

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

CITY OF DALY CITY,

Plaintiff,

v.

SPECIALTY NATIONAL INSURANCE COMPANY,

Defendant.

No. C 08-03603 CW

ORDER DENYING  
DEFENDANT'S MOTION  
TO DISMISS

Defendant Specialty National Insurance Company has filed a motion under Federal Rule of Civil Procedure 12(b)(6) to dismiss each of Plaintiff City of Daly City's three claims against it. The City opposes the motion.

Having considered all of the papers filed by the parties, the Court DENIES Specialty's motion.

BACKGROUND

The following facts are alleged in the complaint. On July 17, 2001, the City and Specialty entered into a contract for Specialty to provide to the City liability insurance coverage for the one year period between July 1, 2001 and July 1, 2002. Pl.'s Ex. A, at 1. The contract included a \$100,000 self-insured retention, which meant that the City was obliged to pay up to \$100,000 for each occurrence before Specialty was required to pay any claim. Id. at

1 1. The contract covered defense costs, and provided that Specialty  
2 "shall have the right and opportunity to associate with the Insured  
3 in the defense, appeal and control of any Claim or suit . . .  
4 seeking Damages in excess of the Insured's Retained Limit." Id. at  
5 1 of 16.

6 During the coverage period, the City was sued on two occasions  
7 which gave rise to the insurance claims at issue in this dispute.  
8 Each lawsuit alleged excessive force by police officers. The first  
9 was Ernest Espinoza and Juan Camberos v. City of Daly City, et al.  
10 (Case No. C-03-2896-SBA) (Espinoza), in which the court granted  
11 summary judgment for the City against Espinoza, and against  
12 Camberos on all but one claim. The City settled with Camberos for  
13 \$15,000. The City incurred \$116,912.46 in defense fees and costs  
14 for a total expenditure of \$131,912.46. The second case was Junior  
15 Williams v. Daly City Police Officers, C. Austria and M. Price  
16 (Case No. C-02-02745-JSW) (Williams), which settled for \$32,000.  
17 The City incurred \$158,632.50 in defense costs and fees for a total  
18 expenditure of \$191,132.50. The City characterizes both  
19 settlements as being for "nuisance value."

20 In Espinoza, the City's self-insured retention was exceeded  
21 after it settled on November 3, 2005. On July 17, 2006, the City  
22 tendered its Espinoza claim to Specialty. The initial tender was  
23 returned to the City as undeliverable. On August 8, 2006, the City  
24 contacted its insurance broker asking it to notify Specialty of the  
25 claim. On November 14, 2006, Specialty acknowledged the claim. On  
26 November 22, 2006, Specialty denied the claim, incorrectly  
27 asserting that defense costs were not included in the contract and  
28 therefore the \$100,000 threshold had not been met. On February 2,

1 2007, Specialty issued a second denial stating additional grounds  
2 not specified in the complaint.

3 The City initially tendered the Williams claim to the wrong  
4 insurer and correctly tendered the claim to Specialty on October  
5 23, 2006. On November 3, 2006, Specialty acknowledged receipt of  
6 the claim. The case settled on December 13, 2006. On April 18,  
7 2007, Specialty denied the claim, with the explanation that the  
8 City had given late notice and made voluntary payments in settling  
9 the matter.

10 On July 28, 2008, the City filed its complaint in this Court  
11 based on diversity jurisdiction.

12 The City pleads three causes of action: (1) breach of  
13 contract; (2) breach of the implied covenant of good faith and fair  
14 dealing; and (3) declaratory relief.

15 LEGAL STANDARD

16 A complaint must contain a "short and plain statement of the  
17 claim showing that the pleader is entitled to relief." Fed. R.  
18 Civ. P. 8(a). When considering a motion to dismiss under Rule  
19 12(b)(6) for failure to state a claim, dismissal is appropriate  
20 only when the complaint does not give the defendant fair notice of  
21 a legally cognizable claim and the grounds on which it rests. See  
22 Bell Atl. Corp. v. Twombly, \_\_ U.S. \_\_, 127 S. Ct. 1955, 1964  
23 (2007).

