

United States District Court  
For the Northern District of California

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E-FILED on 2/10/12

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA  
SAN JOSE DIVISION

NEXTG NETWORKS, INC.,  
  
Plaintiff,  
  
v.  
  
ONE BEACON AMERICA INSURANCE  
COMPANY,  
  
Defendant.

No. 11-cv-05318-RMW

ORDER GRANTING MOTION TO DISMISS  
WITH LEAVE TO AMEND

[Re Docket No. 14]

Plaintiff NextG Networks, Inc. ("plaintff") brings claims for breach of contract, declaratory relief and breach of the covenant of good faith and fair dealing against defendant One Beacon America Insurance Company ("defendant") resulting from the insurer's refusal to pay for plaintiff's participation in a pending administrative investigation. Defendant moves to dismiss under Fed. R. Civ. P. 12(b)(6). For the reasons below, the court grants the motion to dismiss with thirty days leave to amend.

ORDER GRANTING MOTION TO DISMISS WITH LEAVE TO AMEND  
No. 11-cv-05318-RMW  
EDM

**I. BACKGROUND**

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2 This action arises out of an October 2007 fire that burned over 3,800 acres in the Malibu area  
3 of Southern California (the "Malibu Fire"). The fire allegedly started when utility poles partially  
4 owned and maintained by plaintiff fell to the ground and made contact with nearby vegetation. *See*  
5 Dkt. No. 14, Ex. A (Order Instituting Investigation).<sup>1</sup>

6 At the time of the Malibu Fire, plaintiff was insured under a primary Commercial General  
7 Liability Policy issued by defendant (the "Policy"). Dkt. No. 11 (Compl.) ¶ 6.<sup>2</sup> The policy requires  
8 defendant to defend plaintiff against any "suit" seeking "damages" as a result of "bodily injury" or  
9 "property damage." Compl., Ex. A at 1. In late 2007 and 2008, plaintiff was joined as a defendant  
10 in one or more civil actions (the "Civil Actions") stemming from the Malibu Fire. Compl. ¶ 8.  
11 Pursuant to the policy, plaintiff requested that defendant pay for its defense. *Id.* ¶ 9. Defendant  
12 accepted, appointing the law firm of Wilson, Elser, Moskowitz, Edelman and Dicker LLP (the  
13 "Wilson Firm") to act as plaintiff's counsel of record in the various civil actions. *Id.*

14 On January 29, 2009, the California Public Utilities Commission ("CPUC") initiated an  
15 investigation into whether plaintiff and other entities had "violated any provision of the Public  
16 Utilities Code, general orders, other rules, or requirements regarding their facilities linked to the  
17 Malibu fire." Order Instituting Investigation at 4. The CPUC indicated that plaintiff would be  
18 required to appear at public hearings and reply to specific questions, and that the investigation would  
19 determine the appropriate remedies for any proven violation. *See id.*

20 Subsequently, plaintiff advised defendant that "legal and/or other professional assistance"  
21 was necessary to "participate meaningfully" in the CPUC investigation, and asked that defendant  
22 pay the costs of such assistance. *Id.* ¶ 12. Defendant refused. *Id.* In a letter dated July 12, 2010,

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24 <sup>1</sup> The court takes judicial notice of the Order Instituting Investigation because it is a public record  
25 "capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably  
26 be questioned." Fed. R. Evid. 201(b); *see also Reyn's Pasta Bella, LLC v. Visa USA, Inc.*, 442 F.3d 741,  
746 n.6 (9th Cir. 2006) (The court "may take judicial notice of filings and other matters of public  
record."). Unlike the allegations of the complaint, however, the court does not assume the content of  
such a document to be accurate in considering this motion.

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28 <sup>2</sup> Plaintiff was also covered by a Commercial Umbrella Liability Policy issued by defendant, and  
alleges that defendant breached both policies.

1 defendant again rejected a similar request, indicating that it "has no obligation to defend or  
2 indemnify [plaintiff] in the PUC Regulatory Proceeding." *Id.* ¶ 11. Plaintiff made four additional  
3 requests that defendant cover the fees associated with the CPUC investigation between December 6,  
4 2010 and May 23, 2011. *Id.* ¶ 15. Each request was rejected. To date, plaintiff alleges that it has  
5 incurred "legal and/or professional fees" related to its participation in the CPUC investigation in  
6 excess of \$500,000. *Id.* ¶ 18.

7 While defendant denied plaintiff's requests to pay for its CPUC investigation-related  
8 expenses, it authorized the Wilson Firm to participate in "various aspects" of the investigation. *Id.* ¶  
9 14. According to plaintiff, the Wilson Firm's participation was encouraged because defendant  
10 "knew or believed that the orders, rulings, determinations, motion practice, discovery and other  
11 activity in connection with the Fire Investigation and/or Proceeding had the potential to directly and  
12 substantially affect [defendant's] liability, if any, in the Civil Actions." *Id.* ¶ 14.

