UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF CALIFORNIA

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DALE M. WALLIS, D.V.M., JAMES L. WALLIS, and HYGIEIA BIOLOGICAL LABORATORIES, INC., a California Corporation,

Plaintiffs,

v.

CENTENNIAL INSURANCE COMPANY, INC., a New York corporation, and ATLANTIC MUTUAL INSURANCE, CO., INC., a New York corporation,

Defendants,

/

AND RELATED COUNTERCLAIMS AND THIRD-PARTY COMPLAINT.

/

NO. CIV. 08-02558 WBS GGH

MEMORANDUM AND ORDER RE: MOTION TO DISMISS

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Plaintiffs Dale M. Wallis ("Dr. Wallis"), James L. Wallis ("Mr. Wallis"), and Hygieia Biological Laboratories Inc. ("Hygieia") brought this action against defendants Centennial Insurance Company Inc. ("Centennial") and Atlantic Mutual

Insurance Co., Inc. ("Atlantic Mutual") arising from plaintiffs' veterinarian professional liability insurance policy. Defendants now move to dismiss plaintiffs' claims against Atlantic Mutual and plaintiffs' declaratory judgment claim against both defendants pursuant to Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted.

I. Factual and Procedural Background

The factual background of this case is set forth indetail in the court's February 28, 2013 Order granting defendants' motion for judgment on the pleadings. (Feb. 28, 2013 Order (Docket No. 212).) Generally, plaintiffs allege that Centennial issued a policy of professional liability insurance to Dr. Wallis, which also covered Mr. Wallis and Hygieia. (First Am. Compl. ("FAC") ¶ 15, Exs. A, B (Docket No. 217).) Plaintiffs filed this suit after a dispute arose over defendants' defense of plaintiffs in an underlying lawsuit in state court. (Id. ¶¶ 26-30.)

Plaintiffs' original complaint failed to allege sufficient facts to support a theory to hold Atlantic Mutual, a non-signatory to the insurance policy between plaintiffs and Centennial, liable for breach of contract or breach of the implied covenant of good faith and fair dealing. (Feb. 28, 2013 Order at 11:9-13:10.) The court dismissed plaintiffs' claims against Atlantic Mutual with leave to amend in order to give plaintiffs an opportunity to allege facts sufficient to support such a theory. (Id. at 13:19-23.)

Plaintiffs now allege that the brochures related to the professional liability insurance Dr. Wallis purchased referred

only to Centennial and that her policy issued from Centennial as a member of the "Atlantic Mutual Companies." (FAC ¶ 9.) They further allege that although Dr. Wallis was the named insured under the policy since 1988, she did not learn that her insurance carrier was actually Atlantic Mutual until she received a letter in June 2004 regarding the cancellation of her policy. (Id. ¶¶ 9, 15.) The letter advised her that "the insurance carrier, Atlantic Mutual, has declined to offer coverage . . . ." (Id. ¶ 9.) Plaintiffs now allege that Centennial is a wholly owned subsidiary of Atlantic Mutual. (Id. ¶ 8.)

Plaintiffs next allege that when Dr. Wallis tendered her defense of the underlying lawsuit, defendants requested that the tender be sent to an Atlantic Mutual "Claims Representative." (Id. ¶ 10(a).) When Dr. Wallis received a letter in response to her tender, the letter came on "Atlantic Mutual Companies" letterhead, which listed both Atlantic Mutual and Centennial. (Id. ¶ 10(b).) This letter indicated that Centennial was the company accepting the initial tender of the defense. (Id.) Each employee that handled the defense of the underlying lawsuit, however, was employed by Atlantic Mutual. (Id. ¶ 10(c).) Plaintiffs allege that no employee of Centennial ever handled their claim and that plaintiffs' Cumis counsel were advised to direct all correspondence and bills to Atlantic Mutual rather than Centennial. (Id.) Defendants further advised plaintiffs' Cumis counsel that they were required to follow billing guidelines issued by Atlantic Mutual. (Id. ¶ 10(f).)

Dr. Wallis received a letter in 2002, on the same letterhead described above, stating that "Centennial is defending

. . . under strict reservation of rights." (Id. ¶ 10(g).) In the tentative settlement agreement reached the following year in the underlying lawsuit, however, the agreement had to be signed by Atlantic Mutual and was signed by an attorney on behalf of Atlantic Mutual. (Id. ¶ 10(h).)

