

United States District Court
For the Northern District of California

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

INDYMAC FEDERAL BANK, F.S.B., by
the FEDERAL DEPOSIT INSURANCE
CORPORATION as Conservator,

No. C 08-04303 WHA

Plaintiff,

v.

PMI MORTGAGE INSURANCE CO.,
an Arizona corporation,

**ORDER DENYING
DEFENDANT’S MOTION TO
DISMISS AND PLAINTIFF’S
MOTION FOR PARTIAL
SUMMARY ADJUDICATION**

Defendant.

AND RELATED COUNTERCLAIMS.

INTRODUCTION

In this breach of contract action, defendant PMI Mortgage Insurance Co. moves to dismiss plaintiff IndyMac Federal Bank’s third and fourth causes of action relating to breach of the implied covenant of good faith and fair dealing under FRCP 12(b)(6). IndyMac also moves for partial summary judgment to address PMI’s alleged duty to provide insurance coverage until the Court reaches a decision on the merits. For the reasons stated below, both motions are **DENIED**.

STATEMENT

IndyMac was involved in the residential mortgage loan business and acquired mortgage insurance from PMI. This insurance — referred to as the Lender Paid Mortgage Insurance —

1 covenant for exercising an express contractual right. *Second*, PMI argues that even if its actions
2 were not covered by the express provisions of the contract, its reliance on interpretation of the
3 express language was objectively reasonable and thus prevents a claim for breach of the implied
4 covenant.

5 The parties agree that every contract imposes a duty of good faith and fair dealing in the
6 performance of the contract on each of the parties such that neither party shall take any action
7 that effectively destroys or injures the right of the other party to receive the benefits of the
8 contract. PMI argues that the California Supreme Court has held that this implied covenant
9 is subject to the limitation that it cannot preclude what the express terms of the contract permit.

10 *Carma Developers (Cal.), Inc. v. Marathon Dev. Cal., Inc.*, 2 Cal. 4th 342, 374 (1992).

11 In *Carma*, the California Supreme Court held that defendant lessor’s exercise of a lease
12 provision — which granted the lessor the absolute right to terminate the lease on the lessee’s
13 request to sublet a portion of the premises — was not a breach of the covenant of good faith
14 and fair dealing because this act was expressly authorized by the lease provision *and* was within
15 the reasonable expectations of the parties. *Id.* at 371. While it is true that the court held that
16 “as a general matter, implied terms should never be read to vary express terms,” *id.* at 374, the
17 court found it crucial that the conduct covered by the express provision of the contract was
18 within the parties’ legitimate expectations. In *Carma*, the court found that the only incentive
19 for terminating the lease would be in the hopes of receiving a higher rent from a new lessee.
20 Since that was the only purpose of having the express provision, it could not be said that
21 exercising it for this purpose was contrary to any reasonable expectation of the plaintiff and
22 was a violation of the implied covenant.

23 Here, that is not the case. Even assuming that PMI’s actions were expressly permitted
24 by the contract — a holding this order does not reach — IndyMac sufficiently alleges no one
25 could have reasonably expected the bank to turn over 5,565 files within the thirty-day period
26 (Second Amd. Compl. ¶ 33). While PMI had the discretionary power to demand loan files from
27 IndyMac, it is exactly this type of discretionary exercise of power where the implied covenant
28 finds its most particular application. *Carma*, 2 Cal. 4th 342 at 372. PMI was required to

1 exercise this discretionary power in a fair and good faith manner, and IndyMac sufficiently
2 alleges that PMI did not. It is not enough to point to a provision in the contract permitting the
3 allegedly nefarious conduct for if this was enough to avoid a breach of the implied covenant, the
4 implied covenant would cease to have its own meaning as it would always require a breach of
5 the underlying contract itself. The implied covenant is not concerned with the technical
6 permissiveness of conduct pursuant to a contract, it is concerned with assuring that all conduct
7 related to receiving the benefits of the contract is done in good faith. IndyMac sufficiently
8 alleges that PMI's conduct was done in bad faith and thus IndyMac's claims for breach of the
9 implied covenant are sufficient.

