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United States District Court
For the Northern District of California

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

TRAVELERS PROPERTY,
Plaintiff,
v.
CENTEX HOMES,
Defendant.

No. C 10-02757 CRB

**ORDER GRANTING IN PART AND
DENYING IN PART PLAINTIFF'S
MOTION FOR SUMMARY
JUDGMENT**

Plaintiff Travelers Property Casualty Co. filed suit for declaratory and injunctive relief against Defendant Centex Homes regarding its duty to defend Defendant in two construction defect lawsuits. In its complaint, Plaintiff requested that the Court declare that Plaintiff has the right to control the defense and that Defendant had breached its duty to cooperate under Plaintiff's insurance policies. It also sought to enjoin Defendant from refusing Plaintiff's appointed counsel's representation of Defendant in the construction defects actions.

Plaintiff now brings this Motion for Summary Judgment, or, in the alternative, partial summary judgment, arguing that (1) Defendant breached its duty to cooperate and substantially prejudiced Plaintiff's ability to defend Defendant; (2) Plaintiff is excused from its duties to defend and indemnify Defendant because of this breach; (3) Defendant's payments to its defense counsel after refusing Plaintiff's choice of counsel are voluntary

1 payments; and (4) Defendant is barred from suing Plaintiff for failure to completely comply
2 with the policies. The Court GRANTS IN PART and DENIES IN PART Plaintiff's motion
3 for summary judgment.

4 **I. BACKGROUND**

5 On February 17, 2009, a different set of homeowners filed a lawsuit for construction
6 defects (the "Allie Action") against Defendant, the general contractor. Allie v. Centex
7 Homes, No. 34-2009-00034504 (Sacramento Super. Ct.). On March 20, 2009, various
8 homeowner plaintiffs initiated suit for construction defects (the "Agles Action") against
9 Defendant, the general contractor. Agles v. Centex Homes, No. 34-2009-00038327
10 (Sacramento Super. Ct.). Some of the homes involved in these actions were insured under
11 Defendant's "wrap" policies.¹ Pursuant to those policies, Defendant tendered to its wrap
12 policy insurance carriers (not Plaintiff) the defense of the Allie and Agles Actions on
13 February 19, 2009 and March 31, 2009, respectively. Coleman Decl. (Dkt. 113) ¶ 4.

14 Foremost Superior Marble ("Foremost") and American Woodmark were two of the
15 subcontractors that worked on homes involved in the two lawsuits. These homes were built
16 in 2003 when Foremost held a policy with Plaintiff that was effective August 1, 2002
17 through August 1, 2003, Barrera Decl., Ex. 11 (Dkt. 112-2) at 15, and American Woodmark
18 held a policy with Plaintiff that was effective February 8, 2003 through March 1, 2004, id.,
19 Ex. 10 at 5. In mid-May 2009, Defendant tendered its defense to Plaintiffs pursuant to
20 Plaintiff's policies as an additional insured. Id., Ex. 4 (Dkt. 112-1) at 17-18, Ex. 5 at 20-21,
21 Ex. 6 at 23-24. For each tender, Defendant stated that the tender only applied to non-wrap
22 homes. Id. at 17, 20, 23.

23 Plaintiff acknowledged receipt of the tender requests within a week, but requested
24 multiple times from Defendant additional information concerning the wrap policies,
25 construction contracts for the non-wrap homes, pleadings in the actions, and Defendant's
26 counsel's rates and litigation budget as to all three tenders. Pragin Decl., Ex. P (Dkt. 88-1) at
27

28 ¹Wrap insurance covers all parties in a construction project under one umbrella policy. The wrap policy includes the owner, general contractor, sub-contractors and all other parties involved in the construction project.

1 5, Ex. Q at 8-9, Ex. AA at 41-43; Lopez Decl., Ex. D (Dkt. 87-1) at 5, Ex. E at 8. In August
2 and September 2009, Plaintiff accepted the tenders subject to a full reservation of rights. See
3 generally Barrera Decl., Ex. 10, Ex. 11, Ex. 12. Plaintiff agreed that the law firm of
4 Newmeyer & Dillion, retained by Defendant to represent it in both the Agles and Allie
5 Actions from their inceptions, would continue to defend Defendant in both actions. Id. (Dkt.
6 112)² ¶ 9.