In March 2003, defendants obtained attorney Gary Selvin on behalf of both Atlantic Mutual and Centennial. (Id. ¶ 10(i).) Plaintiffs allege that he also "began to take on the role as an agent and/or adjuster for the defendants." (Id.) Selvin wrote two letters concerning the settlement that allegedly indicate that Atlantic Mutual is the insurer holding the policy. (Id.) Two months later, in July 2003, plaintiffs' Cumis counsel received a letter stating that Atlantic Mutual is the insurance company "provid[ing] Dr. Wallis with a defense." (Id. ¶ 10(j).) The letter is signed by an Atlantic Mutual employee. (Id.)

Several letters from Selvin in 2007 again indicated that Atlantic Mutual was the insurer obligated to pay for plaintiffs' defense under California Civil Code section 2860. (Id. ¶ 10(k)-(l).) In another letter from November that same year, plaintiffs allege that Selvin acknowledged "on behalf of Atlantic Mutual" that because Atlantic Mutual is the company obligated to pay for plaintiffs' defense, "it owed a duty to pay the cost of premiums for bonds on appeal." (Id. ¶ 10(m).) Letters from Selvin from early 2008 until July 2009 sometimes suggested that Atlantic Mutual was the party bound by plaintiffs' insurance policy and other times that Centennial was. (See ¶¶ 10(n)-(q).)

Plaintiffs further allege that Atlantic Mutual employed

auditors who imposed Atlantic Mutual's billing guidelines on the invoices submitted by plaintiffs' Cumis counsel for their work in the state lawsuit. (Id. ¶ 10(r).) They also allege that both Centennial and Atlantic Mutual executed judicial admissions in an earlier action before this court acknowledging that plaintiffs are the insureds of both Centennial and Atlantic Mutual. (Id. ¶ 12.)

Plaintiffs also allege that Atlantic Mutual and Centennial had the same officers and directors, home office, mailing address, bank account, telephone numbers, and location of books and records. (Id. ¶ 8.) They further allege that Atlantic Mutual and Centennial utilize a shared bank account. (Id. ¶ 10(e).) In support of this proposition, plaintiffs allege that all checks issued for payment of attorneys' fees and other vendor costs associated with the underlying state lawsuit came from one bank account and that the checks identified both Atlantic Mutual and Centennial as entities on the account. (Id.)

In sum, plaintiffs now allege that Centennial was the agent of Atlantic Mutual and Atlantic Mutual was Centennial's undisclosed principal. (Id. ¶ 6.) They allege that Atlantic Mutual exercised pervasive, continual, and exclusive control over Centennial and that it made all decisions and took all actions with regard to the defense of plaintiffs' underlying lawsuit, either as the principal or together with Centennial. (Id. ¶¶ 8, 11.) Alternatively, they allege that Atlantic Mutual is the alter ego of Centennial and that the corporations failed to respect their purported corporate separateness. (Id. ¶¶ 6, 13.)

Presently before the court is defendants' motion to

dismiss plaintiffs' claims against Atlantic Mutual pursuant to Rule 12(b)(6). Defendants also request dismissal of plaintiffs' claim for declaratory judgment against both defendants.

II. Legal Standard

To survive a motion to dismiss, a plaintiff must plead "only 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). This "plausibility standard," however, "asks for more than a sheer possibility that a defendant has acted unlawfully," Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009), and "[w]here a complaint pleads facts that are 'merely consistent with' a defendant's liability, it 'stops short of the line between possibility and plausibility of entitlement to relief.'" Id. (quoting Twombly, 550 U.S. at 557). In deciding whether a plaintiff has stated a claim, the court must accept the allegations in the complaint as true and draw all reasonable inferences in favor of the plaintiff. Scheuer v. Rhodes, 416 U.S. 232, 236 (1974), overruled on other grounds by Davis v. Scherer, 468 U.S. 183 (1984); Cruz v. Beto, 405 U.S. 319, 322 (1972).

