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**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA**

**BRADLEY D. AUSMUS; ELIZABETH
A. AUSMUS,**

Plaintiffs,

vs.

**LEXINGTON INSURANCE
COMPANY; AMERICAN
INTERNATIONAL GROUP, INC.;**
DOES 1 through 100, inclusive,

Defendants.

CASE NO. 08-CV-2342 L (LSP)

**ORDER GRANTING MOTION TO
DISMISS [doc. #2] and DIRECTING
ENTRY OF JUDGMENT**

On December 22, 2008, Defendants filed a motion to dismiss the action. (Doc. No. 2.) On January 26, 2009, Plaintiffs filed their response in opposition to the motion to dismiss. (Doc. No. 5.) Defendants filed their reply in support of their motion on February 2, 2009. (Doc. No. 7.) The Court concludes that this matter is appropriate for resolution without oral argument and submits the motion on the papers under Civil Local Rule 7.1(d)(1). For the following reasons, the Court dismisses Plaintiffs' complaint and denies leave to amend.

Background

Plaintiffs' complaint alleges causes of action against Defendants for breach of contract, breach of the implied covenant of good faith and fair dealing in connection with damage to their home caused by Defendants' insured, American Coatings, Inc. (Doc. No. 1.)

1 Plaintiffs own the residence located at 1644 Stratford Way, City of Del Mar, California.
2 (Compl. ¶ 2.) American Coatings, Inc., along with several other subcontractors, provided
3 materials and labor used in the construction of plaintiffs' home. American Coatings completed
4 its work on the residence in approximately 1998. (Compl. ¶ 7.) In November 2005, the
5 residence suffered damage due to leaks in and through the foundation walls. These leaks were
6 allegedly caused by defects in construction attributable to the negligence of the subcontractors,
7 including American Coatings. (Compl. ¶ 8.)

8 Subsequently, Plaintiffs filed a complaint against the developer and subcontractors
9 in San Diego Superior Court. (Compl. ¶ 9.) Plaintiffs allege that Defendants initially
10 appointed their in-house attorneys to defend American Coatings in the litigation, but later
11 withdrew from representation. (Compl. ¶ 10.) Before trial, Plaintiffs settled with all
12 defendants, with the exception of American Coatings, in the amount of \$850,000 for the
13 below grade water intrusion damage. (*Id.*) As part of the settlement, the developer and
14 certain subcontractors assigned to Plaintiffs their rights for contribution and indemnity
15 against American Coatings. (Compl. ¶ 12, 13.) American Coatings then settled with the
16 Plaintiffs. The settlement agreement provided for a stipulated entry of judgment against
17 American Coatings in the amount of \$537,575 and an assignment by American Coatings of
18 its indemnification rights against Defendants Lexington Insurance Company ("Lexington")
19 and American International Group, Inc. ("AIG"). (Compl. ¶ 15.)

20 On February 1, 2001, Lexington issued a comprehensive insurance policy to
21 American Coatings. (Compl. ¶ 16; Kurz Decl. in Opp. to Mot. to Dismiss ["Kurz Decl.,"]
22 Ex. 1.) This policy covered work performed by American Coatings with no date
23 restrictions. (*Id.*) The policy was renewed April 1, 2002 and again on April 1, 2003 – each
24 time with no date restrictions on covered work. (Kurz Decl. Ex. 2, 3.) On April 1, 2004,
25 Lexington once again renewed American Coatings's policy. (Kurz Decl. Ex. 4.) This new
26 policy contained an endorsement entitled "Exclusion - Designated Work." (*Id.* at 224.)
27 That endorsement states that the insurance does not apply to property damage arising out of
28 American Coatings's work completed prior to April 1, 2001. (*Id.*) The following year, on

1 April 1, 2005, Lexington issued another renewed policy, which also contained the
2 endorsement limiting the time period for covered work. (*Id.* at 288.)

3 Based on this exclusionary endorsement, nominally in effect when the Residence
4 was damaged, Defendants move for dismissal of Plaintiffs' case under Federal Rule of
5 Civil Procedure 12(b)(6).