7 In March 2010, Plaintiff informed Defendant that it would retain counsel of Plaintiff's
8 choosing in both actions. Plaintiff appointed the law firms of Burch & Cracchiolo in the
9 Allie Action and Robinson & Wood in the Agles Action. Id., Ex. 7 at 26, Ex. 8 at 29, Ex. 9
10 at 2. Defendant asserted that it refused to accept Plaintiff's firms as counsel until Plaintiff
11 would provide information that those firms could provide a conflict-free defense. Id., Ex. 1
12 at 2, Ex. 2 at 7, Ex. 3 at 12. It also claimed the right to independent counsel pursuant to
13 California Civil Code § 2860 due to Plaintiff's reservation of rights on several coverage
14 issues. Id. at 4-5, 9-10, 14-15. Defendant later refused both firms' attempts to associate as
15 defense counsel in both construction defect actions. Reuben Decl., Ex. II (Dkt. 86-1) at 23,
16 Ex. JJ at 25. Defendant never received the information it requested from Plaintiff regarding
17 the potential for conflict of interest. Coleman Decl. ¶¶ 7-10.

18 On June 23, 2010, Plaintiff filed this suit against Defendant for declaratory and
19 injunctive relief concerning Plaintiff's role and ability to control Defendant's defense in the
20 Allie and Agles Actions. See generally Compl. After filing suit, Plaintiff stopped paying
21 any defense fees or costs of Defendant's counsel for the Allie and Agles actions. Kelley
22 Decl. (Dkt. 111) ¶ 12.³ By October 2010, Defendant incurred \$155,238.40 in defense fees

24 ²Plaintiff objects to paragraphs 2, 5-10, and 12 of the Barrera Declaration on various grounds.
25 See generally Objections to Barrera Decl. (Dkt. 121). To the extent the Court relies on this evidence,
26 it does not adversely impact Plaintiff. Therefore, it is unnecessary to address Plaintiff's objections to
parts of the Barrera Declaration.

27 ³The Kelley Declaration actually states: "Since filing this lawsuit, Centex has not paid
28 Newmeyer & Dillion anything towards Centex's defense . . . in [both actions]." The Court assumes that
the Kelley Declaration meant to state that Travelers, not Centex, had not paid. This is confirmed in
Defendant's opposition, which states: "Travelers has paid none of Centex's defense fees and costs . .
. since the filing of its lawsuit." Opp'n at 15.

1 and costs in the Agles Action, of which Plaintiff had paid \$75,770.84. Barrera Decl. ¶ 11.
2 For the Allie Action, it incurred \$180,620.64, of which Plaintiff had paid \$18,431.31. Id.
3 Newmeyer & Dillion continues to represent Defendant in the pending Allie and Agles
4 Actions. Coleman Decl. ¶ 10.

5 **II. LEGAL STANDARD**

6 Summary judgment is appropriate where “the pleadings, depositions, answers to
7 interrogatories and admissions on file, together with the affidavits, if any, show that there is
8 no genuine issue of material fact and that the moving party is entitled to judgment as a matter
9 of law.” Fed. R. Civ. P. 56(c). The burden is on the moving party to demonstrate that there
10 is no genuine dispute with respect to any material fact. Celotex Corp. v. Catrett, 477 U.S.
11 317, 323 (1986). A fact is “material” only if it could affect the outcome of the suit under the
12 governing law, and becomes a genuine issue if it can reasonably be resolved in favor of the
13 nonmoving party. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248-49 (1986).

14 If the moving party does not satisfy its initial burden, the nonmoving party has no
15 obligation to produce anything. Nissan Fire & Marine Ins. Co. v. Fritz Cos., 210 F.3d 1099,
16 1102-03 (9th Cir. 2000). If, on the other hand, the moving party meets its initial burden of
17 production, then the nonmoving party may not rest upon mere allegations or denials of the
18 adverse party’s evidence, but instead must produce admissible evidence that shows there is a
19 genuine issue of material fact for trial. Id. at 1103. If the nonmoving party fails to make this
20 showing, the moving party is entitled to judgment as a matter of law. Celotex, 477 U.S. at
21 323.

22 When deciding a summary judgment motion, a court must view the evidence in the
23 light most favorable to the nonmoving party and draw all justifiable inferences in its favor.
24 Anderson, 477 U.S. at 255.