III. Analysis

A. Breach of Contract and Breach of the Implied Covenant of Good Faith and Fair Dealing

Courts have allowed plaintiffs to proceed on breach of contract and breach of the implied covenant of good faith and fair dealing claims against non-signatories to a contract on the basis of both agency and alter ego theories. See, e.g., Axon Solutions, Inc. v. San Diego Data Processing Corp., 09 CV 2543 JM

RBB, 2010 WL 1797028 (S.D. Cal. May 4, 2010); Dion LLC v. Infotek Wireless, Inc., C 07-1431SBA, 2007 WL 3231738 (N.D. Cal. Oct. 30, 2007); Monaco v. Liberty Life Assur. Co., C06-07021 MJJ, 2007 WL 1140460 (N.D. Cal. Apr. 17, 2007). Particularly, the court has noted in this case that where an agent makes a contract on behalf of an undisclosed principal, the principal is a party to that contract. See Ikerd v. Warren T. Merrill & Sons, 9 Cal. App. 4th 1833, 1839 n.6 (2d Dist. 1992) ("A contract made by an agent for an undisclosed principal is for most purposes the contract of the principal and it may sue or be sued thereon."); Restatement (Third) Of Agency § 6.03(1)-(2) (2006).

If defendants so request, however, plaintiffs may ultimately be required--if they proceed on their agency theory--to elect to proceed against either Atlantic Mutual or Centennial. See Ikerd, 9 Cal. App. 4th at 1839 n.6 (where contract made by agent for undisclosed principal, "the contracting third party may sue either the agent or the principal, but he can not sue both" (internal citations omitted)); Standard Oil Co. of Cal. v. Doneux, 192 Cal. App. 2d 608, 611 (3d Dist. 1961) ("The basic rule is that an undisclosed principal when discovered is liable for the authorized contracts of his agent. But there is a corollary to this rule. Once the third party has discovered that there is an undisclosed principal he may be required to hold either the agent or the principal [liable], for the liability is alternative." (internal citation omitted)); id. at 612 ("[T]he plaintiff cannot hold both the agent and the undisclosed principal and must upon demand of the principal or the agent elect which he will hold.").

1. Agency

Under California law, an agent is defined as "one who represents another, called the principal, in dealings with third persons." Cal. Civ. Code § 2295. To establish liability under an agency theory when the purported principal and agent have a parent-subsidiary relationship, plaintiffs "must show more than mere representation of the parent by the subsidiary in dealings with third persons." Laird v. Capital Cities/ABC, Inc., 68 Cal. App. 4th 727, 741 (3d Dist. 1998). "The control exercised in a typical parent-subsidiary relationship is insufficient to create an agency relationship." Van Maanen v. Youth With a Mission-Bishop, 852 F. Supp. 2d 1232, 1249 (E.D. Cal. 2012) (England, J.). Rather, "[t]he showing required is that 'a parent corporation so controls the subsidiary as to cause the subsidiary to become merely the agent or instrumentality of the parent[.]'" Laird, 68 Cal. App. 4th at 741 (quoting Linskey v. Heidelberg E., Inc., 470 F. Supp. 1181, 1184 (E.D.N.Y. 1979)) (alteration in original). "[T]he parent must be shown to have moved beyond the establishment of general policy and direction for the subsidiary and in effect taken over performance of the subsidiary's day-to-day operations in carrying out that policy." Sonora Diamond Corp. v. Superior Court, 83 Cal. App. 4th 523, 541 (5th Dist. 2000); see id. (control must be "so pervasive and continual that the subsidiary may be considered nothing more than an agent or instrumentality of the parent, notwithstanding the maintenance of separate corporate formalities").

Contrary to defendants' characterization of plaintiffs' allegations, plaintiffs do more than recite mere conclusory

allegations of agency. They allege facts suggesting that Atlantic Mutual's control over Centennial was so "pervasive and continual" that Centennial was no more than the instrumentality of Atlantic Mutual. Sonora Diamond, 83 Cal. App. 4th at 541. Plaintiffs allege that once Centennial issued the policy, Atlantic Mutual assumed responsibility for almost everything else related to defense of the underlying state lawsuit, such as corresponding with plaintiffs and Cumis counsel, paying for plaintiffs' defense, and handling the administration of plaintiffs' claim. While Atlantic Mutual's imposition of billing guidelines might be the kind of general policy decision that does not indicate agency, see id. at 542, its other acts appear to be the quotidian responsibilities that an insurer, like Centennial, would normally complete. Atlantic Mutual's assumption of such tasks suggests that it had more than the usual oversight and control that a parent has over a subsidiary. See id. at 541.

