UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

HEIDE KURTZ, Plaintiff, v. LIBERTY MUTUAL INSURANCE COMPANY, *et al.*, Defendants.	Case No. CV 11-7010 DMG (JCGx) **ORDER RE CROSS- MOTIONS FOR SUMMARY JUDGMENT [68, 70, 79]**

This matter is before the Court on the parties' cross-motions for summary judgment. [Doc. ## 68, 70, 79.] The Court held a hearing on the motions on March 28, 2014. Having duly considered the parties' written submissions and oral argument, the Court now renders its decision.

I.

FACTUAL BACKGROUND

A. Evidentiary Objections

The parties raise voluminous evidentiary objections to declarations and exhibits filed by the opposing party. [Doc. ## 84, 86-1, 86-2, 88, 91, 94-1, 94-2, 95-1, 95-2.] The majority of the objections pertain to evidence that the Court need not consider in order to decide the instant motions, and the Court declines to rule on such objections. The Court addresses the remaining objections as necessary in the fact and discussion sections, *infra*.[1]

B. Undisputed and Disputed Facts[2]

The Court first addresses the joint motion for summary judgment filed by Defendants Liberty Mutual, Zurich American Insurance Company ("Zurich"), Axis Insurance Company ("Axis"), and Twin City Fire Insurance Company ("Twin City"). [*See* Doc. # 70.] As it must on a motion for summary judgment, the Court sets forth the material facts and views all reasonable inferences to be drawn from them in the light most favorable to Kurtz, the non-moving party.

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[1]Defendants request that the Court take judicial notice pursuant to Federal Rule of Evidence 201 of the following: (1) Namco Financial Exchange Corp. ("NFE") was founded in 2005 and (2) two proofs of claim filed by NFE in bankruptcy proceedings [Doc. # 76, Exhs. 30, 31]. [Doc. # 77.] Kurtz has not opposed Defendants' request.

Under Federal Rule of Evidence 201, courts may take judicial notice of adjudicative facts that are not "subject to reasonable dispute." Fed. R. Evid. 201(a) & (b). With respect to Defendants' first request, Defendants have not identified any document that demonstrates that NFE was founded in 2005, and at least one of the documents Defendants submitted suggests that NFE was founded in 1993 [*see* Doc. # 76, Exh. 18]. Accordingly, this "fact" is subject to reasonable dispute and the Court declines to take judicial notice of it. In any event, the year in which NFE was founded is not material to the parties' dispute. With respect to Defendants' second request, the bankruptcy court filings are properly subject to judicial notice under Rule 201. *See Reyn's Pasta Bella, LLC v. Visa USA, Inc.*, 442 F.3d 741, 746 n.6 (9th Cir. 2006) (courts may take judicial notice of "court filings" as they are "readily verifiable, and therefore, the proper subject of judicial notice").

[2]Unless otherwise indicated, the facts recited in this section are undisputed.

Namco Financial Exchange Corp. ("NFE") operated as an "accommodator" of tax-deferred exchanges under section 1031 of the Internal Revenue Code.[3] (Plaintiff's Statement of Genuine Disputes in Response to Defendants' Statement of Undisputed Facts ("Plaintiff's SGD") ¶ 2 [Doc. # 84]; Compl. ¶ 30 [Doc. # 1].) As an "accommodator," NFE held exchange funds on behalf of its clients. (Plaintiff's SGD ¶ 3.)

1. Liberty Mutual Application

NFE purchased a commercial crime policy from Liberty Mutual which covered the period of August 15, 2007 to August 15, 2008. (Defendants' Joint Statement of Genuine Disputes in Response to Plaintiff's Statement of Undisputed Facts ("Defendants' SGD") ¶ 1 [Doc. # 86-1]; Plaintiff's SGD ¶ 4; *see* Schwartz Decl., Exh. G [Doc. # 71].) The policy, number FI4N587509001, had a $5 million limit of liability. (Plaintiff's SGD ¶ 4; *see* Schwartz Decl., Exh. G.) The policy provided coverage for employee theft and for theft of client's property. (Defendants' SGD ¶ 7; *see* Schwartz Decl., Exh. G.)

Among the issues in this litigation is an answer NFE provided in its application for insurance. Question three of the application for the Liberty Mutual policy reads as follows: "Are proceeds from 1031 transactions held in bank accounts segregated from those of your operating funds?" (Plaintiff's SGD ¶ 24; *see* Schwartz Decl., Exh. A.) In its application dated July 2, 2007 and signed by NFE's "Controller" Hamid Tabatabai,[4] NFE answered "no" in response to question three. (Plaintiff's SGD ¶ 25; Muraoka Depo. at 83:6-25; 87:10-25 [Doc. # 76, Exh. 26][5]; *see* Schwartz Decl., Exh. A.)

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[3]Internal Revenue Code § 1031(a)(1) is a "well-worn exception to the general rule that taxpayers must recognize gains or losses realized from the disposition of property in the year of realization." *Teruya Bros., Ltd. v. C.I.R.*, 580 F.3d 1038, 1042 (9th Cir. 2009). "[I]n a so-called 'section 1031' exchange, gain realized on the exchange of like-kind property held for productive business use or investment need not be recognized until the acquired property is finally disposed of" and "the taxpayer retains his original basis in the newly acquired property." *Id.*

[4]Tabatabai signed the application as "Hamid Taba." (*See* Schwartz Decl., Exh. A.)