25 **III. DISCUSSION**

26 Plaintiff moves for summary judgment and argues that Defendant breached its duty to
27 Plaintiff to cooperate in the defense of the Allie and Agles Actions pursuant to the policies.
28 Mot. For Summ. J. (Dkt. 84) at 9-10; Carrillo Decl., Ex. A (Dkt. 89-1) at 59. Before

1 analyzing this alleged breach, however, the Court first analyzes whether Plaintiff fulfilled its
2 duty to defend Defendant.

3 **A. Plaintiff Provided an Immediate, Complete, and Full Defense**

4 Upon an insured's tender of the defense of an underlying action, if any of the claims
5 are at least potentially covered by the insurance policy, the insurer has a duty to defend.

6 Buss v. Super. Ct., 16 Cal. 4th 35, 58-59 (1997). This duty to defend requires that:

7 [T]he insurer must defend immediately. To defend immediately, it must
8 defend entirely. It cannot parse the claims, dividing those that are at least
9 potentially covered from those that are not. To do so would be time
10 consuming. It might also be futile: The "plasticity of modern pleading"
11 allows the transformation of claims that are at least potentially covered into
12 claims that are not, and vice versa.

13 Id. at 49 (citations omitted).

14 Therefore, although the insurer has no duty under the policy to defend claims that are
15 not potentially covered, the insurer has a duty imposed by law to defend the entire "mixed"
16 action. Hurvitz v. St. Paul Fire & Marine Ins. Co., 109 Cal. App. 4th 918, 935 n.6 (2003). In
17 requiring this complete defense, the California Supreme Court sought to avoid the
18 consequent delay in providing a defense if parties attempted to negotiate a percentage of the
19 defense costs according to each insurer's potential exposure. Presley Homes, Inc. v. Am.
20 States Ins. Co., 90 Cal. App. 4th 571, 576-77 (2001). After mounting a complete defense, an
21 insurer can seek contributions from other insurers obligated to defend the insured. Maryland
22 Cas. Co. v. Nationwide Mutual Ins. Co., 81 Cal. App. 4th 1082, 1089 (2000). If an insurer
23 wants to provide a share of the defense instead of a complete one, it must waive its
24 reservation of rights to deny coverage and seek reimbursement. Buss, 16 Cal. 4th at 58.

25 Failure to provide an immediate and complete defense is a breach of an insurer's duty
26 to defend and waives its right to control the defense. Hartford Accident & Indem. Co. v.
27 Civil Serv. Employees Ins. Co., 33 Cal. App. 3d 26, 35 (1973). This, in turn, excuses the
28 insured's performance under the policy, including the duty to cooperate and any restriction
against voluntary payments. Hamilton v. Maryland Cas. Co., 27 Cal. 4th 718, 728 (2002).

1 Defendant argues that, for two reasons, there is a genuine issue as to whether Plaintiff
2 provided a sufficient defense when it accepted Defendant’s tenders. Opp’n (Dkt. 110) at 15-
3 19.

4 **1. Immediate Defense**

5 First, Defendant asserts that Plaintiff failed to provide an immediate defense because
6 it did not accept Defendant’s May 2009 tenders, Barrera Decl. ¶¶ 3-4, until August and
7 September 2009, *id.* ¶¶ 6-8, and it did not appoint counsel until March 2010, *id.* ¶ 5, almost a
8 year after Defendant’s initial tenders to Plaintiff. Opp’n at 16-17. This argument fails. An
9 insurer must reasonably investigate to determine if a duty to defend exists. Cal. Shoppers
10 Inc. v. Royal Globe Ins. Co., 175 Cal. App. 3d 1, 38 (1985). If there was any unreasonable
11 delay in Plaintiff’s response to Defendant’s tenders, it occurred in part because Defendant
12 failed to promptly provide the reasonable, requested information to facilitate Plaintiff’s
13 investigation. Lopez Decl. (Dkt. 87) ¶ 4.b-d; Pragin Decl. (Dkt. 88) ¶¶ 7.b, c, e, g-k. An
14 immediate defense does not require an insurer to appoint new counsel, but simply requires it
15 to mount and fund a defense. Buss, 16 Cal. 4th at 46. Here, Plaintiff agreed to keep
16 Newmeyer & Dillion as defense counsel in the Allie and Agles Actions, so Defendant was
17 not without counsel once Plaintiff accepted the tenders. Barrera Decl. ¶ 9. Furthermore,
18 Plaintiff paid defense costs to Newmeyer & Dillion after accepting the tenders, issuing
19 payments upon receiving the firm’s bills. *Id.* ¶ 11; see, e.g., Lopez Decl., Ex. N at 52.
20 Therefore, Plaintiff provided an immediate defense.