Defendants do not address these particular allegations. Instead of focusing on whether plaintiffs' allegations are sufficient to avoid dismissal, they wrongly rely on cases evaluating whether the plaintiffs offered sufficient evidence of an agency relationship for the court to grant summary judgment or exercise jurisdiction over a defendant. See, e.g., F. Hoffman-La Roche, Inc. v. Superior Court, 130 Cal. App. 4th 782, 799-803 (6th Dist. 2005); Sonora Diamond Corp., 83 Cal. App. 4th at 548-51; Laird, 68 Cal. App. 4th at 741. Whether or not plaintiffs may ultimately be able to prove their allegations and offer sufficient evidence of agency, they have alleged sufficient facts to suggest that Atlantic Mutual exercised such extensive control

over Centennial that Centennial was no more than its agent. Cf. Higley v. Cessna Aircraft Co., CV 10-3345 GHK FMO, 2010 WL 3184516, at *2-3 (C.D. Cal. July 21, 2010) (plaintiffs' allegations insufficient to support agency theory where plaintiffs alleged that subsidiary was wholly owned by parent, at least one director on parent's board also served on subsidiary's board, and because parent owned 100% of the stock of subsidiary, the parent thereby controlled the subsidiary).

2. Alter Ego

"The alter ego doctrine arises when a plaintiff comes into court claiming that an opposing party is using the corporate form unjustly and in derogation of the plaintiff's interests." Mesler v. Bragg Mgmt. Co., 39 Cal. 3d 290, 300 (1985). Under the doctrine, "[a] corporate identity may be disregarded--the 'corporate veil' pierced--where an abuse of the corporate privilege justifies holding the equitable ownership of a corporation liable for the actions of the corporation." Sonora Diamond, 83 Cal. App. 4th at 538. "[C]ourts will ignore the corporate entity and deem the corporation's acts to be those of the persons or organizations actually controlling the corporation" "when the corporate form is used to perpetrate a fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose." Id.

The doctrine may be invoked when two conditions are met: (1) there is such a unity of interest and ownership that the separate corporations are merged, so that one corporation is a mere adjunct of another or the two companies form a single enterprise; and (2) there will be an inequitable result if the

acts in question are treated as those of one corporation alone. Tran v. Farmers Grp., Inc., 104 Cal. App. 4th 1202, 1219 (1st Dist. 2002); Sonora Diamond, 83 Cal. App. 4th at 538. "To put it in other terms, the plaintiff must show specific manipulative conduct by the parent toward the subsidiary which relegate[s] the latter to the status of merely an instrumentality, agency, conduit or adjunct of the former[.]" Laird, 68 Cal. App. 4th at 742 (first alteration in original) (internal quotation marks and citations omitted).

a. Unity of Interest

For the unity of interest element, courts consider several factors, including:

> inadequate capitalization, commingling of funds and other assets of the two entities, the holding out by one entity that it is liable for the debts of the other, identical equitable ownership in the two entities, use of the same offices and employees, use of one as a mere conduit for the affairs of the other, disregard of corporate formalities, lack of segregation of corporate records, and identical directors and officers.

Virtualmagic Asia, Inc. v. Fil-Cartoons, Inc., 99 Cal. App. 4th 228, 245 (4th Dist. 2002)

Plaintiffs allege a number of facts that are sufficient under California law to question the independence and separateness of Atlantic Mutual and Centennial. They allege that Centennial and Atlantic Mutual share a bank account; that Atlantic Mutual repeatedly represented itself as obligated to pay for Centennial's obligations under plaintiffs' insurance policy; that while Centennial issued plaintiffs' policy, Atlantic Mutual completed the obligations under it; that Atlantic Mutual and Centennial share common officers and directors; that Atlantic

Mutual and Centennial used the same home office; and that Atlantic Mutual and Centennial did not respect their purported corporate separateness. These factual allegations are more than the mere "broad and insufficient" allegations of the factors that courts have found fail to show a unity of interest. See, e.g., Mililani Grp., Inc. v. O'Reilly Auto., Inc., 2:12-CV-00891 JAM, 2012 WL 5932980, at *2 (E.D. Cal. Nov. 27, 2012) (Mendez, J.).