24 In considering whether the complaint is sufficient to state a  
25 claim, the court will take all material allegations as true and  
26 construe them in the light most favorable to the the City. NL  
27 Indus., Inc. v. Kaplan, 792 F.2d 896, 898 (9th Cir. 1986).

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DISCUSSION

I. Breach of Contract Claim

A plaintiff must establish four elements in a breach of contract claim: "(1) the existence of a valid contract; (2) the plaintiff's performance or excuse for nonperformance; (3) the defendant's unjustified or unexcused failure to perform; and (4) damage to the plaintiff." Lincoln Nat'l Corp. v. TakeCare, Inc., 1998 WL 281290, \*3 (N.D. Cal.); First Commercial Mortgage Co. v. Reece, 89 Cal. App. 4th 731, 745 (2001).

An insurance contract provision is ambiguous when it is capable of two or more constructions, both of which are reasonable. Suarez v. Life Ins. Co. of North America, 206 Cal. App. 3d 1396, 1402 (1988). Whether a provision is ambiguous is a question of law. Id. Ambiguities in the contract are to be resolved in the insured's favor. E.M.M.I., Inc. v. Zurich American Ins. Co., 32 Cal. App. 4th 465, 471 (2004).

"[I]nsurance coverage is interpreted broadly so as to afford the greatest possible protection to the insured, whereas exclusionary clauses are to be interpreted narrowly against the insurer." MacKinnon v. Truck Ins. Exch., 31 Cal. 4th 635, 648 (2003). Exclusionary clauses must be "conspicuous, plain and clear." Id. (emphasis in original).

The City alleges that clauses in the contract conflict, rendering it ambiguous. The first allegedly conflicting clause is Condition 3(B), which provides: "If Claim is made or suit is brought against the Insured, reasonably likely to involve the Company [Specialty], the Insured shall forward to the Company every demand, notice, summons or other process received by him . . .

1 immediately or within a reasonable time after the Insured has  
2 knowledge of the Claim or suit." Pl. Ex. A, at 12 of 16. The  
3 second conflicting clause, Condition 3(C), provides:

4       The Insured shall not, except at its own cost,  
5       voluntarily make any payment, assume any obligation or  
6       incur any expenses; however, in the event that the  
7       amount of Ultimate Net Loss becomes certain either  
8       through trail [sic] court, judgment or agreement among  
9       the Insured, the claimant and the Company, then the  
10       Insured may pay the amount of Ultimate Net Loss to the  
11       claimant to effect settlement and . . . the Company  
12       shall indemnify the Insured for that part of such  
13       payment which is in excess of the Insured's Retained  
14       Limit, or will, upon request o [sic] the Insured, make  
15       such payment to the claimant on behalf of the Insured.

16       Id. at 12 of 16. The third conflicting clause, which is  
17       unenumerated, provides, "If a Claim is made or a suit is brought  
18       seeking Damages in excess of the Insured's Retained Limit, when  
19       Defense Costs are incurred on behalf of the Company the Insured  
20       shall notify the Company and all such costs shall be reasonable."

21       Id. at 1 of 16 (defense costs clause). The fourth conflicting  
22       clause is Condition E, which provides:

23       [F]ailure to give notice of any Occurrence which, at the  
24       time of its happening, did not appear to involve this  
25       Policy but which, at a later date, would appear to give  
26       rise to Claims hereunder, shall not prejudice such  
27       Claims . . . . [and correspondence regarding the Claim  
28       should be sent to Specialty] as soon as practicable,  
29       provided, however, that failure to give notice of any  
30       Occurrence or Wrongful Act which, at the time of its  
31       happening, did not appear to involve this Policy but  
32       which, at a later date, would appear to give rise to  
33       Claims hereunder, shall not prejudice such claims.