[5]Defendants authenticate Muraoka's deposition testimony and the other deposition testimony included in ECF Docket No. 76 in a declaration at ECF Docket No. 75.

Lockton Insurance Brokers, LLC ("Lockton") was NFE's insurance broker. (Plaintiff's SGD ¶ 9.) In a document dated August 1, 2007, Matthew Dodd of Liberty Mutual provided Claudia Porras of Lockton with a proposal for an insurance policy for NFE. (Schwartz Decl. ¶ 13; *see id.*, Exh. C.) Dodd indicated that the proposal was "subject to receipt, review and acceptance of the following items within 30 days of binding coverage: . . . Confirmation that transaction funds are separated from operating funds." (Schwartz Decl. ¶ 13; *see id*., Exh. C.) On August 2, 2007, Melissa Schwartz of Liberty Mutual sent an email to Porras stating that NFE had responded to question three "in such a way that [it] would not be eligible for coverage under the Clients' Property Insuring Agreement." (Schwartz Decl. ¶ 12; *see id.*, Exh. B.) Schwartz asked Porras to "review and verify that the appropriate controls are in place at [NFE]." (*See id*., Exh. B.)

According to Schwartz, Liberty Mutual would not issue a policy to NFE if NFE responded that it did not segregate its client funds from its operating funds because Liberty Mutual "wanted to make certain that [its] insureds had internal controls in place to reduce the risk client funds could be stolen while in [its] insureds' possession." (*Id.* ¶¶ 6, 20; Plaintiff's SGD ¶¶ 29, 33, 47.)

Porras then wrote to Val Muraoka, the person in charge of day-to-day operations at NFE (Plaintiff's SGD ¶ 39), in an email dated August 2, 2007, stating as follows:

> One of the requirements for insurance to be offered is to have proceeds from 1031 transactions segregated from operating funds, question 3 on the application. According to your application, you do not segregate funds. Please correct the application, initial, sign and fax back to me. I will then re-submit your application to the underwriter.

(Plaintiff's SGD ¶ 26; *see* Defendants' Exh. 14.[6])

Porras sent another email to Muraoka on August 10, 2007, stating as follows:

[6]While Defendants did not file a declaration laying the foundation for this exhibit, foundation is laid in the Muraoka Deposition at 99:5-22, and Kurtz has not objected to admission of the document.

> As a condition of coverage, proceeds from 1031 transactions are to be held in bank accounts segregated from those of your operating funds (question 3 on the application). Please confirm that this is done, correct application, initial and fax back to me as soon as you can.
>
> Let me know if you have any questions.

(Plaintiff's SGD ¶ 27; *see* Defendants' Exh. 15.[7])

On August 13, 2007, Muraoka sent Porras an email with a new copy of the application attached, stating:

> Per your instructions, please find attached NAMCO Financial Exchange Corp.'s Fidelity Bond Application. Unless I hear from you otherwise, I will assume that you do not need a hard copy by mail.

(Plaintiff's SGD ¶ 28[8]; *see* Defendants' Exh. 16.[9]) In the new version of the application, NFE answered "yes" to the question "[a]re proceeds from 1031 transactions held in bank accounts segregated from those of your operating funds?" (*See* Schwartz Decl., Exh. F.) The change was initialed "HT." (Schwartz Decl. ¶ 16; *see id.*, Exh. F.) The application was signed by "Hamid Taba," "Controller." (Schwartz Decl. ¶ 16; *see id.*, Exh. F.) Liberty received the new version of NFE's application, and issued the policy to NFE. (Scharwartz Decl. ¶¶ 16-17; *see id.*, Exh. G.)

NFE obtained additional insurance policies for losses in excess of $5 million. Each of the additional insurance policies followed the form of the Liberty Mutual policy. (Plaintiff's SGD ¶¶ 5-7; Defendants' SGD ¶ 5.)

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[7]While Defendants did not file a declaration laying the foundation for this exhibit, foundation is laid in the Muraoka Deposition at 100:15-21, and Kurtz has not objected to admission of the document.

[8]Plaintiff's lengthy response to Defendants' "undisputed" fact number 28 does not raise a genuine dispute of material fact as to whether NFE answered "yes" in response to the question at issue and initialed the change. (*See* Plaintiff's SGD ¶ 28.) Accordingly, Defendants' fact is uncontroverted.

[9]While Defendants did not file a declaration laying the foundation for this exhibit, foundation is laid in the Muraoka Deposition at 103:25 and 104:1-4, and Kurtz has not objected to admission of the document.

2. Zurich Application

Zurich issued the first layer of excess policy with a $5 million limit of liability for covered loss in excess of $5 million. (Plaintiff's SGD ¶ 5; Defendants' SGD ¶ 2; *see* Mazzella Decl., Exh. 4 [Doc. # 72].)

Lockton informed Donna Mazzella of Zurich that NFE's response to question three on the application for insurance was a mistake. (Mazzella Decl. ¶ 4.) In a document dated August 13, 2007, Mazzella provided Jacob C. Durling of Lockton a quote for an insurance policy for NFE "subject to receipt, review and approval of the following information: . . . Confirmation that transaction funds are separated from operating funds." (*Id.* ¶ 6; *see id.*, Exh. 2.) On October 16, 2007, Mazzella sent an email to Lockton informing Lockton that Zurich had not received "confirmation regarding segregation of exchange funds, and that the policy could not be issued without such confirmation." (*Id.* ¶ 8.) On October 16, 2007, Lockton sent Mazzella an updated application in which NFE answered "Yes" to question three. (*Id.* ¶ 9.)

