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ALLIED WORLD ASSURANCE COMPANY (U.S.) INC.

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN FRANCISCO

INTERNATIONAL WALLS, INC. fka ART.COM, INC.,

Plaintiff and Cross-Defendant,

v.

ALLIED WORLD ASSURANCE COMPANY (U.S.) INC.,

Defendant and Cross-Complainant.

Case No.: CGC-20-587590

~~[PROPOSED]~~ ORDER GRANTING ALLIED WORLD ASSURANCE COMPANY (U.S.) INC.'S MOTION FOR PARTIAL JUDGMENT ON THE PLEADINGS

Hearing Date: November 1, 2021
Hearing Time: 9:30 a.m.
Judge: Hon. Ethan P. Schulman
Dept.: 302

Complaint Filed: November 9, 2020
FAC Filed: November 12, 2020
Trial Date: April 11, 2022

On this 1st day of November, 2021, this matter having been brought before the Court on Defendant Allied World Assurance Company (U.S.) Inc.'s Motion for Partial Judgment on the Pleadings, and the Court having considered the matter,

For good cause appearing, **IT IS HEREBY ORDERED** that:

Defendant's motion for judgment on the pleadings on the second cause of action for declaratory relief is granted. As a matter of law, plaintiff is not entitled to coverage for the derivative lawsuit captioned *Joshua Chodniewicz, et al. v. Art.com, Inc., et al.*, No. RG19001604 ("Derivative Action").

The Court takes judicial notice of the insurance policy per Evidence section 452(h) because both parties refer to the policy and its terms are unambiguous. (See *Ingram v. Flippo* (1999) 74 Cal.App.4th 1280, 1285, fn.3 [taking judicial notice of letter that was referenced in complaint (but not attached) where both parties referred to the letter and quoted from it].) Moreover, the policy is attached to the original complaint.

The interpretation of an insurance contract is a question of law for the court. (See *Waller v. Truck Ins. Exch., Inc.* (1995) 11 Cal.4th 1, 18.) In *Powerine Oil Co., Inc. v. Superior Court* (2005) 37 Cal.4th 377, 390 (internal quotations and citations omitted), the court states:

> While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply. The fundamental goal of contractual interpretation is to give effect to the mutual intention of the parties. Such intent is to be inferred, if possible, solely from the written provisions of the contract. If contractual language is clear and explicit, it governs."

"When interpreting a policy provision, we must give terms their ordinary and popular usage, unless used by the parties in a technical sense or a special meaning is given to them by usage." (*Palmer v. Truck Ins. Exch.* (1999) 21 Cal.4th 1109, 1115 (internal quotations and citations omitted). "Whether a contract is ambiguous is a question of law." (*Aragon-Haas v. Family Security Ins. Services, Inc.* (1991) 231 Cal.App.3d 232, 239 [court will defer to plaintiff's interpretation of contract on demurrer where contract is ambiguous and reasonably susceptible to plaintiff's interpretation].)

"A policy provision will be considered ambiguous when it is capable of two or more constructions, both of which are reasonable. [Citation.] But language in a contract must be interpreted as a whole, and in the circumstances of the case, and cannot be found to be ambiguous in the abstract. [Citation.] Courts will not strain to create an ambiguity where none exists." (*Travelers Prop. Cas. Co. of Am. v. KLA-Tenor Corp.* (2020) 45 Cal.App.5th 156, 163.) A

term is not ambiguous merely because it is undefined in the policy, nor does "disagreement concerning the meaning of a phrase, or the fact that a word or phrase isolated from its context is susceptible of more than one meaning," create ambiguity. (*Terrell v. State Farm Gen. Ins. Co.* (2019) 40 Cal.App.5th 497, 503.) The insured has the burden of proving that a claim falls within a policy's insuring agreement. (See *Aydin Corp. v. First State Ins. Co.* (1998) 18 Cal.4th 1183, 1188.) While the insurer has the burden of proving that an exclusion to coverage applies, the insured has the burden of proving that any exception to that exclusion operates to restore coverage. (*Id.* [insured bears burden of "establishing the exception" because "its effect is to reinstate coverage"; insurer does not bear burden of "negating the exception"].)