21 **2. Complete Defense**

22 Second, Defendant asserts that Plaintiff breached its duty to defend when it did not
23 provide a complete defense. Opp’n at 17-19. Instead of defending the entire action, Plaintiff
24 offered to “participate” in the defense and limited its defense obligations to a “proportionate
25 share of any covered indemnity obligation and/or reasonable defense fees and costs . . . less
26 any amounts . . . [for] claims [which] do not fall within the bounds of coverage.” Barrera
27 Decl., Ex. 10 at 12, Ex. 11 at 16, Ex. 12 at 29. Plaintiff contacted defense counsel to
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1 negotiate Plaintiff's share of defense fees and costs, and only paid a portion of the defense
2 fees incurred in the Allie and Agles Actions. Id. ¶¶ 10-11.

3 At first glance, it would appear that Plaintiff breached its duty by seeking to pay only
4 a share of the defense costs. This is what Presley Homes intended to prevent. However, an
5 insured is entitled to only one full defense. San Gabriel Valley Water Co. v. Hartford
6 Accident & Indem. Co., 82 Cal. App. 4th 1230, 1241 (2000). An insurer's refusal to defend
7 "is of no consequence to an insured whose representation is provided by another insurer:
8 under such circumstances, 'the insured [is] not faced with an undue financial burden or
9 deprived of the expertise and resources available to insurance carriers in making prompt and
10 competent investigations as to the merits of lawsuits filed against their insureds.'" Horace
11 Mann Ins. Co. v. Barbara B., 61 Cal. App. 4th 158, 164 (1998) (quoting Ceresino v. Fire Ins.
12 Exch., 215 Cal. App. 3d 814, 823 (1989)) (internal quotation marks omitted).

13 However, Defendant itself explicitly limited its tenders of the defenses in the Allie and
14 Agles Actions: "To the extent any home is involved in the lawsuit and falls within the [wrap
15 policies] we are not seeking a defense or indemnity contributions. This tender is applicable
16 in connection with non-[wrap] homes only." Barrera Decl., Ex. 4 at 17, Ex. 5 at 20, Ex. 6 at
17 23. Plaintiff accepted the tenders of the defense to those very same non-wrap homes. Id.,
18 Ex. 10 at 5-6, Ex. 11 at 15-16, Ex. 12 at 21-22. Although it accepted the tenders with a full
19 reservation of rights, Plaintiff did not intend anything but a full and complete defense of
20 Defendant. Myron Decl., Ex. KK (Dkt. 85-1) at 3:7-12, 4:21-25, 8:20-9:12; LL at 14:25-
21 18:8; Myron Suppl. Decl., Ex. OO (Dkt. 120-1) at 12:20-23. Therefore, to the extent that it
22 limited the scope of such a defense to non-wrap homes, Plaintiff did so in response to the
23 tenders that were themselves limited to non-wrap homes.

24 Defendant cannot claim an incomplete defense on the basis of Plaintiff's attempts to
25 collect information on Defendant's other insurers and to determine its share of defense costs.
26 Not only did Defendant limit its tenders to non-wrap homes, but it tendered its defense to
27 other insurers in the Allie and Agles Actions. See Coleman Decl. ¶ 4; Lopez Decl., Ex. N at
28 52; Pragin Decl., Ex. U at 20, Ex. V at 23, Ex. W at 27. Plaintiff attempted to allocate

1 defense fees in the underlying actions to avoid unjustly enriching Defendant and its counsel
2 if multiple insurers paid in excess of 100% of the defense fees. Plaintiff therefore did not
3 violate its duty to give a complete defense when it sought to allocate defense fees and costs
4 in light of the nature of Defendant's tenders to Plaintiff and the other insurance carriers'
5 acceptance of Defendant's tenders.