According to Mazzella, Zurich would not have issued NFE an insurance policy if Mazzella had known that NFE did not segregate its exchange funds from its operating funds because "failure to segregate exchange funds unreasonably increased the risk of loss." (*Id.* ¶¶ 5, 10; *see* Plaintiff's SGD ¶¶ 34, 47.)

3. Axis Application

Axis issued the second layer of excess policy with a $5 million limit of liability for covered loss in excess of $10 million. (Plaintiff's SGD ¶ 6; Defendants' SGD ¶ 3; *see* Polonsky Decl., Exh. F [Doc. # 73].) In an email dated August 8, 2007, Ronald Polonsky of Axis told Porras that Axis was rejecting NFE's application for insurance. (Polonsky Decl. ¶ 8; *see id.*, Exh. B.) According to Polonsky, he rejected NFE's application based on the "No" answer to question three. (*Id.* ¶¶ 8, 16.) Axis received the revised version of NFE's application in which the answer to question three was changed to "Yes." (*Id.* ¶ 9; *see id.*, Exh. C.) Axis thereafter issued an insurance policy to NFE. (*Id.* ¶ 12; *see id.*, Exh. F.)

According to Polonsky, Axis would not have issued a policy "to an applicant who disclosed that it did not hold client funds in bank accounts segregated from those of its operating funds" because "Axis wanted to make certain that [its] insureds had internal controls in place with respect to client funds in [its] insureds' possession." (*Id.* ¶¶ 15-16; *see* Plaintiff's SGD ¶¶ 35, 47.)

4. Twin City Application

Twin City issued the third layer of excess policy with a $5 million limit of liability for covered loss in excess of $15 million. (Plaintiff's SGD ¶ 7; Defendants' SGD ¶ 4; *see* Leason Decl., Exh. 2.) In an email on August 30, 2007, Kevin Leason of Twin City told Porras to "confirm that all 1031 trust investments are in segregated accounts of a bank." (*See* Leason Decl. ¶¶ 3-4; *id.*, Exh. 1.) Porras provided Leason with the revised application answering "Yes" to question three. (*Id.* ¶ 4; *see id.*, Exh. 1.) Twin City issued NFE a policy. (*Id.* ¶ 6; *see id.*, Exh. 2.)

According to Leason, Twin City would not have issued the policy if NFE had responded "No" to question three or if he knew that NFE's answer was false because segregation of accounts made "it more difficult for a dishonest employee to take client funds and avoid discovery, or for the insured to utilize the 1031 exchange funds for its own purposes, knowingly or not." (*Id.* ¶¶ 8-9; *see* Plaintiff's SGD ¶¶ 36, 47.)

5. NFE's Account Practices

It is uncontroverted that NFE's standard practice before and after it applied for the insurance policies was to hold client funds in the same bank account in which it kept its operating expenses.[10] (Plaintiff's SGD ¶¶ 37, 40; Muraoka Depo. at 78:6-16; 90:6-25; 91:1-4; 105:17-25; 106:1-2.)

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[10]Kurtz objects to Defendants' "undisputed" facts 37 and 40 on the ground of lack of personal knowledge, but does not provide any analysis in support of this contention. Defendants submitted deposition testimony of Val Muraoka, who managed NFE's day-to-day operations (Plaintiff's SGD ¶ 39), in which Muraoka was asked if she had knowledge regarding whether "proceeds from 1031 transactions held in bank accounts [were] segregated from those of [NFE's] operating expenses." (Muraoka Depo. at 89:6-10.) Muraoka testified that "to the best of [her] knowledge," the answer was

Shahrokh Ettehadieh, NFE's bookkeeper (Plaintiff's SGD ¶ 42), testified that NFE's primary bank account was a Security Pacific Bank account ending in the numbers 4918. (Ettehadieh Depo. at 83:13-24 [Doc. # 76, Exh. 25]; *see* Muraoka Depo. at 52:5-10.) This bank account was used for client exchange funds. (Ettehadieh Depo.at 69:12-15.)

Muraoka testified that NFE paid operating expenses out of its primary bank account ending in the number 4918. (Muraoka Depo. at 66:17-23.) Muraoka also testified that "to the best of [her] knowledge," the correct answer to question three on the insurance application would be "no" because client exchange money was held in one bank account and that account was also used to pay operating expenses. (*Id.* at 89:6-25; 90:1-4.) Finally, Muraoka had no knowledge of NFE using separate accounts for client exchange funds and operating expenses after August 13, 2007, and "[t]o the best of [her]

"no" because clients' exchange funds and NFE operating expenses were held in one account. (*Id.* at 89:11-25; 90:1-4.) Defendants also presented deposition testimony of Shahrokh Ettehadieh, NFE's bookkeeper (Plaintiff's SGD ¶ 42), that NFE used the internal account designation number ending in 4918 as NFE's "primary . . . bank account." (Ettehadieh Depo. at 83:13-24.) As Plaintiff has identified no evidence controverting Muraoka and Ettehadieh's personal knowledge of the testimony they provided, Kurtz's objection is **OVERRULED**.