The policy provides that there is no coverage for any Claim:

> brought by or on behalf of any Insured, other than an Employee of a Company, provided, however, that this Exclusion shall not apply to: ...
> (2) a shareholder derivative action, but only if such action is brought and maintained without the solicitation, approval, assistance, active participation or intervention of any Insured or any Affiliate thereof; [or]
> (3) any Claim brought by any director, officer, trustee or governor of a Company who has not served in such capacity, nor acted as a consultant to the Outside Entity, for at least two (2) years prior to such Claim being first made . . .

(Complaint, Ex. A [Policy, Section III.I, as amended by End. No. 20].) In this case, the policy is unambiguous and plaintiff cannot establish that coverage exists for the Derivative Action.

The policy's insured v. insured exclusion bars coverage for two categories of Claims: (1) Claims "brought by" an Insured; and (2) Claims brought "on behalf of" an Insured. (Complaint, Ex. A [Policy, Section III.I, as amended by End. No. 20.] A shareholder derivative action is not brought "by" an officer or director within the meaning of Exception 3. Rather, a derivative lawsuit is "a representative action brought *on behalf* of the corporation." (*Chih Teh Shen v. Miller* (2012) 212 Cal.App.4th 48, 57 (emphasis added).) "If successful, a derivative claim will accrue to the direct benefit of the corporation and not to the stockholder who litigated it." (*Grosset v. Wenaas* (2008) 42 Cal.4th 1100, 1114.) Exception 2 makes it clear that a shareholder derivative action is covered "only if" an insured or an insured person does not participate, which is not the situation here. (Amended Complaint, ¶ 22 [alleging that both named plaintiffs in Derivative Action are

insured persons].) "The phrase 'only if' denotes exclusivity; it does not suggest one of multiple options." (See *Fed. Lab. Rels. Auth. v. Aberdeen Proving Ground*, 485 U.S. 409, 412 (1988).) Thus, under the plain language of the policy, coverage of the Derivative Action is barred by the exclusion.

Plaintiff's reliance on Exception 3 is misplaced. Exception 3 is a separate exclusion, not an exception to the exclusion set forth in Exception 3. Further, Plaintiff's interpretation of Exception 3 as restoring coverage for a shareholder derivative action brought by a current or former director or officer is unreasonable in light of Exception 2. If the parties had intended Exception 3 to apply to claims that are brought on behalf of insureds, then the parties would have used language similar to Exception 6 ["any Claim brought or maintained by or on behalf of a bankruptcy or insolvency trustee"]. Policy terms must be interpreted "in context" of the policy as a whole and effect must be given to "every part of the policy with each clause helping to interpret the other." (*Palmer v. Truck Ins. Exch.* (1999) 21 Cal.4th 1109, 1115 (internal citation and quotations omitted); see also Civ. Code sec. 1641 ["The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other."]. "Courts must consider . . . disputed policy language in the context of the policy as a whole, as well as the circumstances of the case in which the claim arises and common sense." (*St. Mary & St. John Coptic Orthodox Church v. SBC Ins. Servs. Inc.* (2020) 57 Cal.App.5th 817, 825.)

Plaintiff's interpretation of Exception 3 is also irreconcilable with Exception 2. Exception 2, which expressly addresses shareholder derivative actions, would be rendered essentially meaningless under plaintiff's construction, which would allow a party simply to locate an officer/director who has not served in that capacity (nor acted as a consultant) for a couple of years and adding them as a named plaintiff to generate coverage. The Court cannot countenance such an artifice. The specific exclusion regarding derivative actions controls and plaintiff's attempt to create an ambiguity by citing a more general inapposite provision fails. (See *Jane D. v. Ordinary Mut.* (1995) 32 Cal.App.4th 643, 651 ["In construing insurance contracts it is also settled that " 'a specific provision relating to a particular subject will govern in respect to that subject, as against a general provision even though the latter, standing alone, would be broad enough to include the subject to which the more specific provision relates.' [Citation.]"].) There is no ambiguity and coverage is

unavailable when the contract is properly read as a whole. (*Castro v. Fireman's Fund Am. Life Ins. Co.* 206 Cal.App.3d 1114, 1120 (1988) ["Ambiguity is not necessarily to be found in the fact that a word or phrase isolated from its context is susceptible of more than one meaning."].)