34       Id. at 14 of 16.

35       There is more than one reasonable interpretation of these  
36       clauses read together. The first, urged by Specialty, is that

1 voluntary payments,<sup>1</sup> even those under the self-insured limit, are  
2 prohibited without notice to and consent from Specialty.  
3 Condition 3(C) seems to support this interpretation. The second  
4 interpretation, urged by the City, is that it must notify  
5 Specialty of a claim once it is reasonably likely to exceed the  
6 self-insured retention, and that claims which initially do not  
7 seem reasonably likely to exceed the self-insured retention, but  
8 later do exceed it, are not precluded by a failure to provide  
9 notice when suit is initially filed against the City. The City  
10 argues that the language in Condition 3(C) about the amount  
11 "becom[ing] certain" weighs against Specialty's more restrictive  
12 reading. The City continues that it did not view the two lawsuits  
13 at issue as meritorious and that it acted reasonably by notifying  
14 Specialty in a timely manner when it became apparent that the  
15 self-insured retention would be exceeded. Under its  
16 interpretation, the City claims it acted reasonably and fulfilled  
17 its duties under the contract. Conditions 3(B) and (E) seem to  
18 support the City's interpretation, as does the defense costs  
19 clause.

20 The City has stated a claim based on its interpretation of  
21 the ambiguous contract language and the reasonableness of the  
22 City's notice of both claims. Specialty's motion to dismiss is  
23 DENIED as to the breach of contract claim.

24 II. Breach of the Implied Covenant of Good Faith and Fair Dealing

25 A covenant of good faith and fair dealing is implied in every  
26 insurance contract. Egan v. Mutual of Omaha Insurance Co., 24

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28 <sup>1</sup> The contract does not explicitly define "voluntary payment."

1 Cal. 3d 809, 818 (1979). "An insurer, like any other party to a  
2 contract, owes a general duty of good faith and fair dealing  
3 . . . . There are at least two separate requirements to establish  
4 breach of the implied covenant: (1) benefits due under the policy  
5 must have been withheld; and (2) the reason for withholding  
6 benefits must have been unreasonable or without proper cause."  
7 Love v. Fire Ins. Exch., 221 Cal. App. 3d 1136, 1147, 1152 (1990).

8 The implied covenant of good faith and fair dealing acts as a  
9 "supplement to express contractual covenants, to prevent a  
10 contracting party from engaging in conduct that frustrates the  
11 other party's rights to the benefits of the agreement." Waller v.  
12 Truck Ins. Exchange, Inc., 11 Cal. 4th 36, 44 (1995). "Absent [a]  
13 contractual right, however, the implied covenant has nothing upon  
14 which to act as a supplement, and 'should not be endowed with an  
15 existence independent of its contractual underpinnings.'" Id.  
16 (quoting Love, 221 Cal. App. 3d at 1136, 1153).

17 Like the breach of contract claim, the City has stated a  
18 claim for breach of the implied covenant of good faith and fair  
19 dealing. Specialty's motion to dismiss is DENIED as to the breach  
20 of the implied covenant of good faith and fair dealing claim.

21 III. Declaratory Relief

22 Declaratory relief is available at the discretion of the  
23 district court. See 28 U.S.C. § 2201; Government Employees Ins.  
24 Co. v. Dizol, 133 F.3d 1220, 1223 (9th Cir. 1998). Declaratory  
25 relief is an equitable remedy which "brings to the present a  
26 litigable controversy, which otherwise might only be tried in the  
27 future." Societe de Conditionnement v. Hunter Eng. Co., Inc., 655  
28 F.2d 938 (9th Cir. 1981).

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The claim for declaratory relief depends on a determination of the breach of contract claim. Because the latter is not dismissed, Specialty's motion to dismiss the former is also DENIED.

CONCLUSION

For the foregoing reasons, the Court DENIES Specialty's motion to dismiss.

IT IS SO ORDERED.

Dated: 11/17/08



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CLAUDIA WILKEN  
United States District Judge