13 Plaintiff filed the instant action on November 30, 2011. It alleges that in refusing to fund  
14 plaintiff's participation in the CPUC investigation, defendant has breached its contractual obligations  
15 under the policy, and seeks a declaratory judgment that defendant is required to pay any "legal  
16 and/or professional fees and expenses that have been or may be incurred" in connection with the  
17 investigation. *Id.* ¶ 37.

## 18 19 II. DISCUSSION

### 20 A. The costs of participating in the CPUC investigation may fall within the duty to defend 21 if they are "reasonable and necessary" to minimize liability in the civil actions

22 Standard commercial general liability insurance policies require the insurer to defend the  
23 insured in any action seeking damages for a covered claim. The duty to defend "entails the  
24 rendering of a service, viz., the mounting and funding of a defense ... in order to avoid or at least  
25 minimize liability." *Aerojet-General Corp. v. Transport Indemnity Co.*, 17 Cal. 4th 38, 58 (Cal.  
26 1997) (internal citations omitted). The instant dispute turns on whether the costs associated with  
27 plaintiff's participation in the CPUC investigation are "reasonable and necessary" to minimize  
28 plaintiff's potential liability in the pending civil actions. *Id.* at 60-61.

1 In *Aerojet-General Corp.*, the insured, a manufacturer of aerospace equipment, discharged  
2 hazardous substances at its Sacramento, California plant for decades, causing significant property  
3 damage. The insured was sued by numerous entities, including private plaintiffs, the State of  
4 California and the United States. In response to both the private actions and various governmental  
5 decrees, the insured spent approximately \$26 million in "site investigation expenses" to investigate  
6 the extent of the contamination and the viability of cleanup options, and to monitor the spread of  
7 waste from the site. The trial court found that the insurer was liable for the insured's "legal"  
8 expenses, but that investigation expenses did not fall within the scope of the duty to defend.

9 The California Supreme Court disagreed, holding that investigation expenses could  
10 constitute "defense costs" as long as such expenses: (1) were incurred within the temporal limits of  
11 the insurer's duty to defend, i.e., between tender of the defense and conclusion of the action; (2) were  
12 connected to a reasonable and necessary effort to avoid or at least minimize liability; and (3) were  
13 reasonable and necessary for that purpose. *See id.* at 60-61. The Court further concluded that  
14 whether expenses are "reasonable and necessary" must be assessed under an objective standard. *Id.*  
15 As the California Court of Appeal later clarified, "the subjective motivations of the insured and/or its  
16 attorneys are not relevant in the analysis." *Barratt American, Inc. v. Transcontinental Ins. Co.*, 102  
17 Cal. App. 4th 848, 858 (Cal. Ct. App. 2002) (citing *Aerojet-General Corp.*, 17 Cal. 4th at 63).  
18 Instead, the question is whether a "reasonable insured would have engaged in a similar defense  
19 strategy." *Barratt American, Inc.*, 102 Cal. App. 4th at 863.

20 As an initial matter, the parties debate the applicability of *Aerojet* and its progeny to the case  
21 at hand. Defendant first argues that *Aerojet* is inapposite here because plaintiff seeks legal fees  
22 rather than expenses associated with "investigation, remediation or abatement." Dkt. No. 16 at 4.  
23 The court does not interpret *Aerojet* to be limited to certain classes of expenses. Indeed, *Aerojet*  
24 specifically rejected the argument that the fact that site investigation expenses were "peculiar" to  
25 toxic tort claims was of legal significance. *Aerojet-General Corp.*, 17 Cal. 4th at 65. Furthermore,  
26 this court has previously applied *Aerojet* to determine whether legal fees incurred in a non-covered  
27 action were recoverable under the duty to defend. *See Kla-Tencor Corp. v. Travelers Indem. Co. of*  
28 *Illinois*, No. 02-05641, 2004 WL 1737297, at \*7 (N.D. Cal. Aug. 4, 2004) (costs of prosecuting a

1 patent infringement claim could be reasonable and necessary to minimizing liability in a related  
2 disparagement case where allegedly disparaging statements concerned infringement of the patent).  
3 Defendant also attempts to distinguish *Aerojet* by noting that the investigative costs in that case  
4 could have been characterized as CERCLA "response costs" covered by the insurer's duty to  
5 indemnify, while "there is *no possibility* that [plaintiff] will face liability for 'damages' in the PUC  
6 Investigative proceeding." Dkt. No. 16 at 5 (emphasis in original). However, as "it is plain that the  
7 insurer's duty to defend is broader than its duty to indemnify," *Aerojet-General Corp.*, 17 Cal. 4th at  
8 59, the fact that defendant will not ultimately be obligated to indemnify plaintiff for penalties  
9 assessed by the CPUC does not establish the boundaries of its duty to defend. The court thus finds  
10 that the principles articulated in *Aerojet* are applicable in this case.