Defendants cite no case holding that comparable allegations are insufficient to show a unity of identity. Cf. Pac. Mar. Freight, Inc. v. Foster, 10-CV-0578-BTM-BLM, 2010 WL 3339432, at *6 (S.D. Cal. Aug. 24, 2010) (noting that "[t]he identification of the elements of alter-ego liability plus two or three factors has been held sufficient to defeat a 12(b) (6) motion to dismiss"). Cases found by the court support the proposition that plaintiffs have alleged facts supporting factors--commingling of funds, the holding out by one entity that it is liable for the debts of the other, use of one entity as the mere conduit of the other--that are particularly indicative of a unity of interest and, where pled, sufficient to avoid dismissal of a defendant who is alleged to be liable as an alter ego. See id. at *7 (unity of interest sufficiently alleged where plaintiff pled commingling of funds and domination and control of sole owner over entity); Axon Solutions, Inc., 2010 WL 1797028, at *3 (unity of interest sufficiently alleged where plaintiff alleged that city wholly owned company, city deliberately undercapitalized company, city and company commingled funds, and city represented that it was liable for company's debts). Plaintiffs have therefore sufficiently pled the first prong for

alter ego liability.

b. Inequitable Result

To allege the inequitable result element of the alter ego theory, plaintiffs must allege bad-faith conduct by defendants. Mid-Century Ins. Co. v. Gardner, 9 Cal. App. 4th 1205, 1213 (3d Dist. 1992). "[T]he kind of inequitable result that makes alter ego liability appropriate is an abuse of the corporate form, such as under-capitalization or misrepresentation of the corporate form to creditors." Firstmark Capital Corp. v. Hempel Fin. Corp., 859 F.2d 92, 94 (9th Cir. 1988) (internal quotation marks and citations omitted) (applying California law). "[W]hile the doctrine does not depend on the presence of actual fraud, it is designed to prevent what would be fraud or injustice, if accomplished." Associated Vendors, Inc. v. Oakland Meat Co., 210 Cal. App. 2d 825, 838 (1st Dist. 1962).

Plaintiffs allege that "severe injustice would be imposed upon the plaintiffs by recognizing defendants as separate entities, in that defendants would be permitted to create an artifice to promote injustice to avoid bad faith liability to the plaintiffs, whereby Centennial issued the policy, but Atlantic Mutual, which committed and engaged in the many acts [in] bad faith, disclaims responsibility as a non-signatory to the policy." (FAC ¶ 13(d).) Plaintiffs thus allege that recognizing separateness between Atlantic Mutual and Centennial would allow Atlantic Mutual to use the corporate form to avoid liability for the harm it allegedly caused to plaintiffs by preventing fulfillment of the obligations due to them under their insurance policy. Plaintiffs' allegations are therefore sufficient to met

the inequitable result prong at the pleading stage. See Axon, 2010 WL 1797028, at *3 (finding fact that alter ego could dissolve wholly owned corporation to destroy any remedy available to the plaintiff rose to the level of an inequitable act for purposes of alter ego doctrine at the pleading stage). Accordingly, plaintiffs' claims for breach of contract and breach of the implied covenant of good faith and fair dealing against Atlantic Mutual cannot be dismissed.

B. Declaratory Relief

Defendants argue that plaintiffs' claim for declaratory relief should be dismissed because plaintiffs no longer have any basis to seek declaratory relief as to defendants' obligation to pay defense costs and there is no action to which such a prospective duty would apply. (Mem. in Supp. at 13:20-28 (Docket No. 219-1).) Plaintiffs did not oppose this argument; they failed to address it all. Accordingly, plaintiffs' claim for declaratory relief will be dismissed. See Silva v. U.S. Bancorp, 5:10-CV-01854-JHN, 2011 WL 7096576, at *3 (C.D. Cal. Oct. 6, 2011) (finding that plaintiff conceded that claim should be dismissed by failing to address defendants' arguments in his opposition).

IT IS THEREFORE ORDERED that defendants' motion to dismiss be, and the same hereby is, DENIED IN PART as to plaintiffs' claims for breach of contract and breach of the implied covenant of good faith and fair dealing against Atlantic Mutual and GRANTED IN PART as to plaintiffs' claim for declaratory relief.

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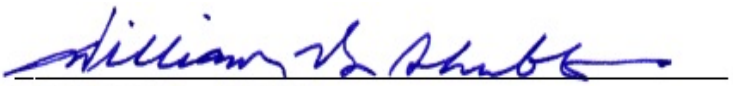
DATED: July 19, 2013



WILLIAM B. SHUBB
UNITED STATES DISTRICT JUDGE