6 Defendant also argues that the limited defense reserves set aside under each policy
7 demonstrate Plaintiff's intent to only provide a partial defense. Kelley Decl., Ex. 10 (Dkt.
8 111-2) at 13-14 (\$150,000 for the Allie Action), Ex. 11 at 28 (\$50,000 for the Agles Action
9 for American Woodmark), Ex. 12 at 37 (\$50,000 for the Agles Action for Foremost).
10 Plaintiff's reserve levels could not possibly cover the litigation budget proposed by
11 Newmeyer & Dillion, which exceeded \$1.8 million. Barrera Decl. ¶ 12. However,
12 Defendant merely cites to initial reserve levels set before receiving the litigation budget and
13 which were subject to adjustment upon additional information. Myron Suppl. Decl., Ex. MM
14 at 6:10-12, Ex. NN at 8:3-9:13. These figures cannot support an inference that Plaintiff had
15 an intent to provide Defendant only a partial defense.⁴

16 In sum, Defendant does not identify a genuine issue of material fact and Plaintiff is
17 entitled to judgment on Defendant's argument that Plaintiff failed to provide a full and
18 complete defense. Plaintiff did not breach its duty to defend, but in fact provided Defendant
19 an immediate, full, and complete defense in response to its tenders for the Allie and Agles
20 Actions.

21 Having so determined, the Court now turns to whether Defendant breached its duty to
22 cooperate under the policies.

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28 ⁴Neither party submitted evidence of the current reserve levels or what adjustments Plaintiff made, if any, once Plaintiff received additional information about the lawsuits.

1 **B. Defendant Breached its Duty to Cooperate By Refusing Plaintiff's**
2 **Appointed Counsel⁵**

3 **1. Right to Control Litigation and Duty to Cooperate**

4 “[I]n the event of a claim, occurrence, or suit, the insured will tender the defense to
5 the insurer, which will provide a defense and control the litigation with the full cooperation
6 of the insured.” Truck Ins. Exch. v. Unigard Ins. Co., 79 Cal. App. 4th 966, 979 (2000). The
7 right to control the defense generally includes the right to select defense counsel. See State
8 Farm Mut. Auto. Ins. Co. v. Fed. Ins. Co., 72 Cal. App. 4th 1422, 1429 (1999).

9 As discussed above, Plaintiff fulfilled its duty to defend and provided Defendant a
10 defense. Under the policies, it had the “right and duty to defend [Defendant from] any ‘suit’
11 seeking those damages [to which the policies apply].” Carrillo Decl., Ex. A at 56. Plaintiff
12 exercised this right to control the defense by retaining law firms for the Allie Action and
13 Agles Action. Barrera Decl., Ex. 7 at 26, Ex. 8 at 29-30, Ex. 9 at 2.

14 Upon being provided a defense, the insured has no right to interfere with the insurer’s
15 right to control the defense. Safeco Ins. Co. v. Super. Ct., 71 Cal. App. 4th 782, 787 (1997).
16 The right to control the defense imposes upon an insured the duty to cooperate with the
17 insurer with regards to its defense. Truck Ins. Exch., 79 Cal. App. 4th at 979. Failure to
18 comply with a policy’s cooperation clause constitutes breach of the insurance contract. See
19 Hall v. Travelers Ins. Cos., 15 Cal. App. 3d 304, 308-09 (1971).

20 Defendant asserts that it did not reject Plaintiff’s appointed counsel, but refrained
21 from accepting Plaintiff’s appointed counsel because it sought “information so [Defendant]
22 [could] adequately assess [Plaintiff’s] offer to appoint separate counsel” and determine if
23 appointed counsel had any conflicts of interest with Defendant. Barrera Decl., Ex. 1 at 2, Ex.
24 2 at 7, Ex. 3 at 12. Plaintiff still has not confirmed whether Plaintiff’s counsel for the Allie

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27 ⁵Plaintiff also argues that Defendant breached its duty to cooperate with its initial refusal to
28 produce the wrap policies to Plaintiff. Mot. For Summ. J. at 11, 14. Defendant produced the wrap
policies on January 10, 2011. Kelley Decl. ¶ 11. Because the Court finds that the Defendant breached
its duty to cooperate through its refusal of Plaintiff’s counsel, a full analysis of whether Defendant
breached through other means is not necessary.

1 and Agles Actions is competent to defend Defendant or has a conflict of interest with
2 Defendant. Coleman Decl. ¶ 9; see generally Kelley Decl. Ex. 5, Ex. 6.