11 The court also finds unpersuasive the argument that costs incurred in responding to a  
12 governmental order are not included within the duty to defend. Expenses assumed by an insured are  
13 "potentially recoverable even though they may serve more than one objective." *Barratt American,*  
14 *Inc.*, 102 Cal. App. 4th at 860. The costs of participating in the CPUC investigation may serve to  
15 both satisfy the agency *and* minimize potential liability in the civil actions. *See Aerojet-General*  
16 *Corp.*, 17 Cal.4th at 63 (noting that site investigation expenses were most likely incurred "both to  
17 resist liability and to satisfy the government"). Regardless of the impact of or the impetus for such  
18 expenditures, as long as plaintiff can show that a "reasonable insured would have engaged in a  
19 similar defense strategy," the costs may be recoverable. *Barratt American, Inc.*, 102 Cal. App. 4th at  
20 863.

21 Defendant next argues that because the CPUC proceeding is not a "suit" for "damages" under  
22 the terms of the policy, it is not covered even though it "shares facts" with civil actions for which a  
23 defense has been tendered. Dkt. No. 16 at 5. Defendant relies primarily on *United Pac. Ins. Co. v.*  
24 *Hall*, 199 Cal. App. 3d 551 (Cal. Ct. App. 1988), which held that an insurer was not liable for  
25 defending a juvenile criminal proceeding although it had undertaken the defense of a related civil  
26 action, because the criminal proceeding was not a "suit" for "damages" covered by the insurance  
27 policy. *Hall* is unavailing here for two reasons. First, *Hall* preceded *Aerojet* by nearly a decade, and  
28 is therefore of questionable precedential value. Second, the *Hall* court expressly considered whether

1 the expense of defending the juvenile proceeding was "reasonably necessary" to the defense of the  
2 civil action, but rejected the plaintiff's arguments that the criminal trial could be used as a discovery  
3 device or an opportunity to observe witness demeanor. *See Hall*, 199 Cal. App. 3d at 557. Other  
4 cases finding no duty to defend in criminal actions are even further afield. *See Stein v. Int'l Ins. Co.*,  
5 217 Cal. App. 3d 609, 615 (Cal. Ct. App. 1990) (no duty to defend in criminal action where no  
6 related civil action ever filed); *Perzik v. St. Paul Fire & Marine Ins. Co.*, 228 Cal. App. 3d 1273,  
7 1275 (Cal. Ct. App. 1991) (same). Similarly, *Foster-Gardner, Inc. v. National Union Fire Ins. Co.*,  
8 18 Cal. 4th 857 (Cal. 1998), which held that an administrative action *alone* was not a "suit" for  
9 "damages" triggering the duty to defend, is distinguishable because it did not involve related actions  
10 for which the insurer had already tendered a defense. In sum, none of the cases cited by defendant  
11 forecloses the possibility that the cost of participating in an administrative proceeding where  
12 "damages" are not sought may be recoverable *if* such costs are reasonably necessary to minimize  
13 liability in the civil actions.

14 **B. Plaintiff has failed to demonstrate that the costs are "reasonable and necessary"**

15 In order to recover from defendant, plaintiff bears the burden of demonstrating the  
16 relationship between the \$500,000 it alleges to have spent defending the CPUC investigation and the  
17 minimization of liability in the civil actions. *See Aerojet-General Corp.*, 17 Cal. 4th at 64; *Barratt*,  
18 102 Cal.App. 4th at 863. Ultimately, plaintiff must "establish[] a connection between the particular  
19 [costs] and the defense theory" being advanced in a covered action. *Id.* Plaintiff argues that such an  
20 inquiry is too fact-intensive to be considered on a motion to dismiss. *See* Dkt. No. 15 (citing  
21 *Barratt*, 102 Cal.App. 4th 868; *Kla-Tencor Corp.*, 2004 WL 1737297). However, while each of  
22 the cases cited by plaintiff involved a more developed factual record than is presently before the  
23 court, that does not relieve plaintiff of its burden to include in its complaint "enough facts to state a  
24 claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570  
25 (2007).