Kurtz also objects that Defendants' facts "call[ ] for a legal conclusion" and "the cited deposition testimony does not support the alleged fact." Plaintiff did not interpose any objections during the depositions as to the questions posed and there was no indication that Muraoka and Ettehadieh did not understand the questions asked. Kurtz's objections are therefore **OVERRULED**.

Finally, Kurtz purports to dispute Defendants' facts by identifying evidence that NFE assigned different internal account designations to each client and thus "segregated" client exchange funds from operating funds, in compliance with the insurance *policy*. Here, however, the issue is not whether NFE complied with the language of the insurance policy, but rather whether NFE truthfully answered question three of the insurance *application*. Kurtz has identified no evidence that would allow a reasonable inference that NFE's practice was to hold client exchange funds in bank accounts segregated from the bank account(s) in which it held its operating expenses. Indeed, the only evidence the parties have identified that NFE ever used different bank accounts for client exchange funds and operating expenses was Muraoka's testimony that NFE provided segregated accounts "[o]nly to the extent that the client would request a segregated account," which occurred on five or fewer occasions. (Muraoka Depo. at 78:6-16.) Thus, the fact that NFE did not hold client exchange funds in bank accounts separate from an account holding operating expenses is uncontroverted.

recollection," the funds continued to be held in the same account. (*Id.* at 105:17-25; 106:1-2.)

5. Kurtz's Claim

On April 2, 2009, a Chapter 7 involuntary petition was filed against NFE in U.S. Bankruptcy Court for the Central District of California. (Plaintiff's Statement of Genuine Disputes in Response to Liberty Mutual's Statement of Undisputed Facts ("Plaintiff's SGD to Liberty Mutual's SUF") ¶ 14 [Doc. # 88].) Plaintiff Heidi Kurtz was appointed as NFE's Chapter 7 trustee on June 17, 2009. (*Id.* ¶ 15.)

On July 2, 2009, Kurtz submitted insurance claims to Defendants contending that NFE had misappropriated monies in excess of $35 million. (*Id.* ¶ 16.) Kurtz provided a proof of loss document dated December 16, 2009.[11] (Defendants' SGD ¶ 16; *see* Bidart Decl., Exh. 4.) Liberty Mutual formally denied NFE's claim in a letter dated December 6, 2013, in part on the ground that NFE provided false information in its insurance application. (Defendants' SGD ¶ 17; *see* Bidart Decl., Exh. 9.)

II.

LEGAL STANDARD

Summary judgment should be granted "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); *accord Wash. Mut. Inc. v. United States*, 636 F.3d 1207, 1216 (9th Cir. 2011). Material facts are those that may affect the outcome of the case. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). A dispute is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id.*

[11]Kurtz contends that the document was "submitted" on December 16, 2009, but Defendants respond that it was not provided until January 4, 2010. (*See* Defendants' SGD ¶ 16.) Both parties cite to the document itself, which is dated December 16, 2009.

The moving party bears the initial burden of establishing the absence of a genuine issue of material fact. *Celotex Corp.*, 477 U.S. at 323. Once the moving party has met its initial burden, Rule 56(c) requires the nonmoving party to "go beyond the pleadings and by her own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'" *Id*. at 324 (quoting Fed. R. Civ. P. 56(c), (e) (1986)); *see also Norse v. City of Santa Cruz*, 629 F.3d 966, 973 (9th Cir. 2010) (*en banc*) ("Rule 56 requires the parties to set out facts they will be able to prove at trial."). "[T]he inferences to be drawn from the underlying facts . . . must be viewed in the light most favorable to the party opposing the motion." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986).

A court presented with cross-motions for summary judgment should review each motion separately, giving the nonmoving party for each motion the benefit of all reasonable inferences from the record. *Center for Bio-Ethical Reform, Inc. v. Los Angeles County Sheriff Dep't*, 533 F.3d 780, 786 (9th Cir. 2008), *cert. denied*, 555 U.S. 1098, 129 S. Ct. 903, 173 L. Ed. 2d 108 (2009). The Court must consider all evidence submitted by both parties when ruling on cross-motions for summary judgment. *Fair Hous. Council of Riverside Cnty., Inc. v. Riverside Two*, 249 F.3d 1132, 1136 (9th Cir. 2001).

III.

DISCUSSION

A. Defendants are Entitled to Rescind the Policy Due to NFE's Misrepresentation

Defendants contend that NFE's misrepresentation in its application for the insurance policies voids the policy and/or is a complete defense to coverage. (Mot. at 8-12 [Doc. # 70].) "When a policyholder conceals or misrepresents a material fact on an insurance application, the insurer is entitled to rescind the policy." *LA Sound USA, Inc. v. St. Paul Fire & Marine Ins. Co.*, 156 Cal. App. 4th 1259, 1266, 67 Cal. Rptr. 3d 917

(2007). "'Each party to a contract of insurance shall communicate to the other, in good faith, all facts within his knowledge which are or which he believes to be material to the contract.'" *Id.* (quoting Cal. Ins. Code § 332). "'[I]f a representation is false in a material point . . . the injured party is entitled to rescind the contract from the time the representation becomes false.'" *Id.* at 1266-67 (quoting Cal. Ins. Code § 359). "[A] rescission effectively renders the policy totally unenforceable from the outset so that there was never any coverage and no benefits are payable.'" *Id.* at 1267 (quoting *Imperial Casualty & Indemnity Co. v. Sogomonian*, 198 Cal. App. 3d 169, 184, 243 Cal. Rptr. 639 (1988)).