3 Defendant had a duty to cooperate under the policies. Carrillo Decl., Ex. A at 59.
4 Instead, Defendant foreclosed Plaintiff’s right to select defense counsel by (1) informing
5 Plaintiff that until all outstanding issues were resolved between them, Defendant would
6 maintain control of its defense through Newmeyer & Dillion; (2) objecting to Plaintiff
7 appointing new defense counsel; and (3) not authorizing Plaintiff’s appointed counsel to take
8 any action on its behalf. Barrera Decl., Ex. 1 at 5, Ex. 2 at 10, Ex. 3 at 15. Furthermore,
9 Defendant rebuffed efforts of Plaintiff’s appointed counsel to associate in the cases. Reuben
10 Decl., Ex. II at 23, Ex. JJ at 25. Accordingly, Plaintiff has demonstrated that Defendant
11 breached its duty to cooperate by refusing to accept Plaintiff’s appointed counsel.

12 2. Substantial Prejudice

13 For an insurer to be excused from its duties to defend and indemnify after an insured’s
14 breach of the cooperation clause, the insurer must show that it suffered substantial prejudice
15 from the insured’s breach. Truck Ins. Exch., 79 Cal. App. 4th at 976. Actual prejudice must
16 be shown. Billington v. Interinsurance Exch. of So. Cal., 71 Cal. 2d 728, 737 (1969). The
17 insurer must establish “that if the cooperation clause had not been breached there was a
18 substantial likelihood the trier of fact [in the underlying actions] would have found in the
19 insured’s favor.” Id. Often prejudice is not determinable while an underlying action is
20 pending. See United Servs. Auto. Ass’n. v. Martin, 120 Cal. App. 3d 963, 966 (1981). This
21 is because other failure to cooperate cases involve different types of breaches, such as
22 failures to appear for depositions or trial. See, e.g., Campbell v. Allstate Ins. Co., 60 Cal. 2d
23 303, 306 (1963) (no prejudice to insurer when default judgment entered in car accident
24 against insured who had disappeared because insured admitted to drinking in the police
25 report).

26 However, prejudice may be presumed where it “naturally, inherently and necessarily
27 exist[s].” Nw. Title Sec. Co. v. Flack, 6 Cal. App. 3d 134, 140-41 (1970) (citing Valladao v.
28 Fireman’s Fund Indem. Co., 13 Cal. 2d 322, 333-34 (1939)). The California Supreme Court

1 held that two cases (Valladao, 13 Cal. 2d 322, and Purefoy v. Pac. Auto. Indem. Exch., 5 Cal.
2 2d 81 (1935)) that presumed prejudice were not contrary to the requirement that an insured's
3 failure to cooperate must substantially prejudice the insurer because "under the facts [in those
4 cases] prejudice was established and . . . a showing of prejudice was not required." Id. at 141
5 (citing Campbell, 60 Cal. 2d at 306).

6 In Cybernet Ventures, Inc. v. Hartford Ins. Co. of the Midwest, 168 Fed. Appx. 850,
7 852 (9th Cir. 2006), the Ninth Circuit held that an insured substantially prejudiced its insurer
8 by failing to turn the defense of a copyright and trademark infringement action over to the
9 insurer's appointed attorneys. It did not analyze whether the trier of fact in the infringement
10 action would likely have found for Cybernet, the insured, had Hartford's counsel had been
11 accepted, but instead concluded that Cybernet's refusal in and of itself substantially
12 prejudiced Hartford. See id. When an insured refuses an insurer's choice of counsel, the
13 insured not only violates the duty to cooperate, but also interferes with the insurer's right to
14 conduct a defense. Id. This breach provides sufficient grounds to deny the insured's claims
15 for defense costs and indemnification. See id.; Twin City Fire Ins. Co. v. Ben Arnold-
16 Sunbelt Beverage Co. of S.C., 433 F.3d 365, 374-75 (4th Cir. 2005).

17 Here, prejudice inherently existed when Defendant refused Plaintiff's choice of
18 counsel. Defendant argues that its conduct does not rise to the level of breach to satisfy the
19 substantial prejudice standard. Opp'n at 5-6. However, under these facts, as in Cybernet and
20 Twin City, Defendant's failure to cooperate "could not have been more stark." See Twin
21 City, 433 F.3d at 375. Defendant's breach involved a failure to cooperate and a denial of the
22 Plaintiff's right to defend the underlying actions. Defendant refused to turn over defenses in
23 the Allie and Agles Actions to Plaintiff's appointed counsel, and also prevented those firms
24 from associating into either action. Barrera Decl., Ex. 1 at 2, Ex. 2 at 7, Ex. 3 at 12; Reuben
25 Decl., Ex. II at 23, Ex. JJ at 25. Therefore, Defendant substantially prejudiced Plaintiff,
26 which relieves Plaintiff of its duties to defend and indemnify Defendant in the Allie and
27 Agles Actions.