26 Courts considering whether particular costs fall within the duty to defend have performed  
27 searching analyses. In *Barratt*, the insured was a residential developer sued by 70 homeowners for  
28 construction defects in their homes. As the litigation progressed, the insured conducted inspections

1 and repairs of a number of nonplaintiff homes in the same development, incurring \$514,685.33 in  
2 costs. *Barratt*, 102 Cal. App. 4th at 853. In a subsequent dispute with the insurer over liability for  
3 those costs, the insured argued that one purpose of repairing nonplaintiff homes was to develop  
4 information to assist in the defense of the ongoing litigation. The court of appeal found the  
5 argument plausible, but held that meaningful proof establishing a connection between the particular  
6 repairs and the defense theory was lacking. *See id.* at 861, 863. First, there was no evidence that the  
7 problems found at the nonplaintiff homes were similar to the problems complained of by the  
8 plaintiff homeowners. Second, it was not enough that such repairs were "helpful" or "useful."  
9 Rather, the plaintiff was required to present evidence "that a reasonable insured would have engaged  
10 in a similar defense strategy, which necessarily involves a consideration of whether the benefits of  
11 the strategy are worth the cost." *Id.* at 862.

12 In *KLA-Tencor*, the insured filed an action for patent infringement. The insured later filed  
13 another suit against the same defendant for infringement of a different patent. In the second suit, the  
14 defendant filed counter-claims against the insured for, *inter alia*, making disparaging statements that  
15 included a remark that the defendant "clearly has infringed" the patent at issue in the first action.  
16 *KLA-Tencor*, 2004 WL 1737297, at \*2. Ultimately, the insured sought "defense costs" for  
17 prosecuting the first patent suit, arguing "essentially, that the best defense to the disparagement  
18 counterclaims was showing that the [first] patent was valid, and further that [the counterclaimant's]  
19 products infringed that patent." *Id.* at \*4. The court conducted an in-depth factual analysis,  
20 awarding costs for prosecuting the first patent suit but disallowing other costs that were "too far  
21 afield" from the disparagement counterclaims. *Id.* at \*8.

22 Unlike in *Barratt* and *KLA-Tencor*, plaintiff's allegations do not provide enough factual  
23 information to determine the relationship between the costs incurred in the CPUC investigation and  
24 the defense of the civil action. While the court is mindful that at this stage of the litigation, plaintiff  
25 need not provide any *evidence*, it nevertheless must offer factual *allegations* demonstrating it is  
26 entitled to relief. Instead plaintiff simply asserts that the "orders, rulings, determinations, motion  
27 practice, discovery and other activity in connection with the Fire Investigation and/or Proceeding  
28 have the potential to directly and substantially affect [plaintiff's] liability, if any, in the Civil

1 Actions." Compl. ¶ 10. Such a conclusory statement does not demonstrate that the disputed costs  
2 are reasonable and necessary to minimize liability in the civil actions because it does not explain, for  
3 example, what orders or rulings may issue from the CPUC, the nature of plaintiff's defense theory in  
4 the civil actions, and how findings in the administrative proceeding could impact liability. Such  
5 information is ostensibly within plaintiff's control, and is central to a determination of whether the  
6 "benefits of [plaintiff's strategy before the CPUC] are worth the cost." *Barratt*, 102 Cal. App. 4th at  
7 862.

8 Plaintiff also relies heavily on the fact that the Wilson Firm participated in "various aspects"  
9 of the CPUC investigation to show that defendant "knew or believed" the CPUC investigation could  
10 affect its liability. Compl. ¶ 14. However, "the subjective motivations of the insured and/or its  
11 attorneys are not relevant in the analysis." *Barratt*, 102 Cal.App.4th at 858. In addition, as an  
12 insurer generally has a right to control the defense of a covered claim, *see Buss v. Superior Court*, 16  
13 Cal. 4th 35, 63 (Cal. 1997), it should not be precluded from having *any* involvement in a related  
14 proceeding for fear that it will create exposure to additional defense costs. Finally, it is unclear from  
15 the complaint in what "aspects" of the CPUC proceeding the Wilson Firm has been involved, and  
16 thus the court cannot conclude from this allegation whether the costs incurred are reasonable and  
17 necessary to minimize liability in the civil actions.<sup>3</sup>

18 In summary, while defendant's duty to defend may encompass the costs of participating in  
19 the CPUC investigation, plaintiff has not met its burden to plead facts showing that such costs are  
20 reasonable and necessary to minimize liability in the civil actions. Accordingly, the court grants the  
21 motion to dismiss with thirty days leave to amend.

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26 <sup>3</sup> Plaintiff includes a more detailed description of the Wilson Firm's participation in the CPUC  
27 proceeding in its opposition motion. Such allegations are not properly before the court on a motion to  
28 dismiss under Rule 12(b)(6). See *Schneider v. Cal. Dep't. of Corr.*, 151 F.3d 1194, 1197 n.1 (9th Cir.  
1998) ("In determining the propriety of a Rule 12(b)(6) dismissal, a court may not look beyond the  
complaint to a plaintiff's moving papers, such as a memorandum in opposition to a defendant's motion  
to dismiss.").



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**III. ORDER**

For the foregoing reasons, the court grants defendant's motion to dismiss with thirty days leave to amend.

DATED: February 10, 2012



RONALD M. WHYTE  
United States District Judge