In this case, it is undisputed that NFE indicated on its application that "proceeds from 1031 transactions [were] held in bank accounts segregated from those of [its] operating funds." It is also uncontroverted that NFE's standard practice before and after it applied for the insurance policies was to hold client funds in the same bank account in which it kept its operating expenses. The issue is thus whether NFE's misrepresentation on its application was "false in a material point," such that Defendants are entitled to rescind the contract.

"Materiality is to be determined not by the event, but solely by the probable and reasonable influence of the facts upon the party to whom the communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries." Cal. Ins. Code § 334. "'The fact that the insurer has demanded answers to specific questions in an application for insurance is in itself usually sufficient to establish materiality as a matter of law.'" *LA Sound*, 156 Cal. App. 4th at 1268-69 (quoting *Thompson v. Occidental Life Ins. Co.*, 9 Cal. 3d 904, 916, 109 Cal. Rptr. 473 (1973)).

Here, it is uncontroverted that the insurance application included a question to which NFE provided a false answer. The Court cannot draw any other reasonable inference from the facts in the record. Moreover, materiality may be shown "by the effect of the misrepresentation on the 'likely practice of the insurance company,'" specifically "'the effect which truthful answers would have had *upon the insurer*.'" *Id.*

at 1268 (emphasis added). This has been described as a "subjective standard." *Cummings v. Fire Ins. Exch*, 202 Cal. App. 3d 1407, 1414 n. 7, 249 Cal. Rptr. 568 (1988). In this case, there is uncontroverted testimony from each insurer that it would not have issued the policy if NFE had answered the question differently. *See Fed. Ins. Co. v. Curon Medical, Inc.*, No. 03-1356, 2004 WL 2418318, at *6 (N.D. Cal. 2004) (materiality established by insurance company's testimony that it would not have authorized issuance of policy or would have issued different policy if it had known fact misrepresented by insured).

Kurtz's arguments to the contrary are unavailing. First, Kurtz contends that the Court should look to the language of the insurance *policy*, rather than that of the insurance *application* because "[t]o do otherwise would be to suggest that terms in the policy should be interpreted in a radically different manner from the same terms in the application." (Opp'n at 16-17 [Doc. # 83].) As an initial matter, Kurtz cites no authority for the proposition that where terms in an insurance application and an insurance policy are inconsistent, the policy controls for the purposes of determining rescission due to a misrepresentation in the application. Moreover, California appellate courts have held that the language in an insurance policy applies *after* the policy has issued, but not to statements made in order to obtain the policy in the first place. *See LA Sound*, 156 Cal. App. 4th at 1270; *Mitchell v. United Nat'l Ins. Co.*, 127 Cal. App. 4th 457, 473, 25 Cal. Rptr. 3d 627 (2005).

Kurtz does not contend that the language in the *application* was ambiguous.[12] Nor has Kurtz identified any extrinsic evidence that would suggest that question 3 was open

[12]At the hearing on this motion, Kurtz argued for the first time that the word "segregate" was ambiguous in question three of the application, and that the question could be reasonably construed to require segregation of funds within a single bank account rather than segregation of funds in multiple bank accounts. As discussed, *supra*, the question reads: "Are proceeds from 1031 transactions held in bank *accounts* segregated from *those* of your operating funds?" (*See* Schwartz Decl., Exh. A (emphasis added).) The Court rejects Kurtz's argument as the grammatical construction of the question lends itself to only one reasonable interpretation.

to multiple interpretations. Nor could she. Indeed, both grammatical construction and the evidence in the record suggest that question three was open to only one interpretation. (*See, e.g.*, Plaintiff's SGD ¶ 25; Muraoka Depo. at 89:6-25; 90:1-4.)

Second, Kurtz argues that Defendants were required to prove that any misrepresentation was intentional, and they have not met their burden. (Opp'n at 18-19.) Kurtz's citations to authority, however, do not support this proposition, as California appellate courts appear to uniformly hold that an insured's misrepresentation of material facts on an insurance application is sufficient to deny coverage even if negligent or unintentional.[13] *Nieto v. Blue Shield of Cal. Life & Health Ins. Co.*, 181 Cal. App. 4th 60, 75-77, 103 Cal. Rptr. 3d 906 (2010) (collecting cases in which courts allowed insurers to rescind insurance policies when the insured had misrepresented or concealed material information in connection with obtaining insurance); *Cummings*, 202 Cal. App. 3d at 1414 n.7 (in application for an insurance contract "rescission will be allowed even though the misrepresentation was the result of negligence or the product of innocence").

Third, Kurtz argues that Defendants waived their right to deny coverage because they failed to investigate NFE's changed answer on question three of the application.