10 PMI alternatively argues that when there is a "genuine dispute" as to the insurer's
11 liability to pay based on the proper interpretation of a policy, and the insurer based its actions
12 on an interpretation of the policy that is objectively reasonable, the insurer's subjective intent is
13 irrelevant and there can be no breach of the implied covenant as a matter of law. *Morris v. Paul*
14 *Revere Life Ins. Co.*, 109 Cal. App. 4th 966, 973 (2003). In *Morris*, the facts were undisputed
15 that plaintiff's illness was not covered in his policy. Rather, the issue of the defendant's
16 liability regarding bad faith depended solely on whether it acted in bad faith when it *interpreted*
17 an incontestability clause in the plaintiff's policy and, thus, the sole question was a question of
18 law and contract interpretation. Because the bad faith was entirely related to the question of
19 defendant's motives in its contract interpretation, the court found that there was only a "genuine
20 dispute" as to the meaning of the contract, invoked the objectively reasonable standard, and
21 upheld the dismissal of the claim.

22 Here, the question does not turn on solely a legal question. The question is whether the
23 parties would reasonably have expected that IndyMac would find and turn over 5,565 files in a
24 single month period. The language itself does not go so far, at least expressly. Perhaps the
25 language can be stretched to cover such an extravagant demand, but that will turn on the
26 commercial setting and the surrounding facts and circumstances, all highly fact intensive and
27 incapable of resolution on the pleadings.

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1 Thus, while it is true that *one* of the issues to be resolved is the legal issue of what the
2 contract permitted, it is not the *sole* issue. The California Supreme Court has stated that “[i]n
3 the insurance bad faith context, a dispute is not ‘legitimate’ unless it is founded on a basis that
4 is reasonable under all the circumstances.” *Wilson v. 21st Century Ins. Co.*, 42 Cal. 4th 713,
5 724 n.7 (2007). When the issues are mixed with factual and legal questions, it is no longer
6 proper to say that the subjective intent is not relevant. Indeed, it would be impossible to find
7 that the implied covenant can be violated by expressly permitted conduct done in bad faith, yet
8 conduct taken in reliance of a mere objectively reasonable interpretation of the contract is
9 immunized from violating the implied covenant. As there are still factual issues to be resolved
10 in conjunction with the legal question of contract interpretation, dismissal is improper. Taken
11 in the light most favorable to IndyMac, the complaint sufficiently alleges a cause of action for
12 breach of the implied covenant of good faith and fair dealing.

13 **2. MOTION FOR PARTIAL SUMMARY ADJUDICATION.**

14 In its motion for partial summary adjudication, IndyMac requests that this Court define
15 PMI’s duty to provide coverage in light of PMI’s rescission. PMI’s position is that unilateral
16 rescission was proper after it provided plaintiff with notice of the rescission and returned the
17 premium and, thus, it had no duty to continue to provide coverage. According to IndyMac, its
18 refusal to accept the premiums back and return of the premiums to PMI made the rescission
19 ineffectual. Plus, IndyMac argues that PMI cannot unilaterally rescind coverage without court
20 approval and that PMI is required to continue providing IndyMac with coverage until the Court
21 rules on the validity of PMI’s unilateral action. PMI counters that IndyMac’s motion is
22 procedurally improper because it requests adjudication of matters outside of the claim or
23 defenses of the parties. PMI further argues that IndyMac essentially requests a mandatory
24 preliminary injunction because IndyMac seeks an order requiring defendant to continue
25 providing coverage until the merits are resolved.

26 IndyMac asserts its “motion has nothing to do with the merits of PMI’s actions. Rather,
27 [its] motion seeks summary adjudication of a discrete, purely legal issue — PMI’s duty to
28 continue providing coverage unless and until this Court affirms PMI’s purported rescissions of

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coverage on the 5,857 loans” (Br. at 1). This order disagrees. This issue is tied up in the merits of the parties’ actions, and consideration of the merits is premature due to the need to allow the parties sufficient opportunity to engage in discovery. There are too many open factual questions. IndyMac’s motion for partial summary adjudication is **DENIED**.

CONCLUSION

For the foregoing reasons, defendant’s motion to dismiss plaintiff’s claims of breach of the implied covenant of good faith and fair dealing is **DENIED**, and plaintiff’s motion for partial summary adjudication is **DENIED**.

IT IS SO ORDERED.

Dated: February 11, 2009.



WILLIAM ALSUP
UNITED STATES DISTRICT JUDGE