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1 **3. Conflicts of Interest**

2 Defendant asserts that, nonetheless, Plaintiff cannot appoint counsel, and that
3 Defendant did not breach, because a conflict of interest exists. An insured is entitled to a
4 conflict-free defense. James 3 Corp. v. Truck Ins. Exch., 91 Cal. App. 4th 1093, 1101-02
5 (2001). If a conflict exists because of an insurer’s control over the litigation, an insured is
6 entitled to independent counsel. Cal. Civ. Code § 2860. Conflicts must be “significant, not
7 merely theoretical, actual, not merely potential.” Dynamic Concepts, Inc. v. Truck Ins.
8 Exch., 61 Cal. App. 4th 999, 1007 (1998). Generally, there are four circumstances in which
9 a conflict will require the insurer to pay for independent counsel: (1) “where the insurer
10 reserves its rights on a given issue and the outcome of that coverage issue can be controlled
11 by the insurer’s retained counsel”; (2) where the plaintiff and defendant are both insured by
12 the insurer; (3) where the insurer has filed a lawsuit against the insured; and (4) “where the
13 insurer pursues settlement in excess of policy limits without the insured’s consent and
14 leav[es] the insured exposed to claims by third parties.” James 3 Corp., 91 Cal. App. 4th at
15 1101 (emphasis added). Defendant alleges two bases for finding a conflict of interest here.
16 Both are without merit.

17 **a. Multiple Parties Insured By the Same Insurer**

18 First, Defendant asserts that there is a conflict because Plaintiff insures both the
19 plaintiff and defendant in another action. Opp’n at 19-20. Defendant has filed cross-
20 complaints against the subcontractors, American Woodmark and Foremost, and Plaintiff
21 insures all three parties. See Barrera Decl., Ex. 1 at 3, Ex. 2 at 8, Ex. 3 at 13. Defendant
22 cites O’Morrow v. Borad, 27 Cal. 2d 794, 798 (1946), and Stevens v. Super. Ct., 155 Cal.
23 148, 150 (1909) to support its claim that this creates a conflict. However, both cases are
24 distinguishable. O’Morrow concerned a car accident where the insurer insured truly adverse
25 plaintiffs and defendants, not co-defendants. 27 Cal. 2d at 795. Stevens was not about
26 insurance coverage at all, but determined the jurisdiction of state courts sitting in probate.
27 See 155 Cal. at 152.

1 Here, Defendant’s cross-complaints against the subcontractors are for indemnification.
2 Defendant’s liability to the plaintiffs in the Allie and Agles Actions will be derivative from
3 the liability of the subcontractors who performed the work. Although Plaintiff insures the
4 Defendant, American Woodmark, and Foremost, it will have the same interest in defending
5 all three entities against plaintiffs’ general allegations in both lawsuits. Defendant’s claim
6 that a conflict of interest exists on this basis is “merely theoretical.”

7 **b. Reservation of Rights**

8 Second, Defendant argues that a conflict of interest arises from Plaintiff’s reservations
9 of rights. Opp’n at 20-22. A reservation of rights alone does not automatically create a
10 conflict. Blanchard v. State Farm Fire & Cas. Co., 2 Cal. App. 4th 345, 350 (1991). A
11 conflict exists “when an insurer reserves its rights on a given issue and the outcome of that
12 coverage issue can be controlled by counsel . . . retained by the insurer for the defense of the
13 claim.” Cal. Civ. Code § 2860(b) (emphasis added). However, if the coverage issue is
14 “independent of, or extrinsic to, the issues in the underlying case,” then independent counsel
15 is not required. Dynamic Concepts, Inc., 61 Cal. App. 4th at 1006. Where the interests of
16 the insured and insurer are aligned in defending against the underlying action, a conflict does
17 not exist. Foremost Ins. Co. v. Wilks, 206 Cal. App. 3d 251, 261 (1988).