6 **I. Legal Standard**

7 Rule 12(b)(6) provides that a complaint may be dismissed for "failure to state a
8 claim upon which relief may be granted." FED. R. CIV. P. 12(b)(6). A complaint fails to
9 state a claim when it lacks a cognizable legal theory or states insufficient facts under a
10 cognizable legal theory. *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 534 (9th
11 Cir. 1984). The Supreme Court has stated that the factual allegations of a complaint must
12 be "enough to raise a right to relief above the speculative level." *Bell Atlantic Corp. v.*
13 *Twombly*, 127 S. Ct. 1955, 1965 (2007). If the complaint fails to "state a claim for relief
14 that is plausible on its face," it should be dismissed. *Twombly*, 127 S. Ct. at 1960.

15 In general, the scope of review on a motion to dismiss for failure to state a claim is
16 limited to the contents of the complaint. *Marder v. Lopez*, 450 F.3d 445, 448 (9th Cir.
17 2006). However, a court may consider evidence on which the complaint "necessarily
18 relies" as long as: (1) the complaint refers to the document; (2) the document is central to
19 the plaintiff's claim; and (3) no party questions the authenticity of the copy attached to the
20 12(b)(6) motion. *Id.*

21 **II. Lexington's Exclusionary Endorsement**

22 As an initial matter, the Court notes that Plaintiffs' complaint necessarily relies on
23 the language of its insurance policy with Defendant Lexington. The complaint refers to the
24 policy and it is central to the Plaintiffs' breach of contract claim. (Compl. ¶ 16-20.)
25 Plaintiffs have not challenged the authenticity of the policy copies submitted along with
26 Defendants' motion to dismiss. Accordingly, under *Marder*, the Court may properly rely
27 on its contents in evaluating Defendants' motion. 450 F.3d at 448.

28 If Lexington's coverage exclusion is binding on the parties, Defendants are not

1 liable for the damage to the Residence and Plaintiffs will have no cognizable legal theory to
2 support their claim. Plaintiffs argue that the exclusion is void for two reasons. First,
3 Plaintiffs assert that Lexington failed to adequately notify American Coatings of the
4 reduction in coverage in the April 1, 2004 policy as required by California state law.
5 Second, Plaintiffs argue that the exclusionary endorsement is not clear and understandable.
6 The Court considers these arguments in turn.

7 **A. Notification of Reduction in Coverage**

8 The Complaint alleges that “[a]t no time prior to either the issuance of the [April 1,
9 2005] policy or to the date American Coatings notified Lexington of plaintiffs’ claim did
10 Lexington notify American Coatings that the policy purported to afford less coverage than
11 the policies issued by it during the first three policy periods” (Compl. ¶ 20.) Plaintiffs
12 argue that this failure to notify American Coatings of reduced coverage violated California
13 Insurance Code § 678.1(c) and renders the exclusion void. That statute requires an insurer
14 to notify a policy holder before the expiration of a policy if the insurer intends not to renew
15 the policy or to condition the renewal upon elimination of coverages. CAL. INS. CODE §
16 678.1(c).

17 However, § 678.1(a) states, “This section applies only to policies of insurance of
18 commercial insurance that are subject to Sections 675.5 and 676.6.” CAL. INS. CODE
19 § 678.1(a). Section 675.5 applies “to any policy of insurance specified in Section 675” and
20 to policies of commercial insurance issued after January 1, 1987. CAL. INS. CODE §
21 675.5(a). While Section 675 includes “policies primarily insuring risks arising from the
22 conduct of a commercial or industrial enterprise,” § 675.5(d)(7) excludes surplus line
23 insurance from its definition of commercial insurance. The policies issued to American
24 Coatings in 2002, 2003, 2004 and 2005 contain full page notices informing the policy
25 holder that Lexington is a surplus line insurer. (Kurz Decl. Ex. 2-5.) Because American
26 Coatings’s carried commercial surplus line insurance, the policies were not covered by §
27 678.1(c).

