CFCA, such as there was in *Downey*. There is no policy that promises a defense based on willful conduct, such as there was in *Marie Y.* Office Depot "cannot point to a policy provision making a specific promise of coverage for conduct as to which indemnification was nonetheless precluded by section 533." *Mez Indus., Inc.*, 76 Cal. App. 4th at 878 n. 21. Thus, there is nothing in the policy that would lead a reasonable insured to believe that willful conduct which violates the CFCA would be covered. General liability clauses are not enough. Thus, considering "the nature and kinds of risks" covered by the policy, there is no indication a willful tort that triggers § 533 would be covered.

[3] Though AIG also presents a number of exclusions that could potentially exclude coverage, the Court does not reach these exclusions since Office Depot had no reasonable expectation of coverage under the basic coverage.

IV. CONCLUSION

For the foregoing reasons, the Court finds that AIG had no duty to defend Office Depot in the *Sherwin* lawsuit. Summary judgment is GRANTED in favor of AIG. The Court lifts the stay on the breach of implied covenant and good faith and fair dealing claim. Because this claim requires a predicate breach of the insurance policy, *see, e.g.*, *Gutowitz v. Transamerica Life Ins. Co.*, 126 F. Supp. 3d 1128, 1149 (C.D. Cal. 2015), the Court is further inclined to dismiss this claim as a matter of law. However, the Court will first allow Office Depot seven (7) days to brief this Court on any reason why this claim should persist. If no supplemental brief is filed within this time frame, the claim will be dismissed with prejudice. If a supplemental brief is filed, AIG may have seven (7) days to respond. Both briefs shall not exceed eight (8) pages.

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