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[13]Kurtz's citation to *Cummings*, 202 Cal. App. 3d 1407, is inapposite, as she cited to a portion of the decision concerning the standard for voiding an insurance *policy* "based upon the insured's violation of the standard fraud and concealment clause," *id.* at 1414 n.7, rather than the standard for rescission due to a misrepresentation made in an *application* for a contract of insurance. (*See* Kurtz's Opp'n at 18.) Kurtz's citation to *Clarendon National Insurance Company v. Insurance Company of the West*, 442 F. Supp. 2d 914 (E.D. Cal. 2006), is similarly inapposite. In *Clarendon*, the parties' insurance *policy* "provided that it would be void if there were fraud or *intentional* concealment or misrepresentation," a higher standard than that imposed by the plain language of the applicable California insurance code sections. 442 F. Supp. 2d at 921 & n.1 (emphasis added). The court held that in order to demonstrate that the contract was void, the insurer had to meet the higher standard set forth in the contract. *Id*. at 933.

In any event, this Court is bound to follow the decisions of California appellate courts absent convincing evidence that the California Supreme Court would reject their interpretation, *see In re Watts*, 298 F.3d 1077, 1083 (9th Cir. 2002). At least one such court, in the context of misrepresentations made in insurance applications, has rejected the rescission analysis in *Clarendon* as "unpersuasive." *LA Sound*, 156 Cal. App. 4th at 1270 n.4.

"The insurer's right to disclosure of material facts may be waived by its own failure to follow up on obvious leads." *Old Line Life Ins. Co. v. Superior Court*, 229 Cal. App. 3d 1600, 1606, 281 Cal. Rptr. 15 (1991). Specifically, "[w]aiver may be found where an insurer 'neglect[s] to make inquiries as to [material] facts, where they are distinctly implied in other facts of which information is communicated.'" *Id.* (quoting Cal. Ins. Code § 336). In *Old Line*, the court considered whether an insured's inconsistent answers on an insurance application and declaration were sufficient to trigger an insurer's duty to investigate and to waive the insurer's right to deny coverage for failure to investigate. *Id.* at 1602-03. The insured indicated that she was a non-smoker on the insurance application, but that she smoked pipes or cigars on a "Non-Smoking Declaration." *Id.* The court rejected the insurance policy beneficiary's argument that the insurance company's underwriting department "should have considered [the insured] unworthy of belief and have conducted an independent investigation" on the ground that it was "too farfetched a scenario to support an inference of waiver." *Id.* at 1607. Noting that the insurance company "had no direct information" about the insured's smoking, the *Old Line* court held that insurer had not waived its right to rescind the insurance policy due to the insured's misstatement on her application materials. *Id.*

In this case, Kurtz's argument is indistinguishable from the argument rejected by the *Old Line* court. If anything, Kurtz's argument is more tenuous than that rejected in *Old Line* as NFE did not offer simultaneously inconsistent answers, but rather provided different answers at different times after the insurers' further inquiry. The record also suggests that at least some of the insurers were informed that NFE's original answer was a mistake. (*See* Mazzella Decl. ¶ 4.) There is no evidence in the record that Defendants had "direct information" that NFE lied on its application. Kurtz has not cited any authority for the proposition that a finding of waiver is appropriate on analogous facts, and the Court has found none.

B. Kurtz Has Not Demonstrated that Estoppel is Appropriate

Kurtz contends that Defendants should be estopped from denying coverage because they failed to comply with a California Department of Insurance regulation requiring a prompt response to an insured's claim. *See* Cal. Code Regs. tit. 10, § 2695.7.

The doctrine of equitable estoppel provides that "a person may not deny the existence of a state of facts if he intentionally led another to believe a particular circumstance to be true and to rely upon such belief to his detriment." *People v. Castillo*, 49 Cal. 4th 145, 156 n.10, 109 Cal. Rptr. 3d 346 (2010). California courts have held that in order for equitable estoppel to apply, the following four elements must be met: "(1) the party to be estopped must be apprised of the facts; (2) he must intend that his conduct shall be acted upon, or must so act that the party asserting the estoppel has a right to believe it was so intended; (3) the other party must be ignorant of the true state of facts; and (4) he must rely upon the conduct to his injury."[14] *Id*.

In the insurance context, "estoppel may arise from a variety of circumstances in which the insurer's conduct threatens to unfairly impose a forfeiture of benefits upon the insured." *City of Hollister*, 165 Cal. App. 4th at 488. While silence will not create an estoppel unless there is a duty to speak, courts have held that the Fair Claims Settlement Practices Regulations issued by the California Insurance Commissioner ("the Insurance Regulations") impose certain duties on insurers to speak. *Id*. at 489-90; *Neufeld v. Balboa Ins. Co.*, 84 Cal. App. 4th 759, 765, 101 Cal. Rptr. 2d 151 (2000); *Spray, Gould & Bowers v. Assoc. Int'l Ins. Co.*, 71 Cal. App. 4th 1260, 1268-69, 84 Cal. Rptr. 2d 552 (1999).

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[14]In *City of Hollister v. Monterey Ins. Co.*, the court provided an alternate, "more accurate" formulation of the standard, clarifying that estoppel is not limited to situations involving fraud:

> (1) The party to be estopped has engaged in blameworthy or inequitable conduct; (2) that conduct caused or induced the other party to suffer some disadvantage; and (3) equitable considerations warrant the conclusion that the first party should not be permitted to exploit the disadvantage he has thus inflicted upon the second party.