28 Section 676.6 applies to “commercial umbrella liability insurance policies,

1 commercial excess liability insurance policies, and commercial excess property insurance
2 policies.” CAL. INS. CODE § 676.6(a). American Coatings’s policies with Lexington do not
3 fall into any of these categories. Accordingly, Lexington had no statutory duty to notify
4 American Coatings of the reduction in coverage.

5 **B. Clarity and Conspicuousness of the Exclusion**

6 Alternately, Plaintiffs argue that the exclusion is void because it is not sufficiently
7 clear and conspicuous. In California, “policy exclusions are strictly construed.” *E.M.M.I.*
8 *Inc. v. Zurich American Ins. Co.*, 32 Cal. 4th 465, 471 (Cal. 2004). To be effective, “the
9 exclusionary clause must be conspicuous, plain and clear.” *Id.* (internal quotes omitted).
10 Whether an exclusion meets this standard is a question of law to be decided by the Court.
11 *See, Malcom v. Farmers New World Life Ins. Co.*, 4 Cal. App. 4th 296, 300 (Cal. Ct. App.
12 1992); *Marquez Knolls Property Owners Assoc., Inc. v. Executive Risk Indemnity, Inc.*,
13 153 Cal. App.4th 228, 233-234 (2007) (“The interpretation of an exclusionary clause is an
14 issue of law subject to this court's independent determination.”).

15 To be conspicuous, “an exclusion must be positioned in a place and printed in a
16 form which will attract the reader’s attention.” *Haynes v. Farmers Ins. Exchange*, 32 Cal.
17 4th 1198, 1216 (Cal. 2004). In this case, the April 1, 2005 policy contains a “Forms
18 Schedule” near the beginning of the document which lists exclusions including the “Past
19 Work Exclusion.” (Kurz Decl. Ex. 5 p. 230.) The exclusion itself is positioned along with
20 the other coverage exclusions and appears on its own page with key portions in capital
21 letters. Accordingly, the Court concludes that the exclusion is sufficiently conspicuous as a
22 matter of law.

23 “To be plain and clear, the substance of the exclusion must be precise and
24 understandable.” *Malcom*, 4 Cal. App. 4th at 301 (internal quotes omitted). Its substance
25 must be “stated in words that convey the proper meaning to persons expected to read the
26 contract.” *Haynes*, 32 Cal. 4th at 1216. Here, the exclusion begins by stating that “this
27 endorsement changes the policy. Please read it carefully.” It is entitled “Exclusion –
28 Designated Work.” It then states that “This insurance does not apply to ‘bodily injury’ or

1 'property damage' included in the 'products – completed operations hazard' and arising out
2 of 'your work' shown in the schedule." On the same page, the schedule defines "your
3 work" as "all work completed prior to the first date of continuous insurance coverage
4 provided by Lexington Insurance Company." (Kurz Decl. Ex. 5 p. 288.) The Court
5 concludes that the exclusion is sufficiently precise and understandable and conveys the
6 proper meaning to persons expected to read it. By its clear language, it excludes designated
7 work from coverage. It then goes on to explain what work is excluded. Accordingly, the
8 exclusion is plain and clear as a matter of law.


9 Because American Coatings's policies are not covered by California Insurance Code
10 § 678.1(c), and because the exclusion is clear and conspicuous, the Court concludes as a
11 matter of law that the Lexington policy did not cover damage arising out of work
12 completed by American Coatings before April 1, 2001. American Coatings completed
13 work on the residence in approximately 1998. Accordingly, the damage to the residence is
14 excluded from coverage and Plaintiffs' complaint lacks a cognizable legal theory.
15 *Robertson*, 749 F.2d at 534.

16 **III. Conclusion**

17 Based on the foregoing, the Court dismisses Plaintiffs' complaint with prejudice.
18 The Court concludes that Plaintiffs are unable to cure the deficiencies of their complaint
19 and denies leave to amend. The Clerk of the Court is directed to enter judgment in
20 accordance with this Order.

21 **IT IS SO ORDERED.**

22 DATED: April 22, 2009

23 
24 M. James Lorenz
United States District Court Judge

25 COPY TO:

26 HON. LEO S. PAPAS
27 UNITED STATES MAGISTRATE JUDGE

28 ALL PARTIES/COUNSEL