This conclusion is consistent with the history and purpose of the insured versus insured exclusion, which "eliminates coverage for suits brought by one insured against another, including the corporation, with the exception of shareholder derivative actions if commenced without the assistance or solicitation of any insured." (Croskey, Cal. Practice Guide: Insurance Litigation (The Rutter Guide 2021) ¶ 7:1684.) While the exclusion was intended to prevent collusive suits between corporations and their officers and directors, it is not so limited; rather, it "precludes coverage for *any* internal dispute between the corporation and its officers or directors, as well as for disputes between or among them personally." (*Id.* ¶ 7:1686 [collecting authorities].) The exclusion was intended to protect insured companies against "claims by outsiders, not intracompany claims." (*Biltmore Assocs. v. Twin City Fire Ins. Co.* (9th Cir. 2009) 572 F.3d 663, 668.) The Derivative Action is just such an intracompany dispute. (Seee, e.g., *Howard Savings Bank v. Northland Ins. Co.* (N.D. Ill. Aug. 11, 1997), 1997 WL 460973, at *5 [insured versus insured clause would exclude coverage "when an insured person, as defined by the Policy, brings a derivative suit asserting claims relating to actions the insured person took part in himself or herself, such as a suit contesting a board of directors vote in which the insured person voted himself or herself"].)

Defendant's motion for judgment on the pleadings is also granted as to the distinct causes of action based on the Derivative Action pleaded in causes of action one and three of the Amended Complaint. A defendant may move for judgment on the pleadings on the complaint or "as to any of the causes of action stated therein." (Civ. Proc. Code sec. 438(c)(2)(A).) Like a demurrer, a motion for judgment on the pleadings "does not lie to a portion of a cause of action." (*PH II, Inc. v. Super. Ct.* (1995) 33 Cal.App.4th1680, 1682.) Nevertheless, "[t]he manner in which a plaintiff elects to organize his or her claims within the body of the complaint is irrelevant to determining the number of causes of action alleged under the primary right theory. '[I]f a plaintiff states several purported causes of action which allege an invasion of the same primary right he has actually stated only one cause of action.'" (*Hinden v. Rust* (2004) 118 Cal.App.4th 1247, 1257.) On the other

hand, where a plaintiff combines distinct causes of action based on separate and distinct obligations, the plaintiff cannot avoid adjudication of those claims by combining them under a single purported "cause of action." (See *Lilienthal & Fowler v. Super. Ct.* (1993) 12 Cal.App.4th 1848 [court could summarily adjudicate distinct claims for legal malpractice even though they were alleged as a single claim].)

Even though this case involves one contract, the breaches were temporally and factually distinct. The Derivative Action relates to a transaction with Walmart, while the DPD Action, which was filed in the Netherlands, alleges mismanagement of a European subsidiary. (Amended Complaint, ¶¶ 21-25.) In *Mycogen Corp. v. Monsanto Co.* (2002) 28 Cal.4th 888, 908, the court suggests that such separate wrongs lead to separate causes of action. In other words, plaintiff's breach of contract/bad faith claims that are based on the two underlying actions seek "to vindicate separate and distinct rights" and address alleged breaches that occurred "at different times." (*Id.*)

Given the above analysis (i.e., lack of coverage for the Derivative Action), plaintiff fails to allege a breach of contract or bad faith claim predicated on the Derivative Action. Those defective claims under the rubric of cause of actions 1 and 3 are therefore dismissed.

Nov. 1, 2021

JUDGE ETHAN P. SCHULMAN