165 Cal. App. 4th 455, 488, 81 Cal. Rptr. 3d 72 (2008).

In order for equitable estoppel to apply, a plaintiff must also show that "the inequitable conduct invoked for the doctrine [was] a cause of harm to the party asserting it." *City of Hollister*, 165 Cal. App. 4th at 513. The "basic theory" underlying an estoppel predicated on an insurer's failure to speak is that without the courts requiring an insurer's compliance with the Insurance Regulations using their equitable powers, insurers would have an incentive to disregard the regulations because any administrative sanctions would apply after-the-fact and do nothing to "'rectify' the wrong the disclosure regulation was 'designed to prevent.'" *Neufeld*, 84 Cal. App. 4th at 761 (quoting and discussing *Spray*, 71 Cal. App. 4th at 1271, 1274).

Kurtz contends that Defendants failed to comply with their disclosure requirements under sections 2695.7(b) and (c)(1) of the Insurance Regulations. (Opp'n at 19-20.) *See* Cal. Code Regs. tit. 10, § 2695.7. Specifically, under section 2695.7(b), an insurer is required "[u]pon receiving proof of claim . . . immediately, but in no event more than forty (40) calendar days later, accept or deny the claim, in whole or in part." Moreover, under section 2695.7(c)(1), if more time is required, the insurer is required to "provide the claimant, within the time frame specified in subsection 2695.7(b), with written notice of the need for additional time" and to provide continuing written notice every thirty days "until a determination is made or notice of legal action is served."

It is undisputed that Kurtz provided a proof of loss document to Liberty Mutual no later than January 2010, and Liberty Mutual did not formally deny NFE's claim until December 6, 2013. Liberty Mutual contends that it required additional documentation from Kurtz, while Kurtz asserts that Liberty Mutual's investigation of the claim was "wholly inadequate." (*See* Plaintiff's SGD to Liberty Mutual's SUF ¶ 22.) Even assuming that Liberty Mutual violated the Insurance Regulations, however, Kurtz has not demonstrated that Defendants' inequitable conduct caused it any harm. Kurtz conclusorily states that "there are triable issues of fact concerning the elements of estoppel" (Opp'n at 20), but Kurtz does not discuss the elements of estoppel or identify

any evidence that it suffered harm as a result of Defendants' failure to comply with the Insurance Regulations.

Nor does it appear that Kurtz *could* identify evidence of harm resulting from Defendants' conduct given that NFE was not entitled to insurance benefits *ab initio* due to its misrepresentation on the insurance application, and *not* as a result of any conduct by Defendants upon which Kurtz relied to her detriment. *Cf. City of Hollister*, 165 Cal. App. 4th at 490 (violation of section 2695.7(b) may sustain the imposition of an estoppel to assert a procedural condition of coverage where an insurer's "only defense to payment is brought into being by its own inequitable conduct" as "[t]he alternative would be that the insurer profits from its own wrong in bringing about the conditions for the insured's loss of coverage").

This case is similar to *R & B Auto Center, Inc. v. Farmers Group, Inc.*, in which a California appellate court held that estoppel was not available despite the insurer's noncompliance with section 2695.7(b). 140 Cal. App. 4th 327, 351-52, 44 Cal. Rptr. 3d 426 (2006). In *R & B Auto*, the insured was licensed to sell only used vehicles, and it mistakenly obtained an insurance policy for lemon law coverage that applied only to the sale of new vehicles. *Id.* at 332. The insurer refused to defend or indemnify the insured in connection with a lemon law suit. *Id.* Nonetheless, the *R & B Auto* court held that estoppel based on failure to comply with section 2695.7(b) was not appropriate because the case did not "involve the forfeiture of a contractual right under the policy" and rather, the insured sought to use "theories of waiver and estoppel to create coverage where none otherwise exists—that is, to create an otherwise nonexistent written contract providing lemon law coverage for used car sales, in order to use the newly created contract as the basis for a claim of breach." *Id.* at 352. Similarly, in this case, Kurtz seeks to use estoppel to create coverage where none exists, and thus estoppel is inappropriate.

Defendants are entitled to rescind their policies due to NFE's misrepresentation in the initial application, and Kurtz has not demonstrated that estoppel is appropriate.

C. Requirements for Rescission

At the hearing on the motions, Kurtz argued—again for the first time—that Defendants could not rescind the contract because they failed to raise rescission as an affirmative defense and they had not tendered the insurance premiums NFE paid.

With respect to Kurtz's first point, Zurich explicitly alleged an affirmative defense that the insurance policy was subject to rescission "to the extent that misrepresentation and/or concealment of material facts is established." [Doc. # 37 at ¶ 65.] Twin City alleged an affirmative defense based on NFE's "material misrepresentations and fail[ure] to disclose material facts to TWIN CITY in its application for insurance." [Doc. # 35 at ¶ 3.] Liberty Mutual and Axis's allegations in their Answers are somewhat less specific. Both Defendants allege "material misrepresentation" as an affirmative defense, explaining:

> Based on the failure to disclose information to [the insurer], coverage under the Policy is deemed void as to the losses alleged in Plaintiff's Complaint by virtue of . . . equitable remedies available to [the insurer].

[Doc. # 39 at ¶ 91; Doc. # 38 at ¶ 88.] While not as clear as the affirmative defenses of Zurich and Twin City, this allegation can be construed as pleading an affirmative defense of rescission.