18 Plaintiff’s reservation of rights do not give rise to a conflict of interest. One of the
19 rights Plaintiff reserved is to deny coverage if the damages alleged occurred outside the
20 policy periods. Barrera Decl., Ex. 10 at 7, 11, Ex. 11 at 18, Ex. 12 at 22. Defendant has
21 asserted a statute of limitations affirmative defense in the Allie and Agles Actions and, thus,
22 the issue of when the damages occurred is being litigated in those actions. Opp’n at 21.
23 Defendant argues against permitting Plaintiff to control Defendant’s defense because
24 Plaintiff’s counsel will be in a position to focus liability outside the policy periods through
25 manipulation of the pre-trial investigation and presentation at trial. Id. 21-22. Defendant
26 also points out that Plaintiff continued its investigation for “proof that there are actual
27 resulting damages in order to stay in the defense.” Kelley Decl., Ex. 10 at 14.

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1 Defendant's claim of a conflict of interest due to its statute of limitations affirmative
2 defense fails because the conflict is a "merely potential" one. Defendant provides no
3 evidence that Plaintiff's appointed counsel could shift the focus of liability outside of
4 Plaintiff's policy periods. More importantly, whether the damages occurred before, during,
5 or after the policy period is a factual issue outside of counsel's control. "The reservations of
6 rights related to the timing of [an insured]'s acts [do] not create a conflict of interest entitling
7 [it] to independent counsel." Citi Apts. Inc. v. Markel Ins. Co., Nos. C 06-5752 CW, C
8 06-7086 CW, 2007 WL 1689013, *5-6 (N.D. Cal. June 11, 2007). Plaintiff and Defendant
9 have the same interest in minimizing liability by establishing that any damages occurred at a
10 time early enough for the statute of limitations defense to apply in the Allie and Agles
11 Actions.

12 Furthermore, any counsel Plaintiff appoints also has legal and ethical obligations and
13 a fiduciary duty to Defendant. See Gafcon, Inc. v. Ponsor & Assocs., 98 Cal. App. 4th 1388,
14 1406 (2002). Defendant's suspicion of an investigation into "actual resulting damages" fails
15 to establish a conflict of interest. A liability insurer's duty to defend is a continuing one,
16 arising on tender of defense and lasting until the underlying lawsuit is concluded, or until it
17 has been shown that there is no potential for coverage. Montrose Chem. Corp. v. Super. Ct.,
18 6 Cal. 4th 287, 295 (1993). Although Plaintiff might have an interest in continuing an
19 investigation into its potential for coverage, this is irrelevant to the ability of Plaintiff's
20 appointed counsel to control the issue of when any covered liability occurs.

21 Defendant fails to present a genuine issue of material fact to support its claim that a
22 conflict of interest exists. As there is no conflict of interest, Defendant is not entitled to
23 independent counsel and had no grounds to refuse Plaintiff's appointed counsel.

24 **C. Plaintiff's Other Requests for Relief Exceed the Scope of its Complaint**

25 In addition to moving that the Court find that Defendant breached its duty to
26 cooperate, Plaintiff further asks the Court come to two additional conclusions: that
27 Defendant's refusal to accept Plaintiff's counsel (1) excuses Plaintiff's obligation to pay
28 defense fees and costs under the "no voluntary payments" clause in the policies; and (2)

1 contractually bars Defendant from suing Plaintiff on the policies under the full compliance
2 requirement. Mot. For Summ. J. at 15-18. Such relief was not pleaded in Plaintiff's
3 complaint. See Compl. at 12-13. The two additional requests in the motion are essentially
4 two new claims for relief, not evidence or matter that is referred to when piercing the
5 pleadings. Compare Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587
6 (1986). It is therefore inappropriate for Plaintiff to move for such relief at this stage.

7 At the motion hearing, Plaintiff argued for the first time that the claims are within the
8 scope of Defendant's counterclaims, Countercl. (Dkt. 37). But Plaintiff did not present this
9 argument in its papers and Defendant has not had an opportunity to fully address it. The
10 Court therefore declines to review such grounds at this time and DENIES the motion as to
11 these two claims for relief.

12 **IV. CONCLUSION**

13 For the foregoing reasons, the Court GRANTS IN PART and DENIES IN PART
14 Plaintiff's motion for summary judgment. The Court finds as a matter of law that Defendant
15 breached its failure to cooperate and substantially prejudiced Plaintiff, and Plaintiff is
16 therefore excused from its duties to defend and indemnify Defendant. The Court declines to
17 review Plaintiff's motion as to the voluntary payments clause and the full compliance
18 condition precedent.

19 **IT IS SO ORDERED.**

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21 Dated: April 1, 2011



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CHARLES R. BREYER
UNITED STATES DISTRICT JUDGE