Moreover, the Ninth Circuit has liberalized the requirement under Federal Rule of Civil Procedure 8 that affirmative defenses must be raised in a defendant's initial pleading or waived. *Simmons v. Navajo Cnty., Arizona*, 609 F.3d 1011, 1023 (9th Cir. 2010) (citing *Rivera v. Anaya*, 726 F.2d 564, 566 (9th Cir. 1984)). "[A]bsent prejudice to the plaintiff, the district court has discretion to allow a defendant to plead an affirmative defense in a subsequent motion." *Id.* Moreover, "[t]he key to determining the sufficiency of pleading an affirmative defense is whether it gives plaintiff fair notice of the defense." *Id.* (internal quotation omitted). In this case, even though Liberty Mutual and Axis did not expressly use the word "rescission" in their material misrepresentation affirmative defenses, there was no prejudice to Kurtz because they gave notice of the

defense by stating the same concept, *i.e.*, that the policy was "deemed void . . . by virtue of . . . equitable remedies available" to them. Zurich and Axis also provided notice of the existence of the rescission defense in their answers to the Complaint.

With respect to Kurtz's second point that Defendants cannot rescind the contract because they failed to tender the insurance premiums, Kurtz is incorrect as a matter of law. In *Resure, Inc. v. Superior Court*, a California court held that an insurer has the right to avoid coverage by asserting cross-claims and affirmative defenses when an insured files an action on the contract before the insurer can file an action for rescission. 42 Cal. App. 4th 156, 163, 49 Cal. Rptr. 2d 354 (1996). The court noted that "[t]o effect a rescission a party to the contract must, promptly[15] upon discovering the facts which entitle him to rescind . . . : (a) Give notice of rescission to the party as to whom he rescinds; and (b) Restore to the other party everything of value which he has received from him under the contract or offer to restore the same upon condition that the other party do likewise, unless the latter is unable or positively refuses to do so." *Id.* (quoting Cal. Civ. Code § 1691). The *Resure* court also noted that "[w]hen notice of rescission has not otherwise been given or an offer to restore the benefits received under the contract has not otherwise been made, *the service of a pleading in an action or proceeding that seeks relief based on rescission shall be deemed to be such notice or offer or both*." *Id.* (quoting Cal. Civ. Code § 1691) (emphasis added). Pursuant to section 1691, Defendants' service of their affirmative defenses of rescission in this action

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[15]While Kurtz argued that Defendants should be estopped from rescinding the contract due to their alleged violation of Cal. Code Regs. tit. 10, § 2695.7, she did not argue that they should be denied relief based on rescission under Cal. Civ. Code § 1693. The rescission procedures set forth in the California Civil Code govern rescission of insurance contracts. *See Resure*, 42 Cal. App. 4th at 163. California Civil Code § 1693 provides "[w]hen relief based upon rescission is claimed in an action or proceeding, such relief shall not be denied because of delay in giving notice of rescission unless such delay has been substantially prejudicial to the other party." Here, Kurtz has not identified any evidence that she has suffered prejudice, let alone *substantial* prejudice, as a result of Defendants' delay.

is deemed notice of rescission *and* an offer to restore the benefits received under the contract.

Thus, Defendants' motion for summary judgment is **GRANTED** as to Kurtz's breach of contract and declaratory relief claims and Defendants shall restore to NFE all benefits received under the rescinded insurance contracts.

C. Liberty Mutual is Entitled to Summary Judgment on Kurtz's Breach of Implied Covenant of Good Faith and Fair Dealing Claim

"[A]bsent any potential for coverage under an insurance policy, there can be no breach of the implied covenant of good faith and fair dealing 'because the covenant is based on the contractual relationship between the insured and the insurer.'" *Brizuela v. Calfarm Ins. Co.*, 116 Cal. App. 4 578, 594, 10 Cal. Rptr. 3d 661, 673 (2004). Kurtz acknowledges as much in her briefing. (Opp'n at 7 [Doc. # 87].) As Defendants are entitled to rescind the policies due to NFE's initial misrepresentation, Liberty Mutual's summary judgment is **GRANTED** as to Kurtz's breach of implied covenant of good faith and fair dealing claim.

D. Liberty Mutual's Motion is Otherwise Moot

As Kurtz no longer has any viable substantive claims, Liberty Mutual's motion as to Kurtz's prayer for attorneys' fees and punitive damages is **DENIED** as moot.

E. Kurtz's Motion for Partial Summary Judgment is Denied

For the same reasons that Defendants are entitled to summary judgment, Kurtz is not. Kurtz cannot enforce the terms of the insurance policies as the policies are deemed void. Viewing the evidence in the light most favorable *to Defendants* does not alter this result. Accordingly, Kurtz's motion for partial summary judgment is **DENIED**.

IV.

CONCLUSION

In light of the foregoing:

1. Defendants' joint motion for summary judgment as to Kurtz's breach of contract and declaratory relief claims [Doc. # 70] is **GRANTED** in its entirety;

2. Liberty Mutual's motion for partial summary judgment as to Kurtz's breach of implied covenant of good faith and fair dealing claim [Doc. # 79] is **GRANTED**;

3. Liberty Mutual's motion is otherwise **DENIED** as moot; and

4. Kurtz's motion for partial summary judgment [Doc. # 68] is **DENIED**.

IT IS SO ORDERED.

DATED: April 14, 2014

DOLLY M. GEE
UNITED STATES DISTRICT JUDGE